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October 31, 2009

Rules on terminating a deal all over the map

Can a buyer refuse to close the purchase of a new home if there are deficiencies in construction, forgotten or incomplete items, or unauthorized changes to the design, layout or materials?

That question was the subject of a paper presented to a builder's conference earlier this year by Harry Herskowitz, of the Toronto law firm DelZotto Zorzi LLP. Herskowitz is well-known and respected as an author, lawyer for builders and developers, and chair of the Tarion Warranty Corp.

In his presentation, Herskowitz carefully analyzes 10 reported Ontario court decisions in which the purchaser was entitled to refuse to close, and seven other cases where the court ruled the buyer was wrong in refusing to close.

According to the Herskowitz analysis, whether or not a purchaser may refuse to close depends on the nature of the builder's default. If it is considered to be a fundamental breach of contract, one which substantially deprives the buyer of the whole benefit of the transaction, the buyer may terminate and get a refund of all deposit money.

If, however, it is a minor or "immaterial" breach of contract, one which is incidental or inconsequential to the main purpose of the contract, the buyer has to close, but may be able to claim damages from the builder.

Unfortunately, the reported court decisions in this area are all over the map. Ontario courts have failed to create a clear guideline so buyers and their lawyers are able to decide when a home deficiency or unauthorized alteration entitles the buyer to terminate the contract.

"One would think," writes Herskowitz, "that over the years, in the aftermath of several real estate recessions ... the courts in Ontario would have clearly delineated when a particular breach or misrepresentation ... will be considered minor, or conversely fundamental..."

He notes that more often than not the demarcation line between a minor and fundamental breach by the builder is blurred by the facts and equities of each particular case.

To me, one of the most puzzling cases cited in the Herskowitz paper is the 1995 decision of Justice Sidney Lederman in the case of Three D Developments (Kingwood) Ltd. v. Gogos. On the day of closing there was only temporary power in the house, the heating was incomplete, and the screens, kitchen desk, kitchen island, garage door and outside steps had not been installed.

The concrete garage floor had not been poured, and there was construction debris strewn around the house.

When the building inspector arrived on the morning of closing, the house failed inspection and he determined that it was not fit for occupancy.

The buyers refused to close and pay the balance of the purchase price, claiming the interior work of the house was not substantially complete so as to permit reasonable occupancy.

By the time the inspector returned at 4 p.m., the water was connected and although the furnace was not completely installed (it was July), the house was deemed fit for occupancy.

The builder sued the buyer for damages and won. The judge found that the issues were "relatively minor in nature." The house "on any objective standard" could reasonably be occupied, said the judge, and the buyer was not justified in refusing to close.

Other court decisions reach opposite results on similar facts.

Herskowitz concludes that the facts of each case are critically important to a court ruling whether or not the purchaser is entitled to terminate. The risk to the purchaser of refusing to close, he says, is very high, but so is the risk to a builder who refuses to acknowledge the purchaser's legitimate concerns.

In situations like these, Herskowitz urges both sides to act with the utmost good faith on closing day, to avoid winding up in a courtroom.
