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When is A Commercial Landlord's Consent to a Lease Assignment or Sublease Required?

A recent decision of the Ontario Superior Court sheds light on when a commercial landlord is required to give consent to an assignment of lease or sublease.

In *Hudson's Bay Co. v. Omers Realty Corp.*, 2015 ONSC 4671, per Justice Conway, the retail tenant in three shopping malls (the "Tenant") operated by the landlord (the "Landlord") entered into a real estate joint venture with a real estate investment trust (the "Co-Venturer"). The Co-Venturer was also a commercial competitor of the Landlord. Under the joint venture (the "Joint Venture"), the Tenant proposed transferring its leases at the Landlord's malls to the Joint Venture. The Tenant sought the Landlord's consent to assign and sublease the Leases under the Joint Venture (the "Assignment"), but the Landlord refused.

Accordingly, the Tenant brought an application under section 23(2) of the *Commercial Tenancies Act*, R.S.O. 1990, c.L.7 for a declaration that the Landlord's consent to the Assignment and sublease was not

required. In the alternative, the Tenant argued that the Landlord was unreasonably withholding its consent.

The terms of the proposed Joint Venture were as follows:

- a. the Tenant and the Co-Venturer would be two limited partners in a limited partnership (the "First LP"). The Tenant would initially hold 90% of the partnership units and the Co-Venturer, the remaining 10%. The sole general partner of the first LP would be a company jointly controlled by the Tenant and the Co-Venturer ("Ontario Inc.");
- b. all of the assets to be contributed to the Joint Venture, apart from the Leases, would be transferred to Ontario Inc. as the general partner of the first LP;

- c. a second limited partnership (the “Second LP”), would be formed to hold the Leases. The Tenant would be the *general partner* of the Second LP. The First LP would be the sole limited partner of the Second LP and will hold a 99.9999% interest in the Second LP;
- d. the Leases would be assigned by the Tenant in its capacity as a general partner of the Second LP;
- e. the leased premises under each of the Leases would be sublet to the Tenant on a “full pass through basis” for the entire remaining terms of each lease, including renewals.

The Tenant argued that the Landlord’s consent to the Assignment was not required. The general partner to whom the leases were being assigned would be the Tenant, not a new company jointly controlled by the Tenant and the Co-Venturer. As the general partner, the Tenant argued that it would have control under the Leases.

The Landlord, however, argued that the revised structure was superficial and did not change the “economic and commercial realities of the Joint Venture deal”. The Landlord expressed serious concern that the Co-Venturer, a commercial competitor of the Landlord, would have control over the leases.

Ultimately, the Court held that the Landlord’s consent was not required to assign the leases.

The Assignee of the Lease was the General Partner of the LP

Each of the leases at issue prohibited the assignment of the leases in broad terms. However, each of the leases included an exception for an assignment of the lease to an *affiliate* of the existing tenant (the “Affiliate Exception”).

In the Tenant’s view, consent was not required to the Assignment because each lease would be assigned to the Tenant as the *general partner* of the Second LP. The Tenant argued that a limited partnership would not hold property and any partnership property had to be held by the general partner. Accordingly, the Tenant would be the assignee of the leases. In any event, the Tenant argued that the Tenant was either the same or an affiliate company under the leases, such that the Affiliate Exception applied and no consent was required.

The Landlord argued that while the Tenant would be taking legal title to the leases as the general partner of the Second LP, the Tenant would in effect be holding the leases for the benefit of the Second LP. In the Landlord’s submission, the Court was required to look beyond the legal title to the leases and had to look at who would become the beneficial owner of the leases, i.e. the Second LP. Since the Second LP was not an affiliate of the tenant, the Affiliate Exception did not apply and the Landlord’s consent to the Assignment was required.

Ultimately, the Court held that the assignee of the Leases would be the general partner, i.e. the Tenant, and not the Second LP.

Limited Partnerships Cannot Hold Title to Real Property

According to the Court, a limited partnership is not a legal entity and is required to act through a general partner at common law. Thus, a limited partnership such as Second LP cannot hold title to real property. A limited partnership can only hold title to real property through its general partner.

Citing the Court’s reasoning in *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24, the Court affirmed:

...The limited partnership is an investment vehicle for passive investment by limited partners...a general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership...The general partner has sole control over the property and business of the limited partnership...

The limited partners do not have any “independent” ownership rights in the property of the limited partnership...

The Court drew three conclusions from this passage:

- i. only the general partner could hold the property in which the limited partnership has an interest. The lease cannot be assigned to the limited partnership, but must be assigned to the general partner;

- ii. the limited partner is a passive investor who is restricted from participating in the control of the business. The general partner has control over the property and is exclusively responsible for the limited partnership's operations;
- iii. the general partner is solely liable for all payments and obligations under a contract. Accordingly, in this case, there would be no relationship between the Landlord and the limited partners. The Tenant would be solely liable for rent and all amounts under the Leases. There would be no change in the legal relationship between the Landlord and the Tenant following the Assignment.

Thus, the leases at issue would be assigned to the Tenant as the general partner and the Tenant would be exclusively liable for the operations of the Second LP. The

general partner was therefore the assignee of the Leases and there was no reason for the Court to look beyond the leases or to focus on "where any other interests may lie".

In any event, the Affiliate Exception applied and the Landlord's consent was not required. Because the sublease would be to the Tenant, which is the same entity as the general partner, the sublease was permitted under the Affiliate Exception and the Landlord's consent was not required.

The Court further held that even if the Assignment required the Landlord's consent, such consent was unreasonably withheld by the Landlord with respect to two of the three leases. A reasonable person would not have withheld consent to the Assignment since: (i) the Tenant would continue to be the operator of the retail stores; (ii) the Tenant would continue to be liable under the leases; (iii) the Tenant would be in control of the leases as the

general partner of the Second LP; (iv) there was no reason to suspect the Tenant's interests would be different from the Landlord's; and (v) there was no probability that the Tenant would default under the leases. In these circumstances, the Landlord's withholding of consent was unreasonable.

The Court's decision in *Hudson's Bay* illustrates that Ontario Courts will be reluctant to look beyond an assignment of lease to determine where the real interests in the property and operations will lie. If, as in this case, the lease is being assigned to a general partner who is solely responsible for operations of a limited partnership, the general partner can be the assignee of the lease, depending of course on the language of the lease. Moreover, the decision confirms that, even if consent is required, a landlord cannot unreasonably withhold the consent, particularly for speculative reasons.

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