



"NOT EVERY TRANSFER TRIGGERS A TENANT'S RIGHT OF FIRST REFUSAL TO PURCHASE"

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Not Every Transfer Triggers a Tenant's Right of First Refusal to Purchase

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A right of first refusal ("ROFR") is an important inducement and a valuable tool for prospective tenants. In essence, it is a right held by a tenant to be the first in line to purchase a property should the landlord choose to sell. The ROFR may be in the form of an agreement whereby the tenant has the first chance to "match" another purchaser's offer, or it may be a stipulation that the tenant has the opportunity to buy the property at a fixed price when and if the landlord decides to sell. Either way, it is a valuable right because it not only provides a tenant with the opportunity to buy a property at a pre-determined and potentially below-market price, but it also allows tenants to protect their investment in the premises.

There are many ways to draft a ROFR, and although diligent drafting might capture most scenarios, there may be circumstances that might not be specifically contemplated. In these situations, courts will generally look beyond the fine print and ascertain the true intention of the parties. Thus, although a provision might seem to trigger a ROFR, one must consider whether the parties had truly intended the ROFR to be triggered in that particular circumstance. A recent Ontario decision illustrates this point well. *Jose Maria Tavares Enterprises Ltd. v. Salvatore Caruso and Desaro Holdings Inc.*, Ont. Sup. Ct. J. File No. 02-BN-10537 (unreported).

Salvatore (Sam) Caruso, a 72-year-old semi-retiree working a few days a week, had amassed a nest egg for his family over his years in the hairdressing business. He owned a building on Jane Street, in Toronto, where his salon was located. He owned another small commercial building on Lakeshore Road in Mississauga, which he had purchased in 1974. These two buildings had been purchased as investments to see Caruso and his family through his retirement. Jose Maria Tavares Enterprises Ltd. was Caruso's tenant at the Lakeshore Road property since 1985, operating a restaurant known as "The Great Canadian Pizza Company."

The lease between Desaro Holdings Inc., a company controlled by Caruso (who held the only voting shares) and Tavares, included a ROFR to purchase in favour of Tavares. The ROFR stated that the right would be triggered if Caruso received a bona fide offer to purchase the property that Caruso was prepared to accept.

In the fall of 1999, Caruso decided to engage in some tax and estate planning. As a result, an estate tax-freeze transaction caused both the Jane Street and the Lakeshore Road properties to be transferred to Desaro Holdings Inc., a company controlled by Caruso (who held the only voting shares). Caruso's wife and children held non-voting shares in Desaro.

The transaction was structured as a rollover, with the consideration for the transfer of the Lakeshore Road property to Desaro being, as set out in the land transfer tax affidavit, \$250,000. The consideration was not paid in cash, but by preferred redeemable shares in Desaro. The transaction was structured to allow for the preference shares to be redeemed whenever Desaro had surplus cash flow to pay the taxes. The intention of the transaction was to reduce the amount of tax payable by Caruso's estate as a result of the deemed disposition of real estate upon his death.

Tavares claimed that Caruso's sale to Desaro triggered the ROFR in Tavares's lease. Tavares claimed that he did not learn of the transaction for over two years, by which time the property was worth more than \$400,000. Tavares commenced an action, claiming that Caruso should have sold the property to Tavares for \$250,000 and that Tavares was entitled to a conveyance from Desaro in exchange for that sum.

Caruso argued that there was never any bona fide offer to purchase the property. There was no offering of the property to the public or any solicitation of offers. It was a non-arm's-length transaction for estate planning purposes. As Caruso testified in court, the sale was "from Sam to Sam."

The court noted that ROFRs to purchase are contractual rights. Once the right is triggered, it converts to an option to purchase, which is an interest in land. The contractual right expires when the lease expires. An interest in land continues after lease expiry. At law, if the property is conveyed to a third party contrary to the option, the third party (in this case, Desaro) could be compelled to transfer the land to the party holding the option to purchase (in this case, Tavares). Tavares claimed that he had an option to purchase triggered by Caruso's transfer to Desaro. Tavares argued that Desaro's relationship to Caruso was of no consequence because the ROFR clause did not make this distinction. The ROFR only called for a transfer to be bona fide, which the Caruso-Desaro transfer was, as it was recognized by federal income tax authorities and the Ontario Ministry of Finance as a transfer with tax consequences.

The trial court disagreed with Tavares on two counts: (1) it found that the interpretation sought by Tavares would generate an unreasonable outcome, allowing Tavares to enjoy the appreciation in the property at the expense of Caruso. (2) The court found that at the time the provision in the lease was negotiated, the intention of the parties was that the ROFR would only be triggered on a sale to a third party. Furthermore, the ROFR was not triggered because there was no offer to purchase the property. Thus, the ROFR was never converted to an option and Desaro was allowed to keep the property.

Although this story has a happy ending for the Caruso family, and one that most readers would be satisfied with as achieving a fair and proper resolution of the dispute, the fact is that it was never a “slam-dunk” that Caruso would win. There is plenty of case law that holds that a single property can be carved out of a transfer of multiple properties for purposes of satisfying a tenant’s ROFR, even if the purchase price is for the entire group of properties without any separate allocation.

For instance, in *Municipal Savings & Loan Corp. v. Oswenda Investments Ltd.*, the court held that a ROFR cannot be avoided simply by the landlord’s addition of properties to the agreement for sale. On the other hand, there is also case law that comes to the opposite conclusion. In *Budget Car Rentals Toronto Ltd. v. Petro Canada Inc.*, the court held that a right of first refusal ROFR was not triggered where the landlord, Petro Canada, entered into an asset sale in respect of all its assets.

There is also case law that a transfer to a related entity does not defeat a ROFR, nor can the transferor give the property away to defeat the ROFR. In *Gardner v. Coutts & Company*, for instance, the vendor had made a gift of the subject property to his sister without offering it to the holder of the ROFR. The court held that it was implicit in the grant of the ROFR that the landlord should not be allowed to give the property away without first offering it to the tenant, which would effectively defeat the ROFR.

So, what type of transfer or sale triggers a ROFR to purchase? As lawyers are wont to say: “It depends.” The starting point of any analysis is, of course, the clause itself. Typically, a clause will call for an offer from a “bona fide” purchaser. The phrase “bona fide” means “good faith,” which is usually defined as the absence of bad faith or the absence of purpose to take unfair advantage of third persons. As *Desaro* shows, application of the term “bona fide” will depend on the facts of a given situation.

While an “offer” to purchase can take many forms, that offer need not come from a third party unless the clause so states or the intention of the parties is later determined to have been so limiting. If the clause does not address every issue, the courts will have to make a determination based on legal principles and the laws of interpretation. Courts will attempt to piece together the commercial setting in which a lease was negotiated. However, many of the difficulties associated with ROFRs arise in matters of interpretation. It is, therefore, wise to eliminate as much of the uncertainty as possible.

ROFRs are an infrequent insertion in most leases. Nonetheless, when such a right is negotiated, parties need to consider whether every “sale” will trigger it. A landlord may want the opportunity to make a change that, although technically a sale, is in fact merely a change in the form of ownership. Parties should, therefore, consider whether related-party transfers trigger the right, whether the triggering offer must be in writing, whether a portfolio sale is caught by the right and whether the transfer must be only for cash consideration to be subject to the right. The interpretation of these clauses will certainly be easier if these issues have been addressed at the outset.

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