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Wall Hides Code Violations

Difference between building defect, title defect

By **Ray Mikkola**

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(October 2, 2019, 2:19 PM EDT) -- The use of title insurance has become a typical aspect of commercial and residential transactions. The benefits of title insurance include protecting an insured against title and other defects. With the proliferation of title insurance policies over the last couple of decades has come case law which sets out the extent of title insurance coverage. One such area of judicial examination concerns building defects. When will a building defect constitute a title defect?

MacDonald v. Chicago Title Insurance Co. of Canada 2015 ONCA 842 is a leading case regarding the issue of whether a building defect can constitute as an insurable title defect. In *MacDonald*, load-bearing walls had been removed during renovations by the previous owners and as such, the structure was severely damaged. On top of that, these renovations were made without a building permit. It was argued by the MacDonalds that the unsafe condition of the house, which required extensive repairs, affected the marketability of title and therefore should be covered under the policy.

The trial judge held that the policy did not cover such defects, but the Court of Appeal overturned the trial judge, finding that had the purchaser's solicitor known of the removal of the load-bearing wall, he would have been alerted to a problem when the response to his search letter would have indicated that no building permit had ever been issued, thereby disclosing that the demolition had been done illegally.

The Court of Appeal found that the dangerous condition of the property "flows directly from the failures of the previous owner to attempt to obtain the necessary municipal approval. That failure has made the appellants' title unmarketable within the meaning of … the policy" (*MacDonald*, para. 74). Leave to appeal to the Supreme Court of Canada was refused on Oct. 16, 2016.

In July 2019, the case of *Breen v. FCT Insurance Company Ltd*. 2019 ONCA 598 considered *MacDonald* and found in favour of the title insurer. In this case, Breen purchased a house in 1999. Prior to this, the building had undergone renovations by the previous owner. However, no final inspection had ever been made by the building department.

Breen's solicitor during the purchase did acknowledge that it was unknown whether the house had ever actually passed a final inspection. He also advised the buyer to not bring the matter to the attention of the building department. Unfortunately for Breen, when a wall was opened up after closing, it revealed numerous building code violations. The insurer denied the claim stating that the insured was on notice of a potential problem, and that even if an off-title search had been conducted, these violations would not have been disclosed to the purchaser and thus would not be covered by the policy. The Court of Appeal overturned the trial judge and held that the defects were not issues that went to the marketability of title, for the following reasons:

- Breen was aware that there may be some issue with the building that might have been disclosed by requesting a final inspection. While he argued that he was unaware of the extent of the issue, it was important that the solicitor made a note that an issue regarding the final inspection existed and chose to ignore it. A central consideration in *MacDonald* was that the purchasers had no reason to know that the renovations had been done without a proper

building permit. There was no record that the MacDonalds' solicitor could have accessed.

- Even if a final inspection had been undertaken by the building department, such inspection would not have uncovered the defects as they were already hidden behind the walls. Title insurance is supposed to negate the necessity for the buyer's solicitor to conduct costly and time consuming off-title searches. Therefore, it was important that the defects in this case would still not have been found had those searches been conducted. In contrast, the defect in *MacDonald*, the removal of a load bearing wall without a permit, could have been discovered by the *absence* of any record of a building permit.

In both cases, it appears that no off-title search inquiries to the relevant building department were undertaken in respect to the physical condition of the property. The key distinguishing features between the cases, firstly, are that in *Macdonald* there was no reason for the purchasers or their solicitors to know that an unauthorized demolition had taken place.

In *Breen*, the purchaser's lawyer had advised Breen that the lawyer had no evidence that a final inspection had taken place by the township (although some inspections had taken place) but he also advised her that "it might be better to let matters lie as they were" (*Breen*, para. 20). On this basis, the Breens were disentitled to rely on the policy as they were willingly blind to a risk of which they were aware.

But the second basis for distinguishing the decisions is more difficult to apply. In *MacDonald*, had the lawyer written for evidence of the issuance of a permit, he would have noted with suspicion the absence of a building permit for the removal of a load-bearing wall. In reality, of course, the solicitor had no such knowledge and therefore, as the Court of Appeal found, he had "no reason … to make any inquiries in that regard" (*Breen*, para.19).

But in *Breen*, the Court of Appeal based its decision on their view that a final inspection would not in any event have revealed the building code defects which were "hidden behind the walls of the cottage that were already constructed" (*Breen*, para. 22). The distinction therefore seems to depend on what a building inspector would have done on a final building inspection, perhaps on the basis of whether the work behind the walls had already passed inspection.

One wonders if the decision may have been different if the building inspector had provided evidence that (i) such hidden work had not in fact been inspected and that the inspector would have required that the work be available for inspection notwithstanding that it was behind a completed wall cover or (ii) if the inspector had access to the technology that would have allowed the inspector to see into the wall to detect the non-complying work.

The clear takeaway from these cases may therefore be the finding that an insured cannot be wilfully blind to a defect of which it is aware and still hope to be covered by the policy. Where the insured is not aware of any such defect, the resolution of coverage may be determined on the basis of what a response to an off-title inquiry might have produced. The insured might therefore be said to be covered for issues that could have been set out in response to an inquiry letter, but not for issues that in any event, would not be included in such a response.

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