Most commercial enterprises believe that they act reasonably in conducting their business affairs and operations. However, reasonableness, like beauty, can often be in the eye of the beholder. What seems reasonable to an entrepreneur borrower looking to expand its operations may not be seen as reasonable in the eyes of a lender that would prefer its borrower to follow a slower and more sustainable growth plan.

Credit Agreements typically contain a series of covenants that restrict or limit certain activities of borrowers. Recognizing their likely future need for a waiver of a particular limitation or prohibition to permit a specific one-time action, borrowers will often request carve-outs from the covenant pattern by adding a link to the words "unless the Lender otherwise consents". Borrowers will also typically try to tie down the discretion of their lenders when it comes to providing their consent. The addition of the words, "such consent not to be unreasonably withheld", is a frequent borrower request. It is important for lenders to understand the implications of any agreement to allow this reasonableness standard to be imported into a future request for consent to a particular covenant variation.

Surprisingly, there are very few reported cases in Canada shedding any light on this issue in the context of the borrower-lender relationship. Rather, the leading Canadian cases relating to commercial consents have arisen in connection with the landlord-tenant relationship. Specifically, the courts have examined the obligations on a landlord asked to consent to a lease assignment, where the lease provided that such consent "shall not be unreasonably withheld".
In Cudmore, the British Columbia Supreme Court considered Petro-Canada’s obligation to consent in the context of an assignment of a service station lease. The lessee was seeking an answer to the question, "Is the remedy of damages available to the Plaintiff (lessee) in an action against the Defendant (lessor) for unreasonable refusal of consent?".

The court concluded that the phrase "which consent shall not be unreasonably withheld" should not be construed as a qualification of the tenant’s covenant. Rather it is essentially a covenant on the part of the landlord not to "refuse his consent arbitrarily or unreasonably", which is subject to a remedy of damages if that covenant is not fulfilled.

In the later case of Welbow, the Ontario Superior Court offered the following additional guidelines in determining whether a landlord had unreasonably withheld its consent in refusing to consent to an assignment of the lease:

(1) The burden is on the tenant to show that the refusal to consent was unreasonable.

(2) Only the information available to the landlord at the time, and the reasons given by the landlord at the time, are relevant to the determination of reasonableness, not any facts or reasons subsequently provided to the court.

(3) The landlord is not entitled to require amendments to the lease that will provide it with more advantageous terms, but it may reasonably withhold consent if the assignment will diminish the value of its rights under it.

(4) A probability that a proposed assignee will default may, depending on the circumstances, be reasonable grounds for refusal of consent.

(5) The financial position of the assignee may be a relevant consideration.

(6) The question of reasonableness is essentially one of fact that must be determined on the circumstances of the particular case, including the commercial realities of the market place and the economic impact of an assignment on the landlord.

Several Ontario cases involving landlords and tenants have followed Welbow. In some instances the courts have assisted tenants challenging landlords who have had ulterior motives for withholding their consent. In others, the courts have recognized there can be legitimate business reasons for a landlord withholding consent to an assignment, especially where the proposed assignee tenant’s covenant is perceived not to be as strong as that of the existing tenant.

Fortunately, courts in the United Kingdom have examined the withholding of consent in
commercial transactions outside of the landlord-tenant relationship. In Porton Capital\(^6\), the purchaser under a share purchase agreement had agreed that it would not stop marketing and developing a product without the consent of the vendors, such consent not to be unreasonably withheld. When sales of the product slumped, the purchaser sought the vendors' consent to stop manufacturing the product. When the vendors refused to provide the consent, the purchaser stopped the manufacture anyways. The English High Court agreed with the vendors' interpretation of the phrase as follows:

(A) The burden is upon the party that requested consent to show that the other party's consent was unreasonably withheld.

(B) The party withholding consent is not required to show that their refusal of consent was right or justified, simply that it was reasonable in the circumstances.

(C) In determining what is reasonable, the party withholding consent is entitled to have regard to its own interests (in this case, its interests in earning as large of an Earn Out Payment as possible).

(D) The party withholding consent is not required to balance its own interests with those of the party requesting consent.\(^7\)

Ultimately the court in Porton Capital found that the vendors' consent was not unreasonably withheld, after taking into account the fact that giving consent would mean that the vendors would receive only a small proportion of their expected profits. Moreover, due to the vendors' limited involvement with the development and marketing of the product after closing, they would have reasons to doubt the purchaser's explanations for the drop in sales.\(^8\)

Finally, in Unicredit Bank\(^9\), the English Court of Appeal considered certain guarantees which contained a provision that allowed Unicredit to terminate the guarantees with the consent of Barclays Bank plc ("Barclays"), which consent was required to be exercised in a "commercially reasonable manner". Barclays offered to give consent only if it received five years of fees. The court held that this was reasonable, finding that Barclays could take into account its own interests, as Barclays was not in a position to assess and measure the other party's interests.\(^10\) The test was that of a reasonable commercial man and the court found that "any commercial man whose consent to a course of action is required but to whom the determination (whether to give that consent) is entrusted would think it commercially reasonable to have primary regard to his own financial interests".\(^11\) The court added that if Barclays had required 11 years payment, or if it had refused to consent at any price, this may have rendered the withholding of consent unreasonable.\(^12\)
It seems somewhat likely that the English case law will be followed in Canada in the borrower-lender scenario, and that the Canadian courts will allow lenders to consider their own interests in making decisions to grant or withhold consent to waivers and covenant variations even when those interests do not align with those of their borrowers. However the following factors might be considered by any lender considering a borrower’s request to add the "such consent not to be unreasonably withheld" phrase into any particular covenant:

- Limit the number of times the phrase is inserted into the Credit Agreement. Although clearly not every request for consent needs to be granted, the phrase will impose a higher level of scrutiny of the lender's actions and draw increased attention to its decision-making process. Consider restricting the addition to those situations where it is needed to preserve a good lender/borrower relationship.
- Be prepared to comply with the words and the added formality in the decision making process that the words entail when a request for consent is made. Some internal notes of the analysis undertaken by a lender considering a request for consent should be documented to support any denial, in case the reasonableness of the refusal is challenged by the Borrower.
- Avoid the addition in any situation where the lender wishes to maintain an overriding discretion in making any decision on account of special circumstances relating to the Borrower’s business, or a change in market practice or industry standards.
- Refrain from the addition in any situation where it might lead the lender to make a decision that is contrary to the reasonable expectations of the borrower as already communicated during the course of discussions or negotiations of the credit agreement where an anticipated "difference of opinion" may very well exist.
- Keep in mind that recent decisions of the Supreme Court of Canada have suggested that contracting parties have "a duty of honesty in contractual performance", and have "good faith as an organizing principle" in the common law of contract.¹³ The application of those concepts has not yet been fully played out in the lower courts, and their extension to matters of consent is not yet known.

Then when a request for consent comes in, a lender will want to ensure it obtains from the borrower all of the information that it would like to have in considering whether to grant consent to a borrower’s request to waive compliance with a particular covenant in order to make a fully informed decision. As requests for consent to a variation in any covenant sought by a borrower from a lender may cover a broad spectrum, additional information may take the form of pro forma financial statements, budgets and other financial data and materials to assist the lender in the exercise of its decision.

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1 Cudmore v. Petro-Canada Inc., 1986 CarswellBC 93 [Cudmore].

2 Cudmore, at para. 3.

3 Cudmore, at para. 21.


5 Welbow, at para. 9.


7 Porton Capital, at para. 223.

8 Porton Capital, at paras. 233 and 234.

9 Barclays Bank plc v Unicredit Bank AG, [2013] EWHC 3655 (Comm) (High Court Decision) and [2014] EWCA Civ 302 (Court of Appeal Decision) [Unicredit Bank].

10 Unicredit Bank, at paras. 15 and 17.

11 Unicredit Bank, at para. 16.

12 Unicredit Bank, at para. 18.

Richard C. Dusome
Counsel - Hamilton

Email
richard.dusome@gowlingwlg.com

Phone
+1 905-540-3279

vCard
Richard C. Dusome

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