



RESIDENTIAL DEVELOPERS: REDUCE YOUR RISK OF FUTURE LEGAL CLAIMS

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In the past decade, changes to the law have increased the risk of developers and their directors to lawsuits, and the length of time they are exposed to those claims. The law of negligence, the implied warranty of habitability, and disclosure statements, are key areas where claims now frequently arise. The new *Real Estate Development Marketing Act* only increases that risk and widens the scope of potential claims.

Risk to these claims can be reduced by improving the specific terms in the standard legal documents that form the foundation for these types of lawsuits: contracts of purchase and sale, disclosure statements, as well as marketing documents.

The following are typical lawsuits against developers. Even if the claims are without merit, the rules of court make it difficult to get out of them. However, if a few of the terms to the standard legal documents are changed, the risk of being sued in the first place, and the ability to get out of them early on - will be improved.

Implied Warranty Of Habitability

One cause of action that exposes developers to potential and uncertain liability is the “implied warranty of habitability”. This is a warranty implied by law (i.e. not written in any contract) that applies to contracts of purchase and sale of residences, such as a home or condominium unit, if it is not completed at the time of sale, (i.e. pre-sales). In these circumstances, the law imposes a warranty that the home will be fit for habitation, constructed in a good and workmanlike manner and with suitable materials.

The difficulty with the implied warranty of habitability is that it does not have a certain time limit like a contractual warranty. One court of appeal judge has said the time period is not open-ended, but will last a “reasonable” length of time, whatever that may be.

The implied warranty of habitability has been successfully applied to cover claims for damage caused by a lack of caulking. Many developers are unaware of this implied warranty because it is imposed by law and is not set out in contract. Developers who are aware of this implied warranty often think it does not apply to their projects because their contracts contain express warranties, such as a two year materials and labour warranty, and other clauses that say there are no warranties other than those set out in the contract. However, the courts have held that those terms do not exclude the implied warranty of habitability and more express language must be used to exclude or limit the implied warranty of habitability.

Director’s Liability

Directors of developers are also now often being sued personally in leaky condominium and other construction deficiency lawsuits, for alleged negligence and alleged misstatements of fact contained in disclosure statements. The latter lawsuits usually relate to the estimated budget for maintenance being alleged to be too low, and for failing to disclose the fact that the building would suffer building envelope failure. None of those claims have been tested in court, and, particularly the latter kind of claim, are likely spurious, as they suggest that somehow a developer knew better than their architect that the

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design would fail. Nevertheless, once named in a lawsuit, the rules of court about multiparty litigation make it very difficult to get out of a lawsuit early on.

The new *Real Estate Development Marketing Act* disclosure statement requirements will likely make these lawsuits even more common and open up new kinds of lawsuits. The Act now requires that “all material facts” be plainly disclosed, without misrepresentation. Material fact is defined in the Act, among other things, as any fact or proposal that would affect the value, price or use of the unit being sold.

Homeowner Protection Act Requirements

The *Homeowner Protection Act* sets out the mandatory home warranty insurance provisions for residential developers. If a developer wants to offer the minimum required, it needs to take steps to ensure only the minimum provisions are being offered. For example, the regulations allow the coverage to be conditional on owners undertaking proper maintenance. However, this can only be relied on if the maintenance requirements and procedures have been given to the owner. Developers can take steps to ensure extensive maintenance manuals are produced and distributed, and properly documented, to ensure the minimum provisions can be relied on.

Negligence Claims

The far reaching effect of the Supreme Court of Canada’s 10-year old case, *Winnipeg Condominium Corporation No. 36 v. Bird Construction*, is still unclear. It has opened the door to a multitude of lawsuits that before that case, could not be brought. Before *Winnipeg Condominium*, developers generally did not face expensive repair claims after warranties had expired, based on negligence. The basic legal principle was that claims for the cost of repairing defects were considered “pure economic loss” claims and not recoverable in negligence. A person could sue for the actual harm caused to persons or property by a defect, but not the cost of repairing the defect. Even the cost of repairing a defect to avoid harm was considered “pure economic loss” and not recoverable.

In *Winnipeg Condominium*, a piece of cladding fell from the 9th storey. A report found that there were serious issues with the cladding and if it wasn’t replaced, there was a risk other parts of cladding would fall off. The Supreme Court of Canada accepted the argument that a person should not escape liability if a defect is repaired before harm results.

The Supreme Court of Canada confirmed that, generally speaking, shoddy construction, or construction deficiencies are pure economic loss claims and not recoverable in negligence. Negligence claims for deficiencies is limited to cases where the defects “pose a substantial danger to the health and safety of the occupants”. The key passage is as follows:

...contractors (as well as sub-contractors, architects and engineers) who take part in the design and construction of a building will owe a duty in tort to subsequent purchasers of a building if it can be shown that it was foreseeable that a failure to take reasonable care in constructing the building would create defects that pose a substantial danger to the health and safety of the occupants. Where negligence is established and such defects manifest themselves before any damage to persons or property occurs, they should in my view, be liable for the reasonable cost of repairing the defects and putting the building back into a non dangerous state.

In leaky condo cases, the argument made by owners is that the water ingress, if left unrepaired, will rot the wood frame, compromise the structural integrity, and cause specific concerns, such as balcony soffits collapsing onto balconies below, health issues from mould, and even electrical concerns - all of which “pose a substantial danger to the health and safety of the occupants”. None of these arguments have been tested in court, and there are good opposing arguments. In any event, it can easily be seen that the kinds of argument raised in leaky condo litigation can apply to almost any kind of construction deficiency that may arise, if left unrepaired. In my view, negligence claims in construction will become more prevalent – outside of leaky condo claims - as plaintiff’s counsel become more creative.

Negligence claims pose significant and additional exposure to developers compared to traditional contract claims because of the potential for joint and several liability. Joint and several liability means that if a developer is found 1% liable, and others 99% liable, the developer could be required to pay 100% of the judgment. The developer will then need to pursue the other wrongdoers to collect their percentage of liability, if they have assets.

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No leaky condo case has gone to court litigating any of the issues raised in the *Winnipeg Condominium* case, such as whether leaks pose a substantial danger, whether the damage was reasonably foreseeable, and the issue of joint and several liability. The *Delta* case dealt only with the issue of municipal liability for inspections, which is an entirely different negligence test, and so these issues remain unresolved.

The cases to date have avoided court largely because the cost of litigating the claims are enormous. They involve multiple parties, multiple experts, and many untested legal issues. As many of the legal issues are unresolved, the risk of going to court for either side are high. The cost of settling are usually far less than just the defence costs of trial.

The other problem faced by developers by potential negligence claims is the length of time developers may be at risk. Our *Limitation Act* generally has a two year limitation period for some claims, but the clock does not start to tick until the facts are within the plaintiff's means of knowledge. For other claims, the limitation period is six years, without any postponement provisions.

In recent years, there have been a series of court cases that suggest the limitation period for leaky condo and other construction negligence claims is six years and the postponement provisions apply. In other words, the six year time limit does not begin to run until the facts are within the plaintiff's means of knowledge. When that begins will depend on the facts of each case. It may begin when leaks first appeared, or perhaps only after they have reached a degree that has caused the owners to obtain a building envelope assessment that reports the building has suffered building envelope failure. If the latter is true, then developers may be exposed to claims, maybe even more than a decade after completion. Many of the B.C. Housing leaky condo claims that have been launched by B.C. Housing go back more than 15 years.

Reduction of Risk

Strategies can be taken to minimize developers and directors to exposure to these types of claims. There is no fail safe way to avoid them, but there are steps that can be taken to minimize the likelihood of these kinds of claims arising, and minimizing the exposure to defence costs and damages if they do arise. Strategies include:

- Incorporation strategies;
- Terms to include in agreements of purchase and sale and disclosure statements;
- Taking advantage of provisions in the *New Home Warranty Act* and Regulations to reduce exposure to warranty claims;
- Insurance coverage;
- Reviewing marketing materials;
- Reviewing maintenance manuals and distribution to purchaser procedures.

We can conduct a legal audit that focuses on these key areas of exposure and provide advice on how to reduce that risk. It includes:

- reviewing business structures;
- analysing the standard contracts of purchase and sale, disclosure statements, marketing materials, and maintenance manuals;
- reviewing trade and consultant contracts;
- reviewing deficiency claim protocols and procedures.

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