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TAB 3

THE SIX-MINUTE Real Estate Lawyer 2014

A Comment on the Appellate Decision in *Toronto Standard Condominium Corp. No. 2095 v. West Harbour City (I) Residences Corp.*

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Can a Declarant Bind the Condominium Corporation to a Limited Recourse Agreement in Respect of Common Element Deficiencies? - - - A Comment on the Appellate Decision in ***Toronto Standard Condominium Corp. No. 2095 v. West Harbour City (I) Residences Corp.***

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SUMMARY

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Can a Declarant Bind the Condominium Corporation to a Limited Recourse Agreement in Respect of Common Element Deficiencies? - - - A Comment on the Appellate Decision in ***Toronto Standard Condominium Corp. No. 2095 v. West Harbour City (I) Residences Corp.***

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1. INTRODUCTION

To some people, the notion of disclaimers, exculpatory clauses and limited recourse agreements which purport to limit or circumscribe one party's liability to another, or which seeks to avoid exposure to certain liabilities altogether, is offensive, obnoxious or unseemly. However, to most cautious or risk-averse business people, such tools to limit or avoid liability are commercially-prudent, if not essential, to the ongoing viability of the commercial business or enterprise, particularly if the business involves extensive financial risk or significant liability exposure. Builders and developers are no exception, and if there's a legitimate way to limit their exposure to potential liability claims, most would assuredly avail themselves of that opportunity.

For residential condominium developers, who are obliged to enrol each of the dwelling units in the condominium project in accordance with the provisions of the *Ontario New Home Warranties Plan Act R.S.O. 1990, as amended,* and the regulations promulgated thereunder (hereinafter collectively referred to as the "**ONHWP Act**"), and who are correspondingly required to pay enrolment fees to Tarion Warranty Corporation (hereinafter referred to as "**Tarion**") which administers the mandatory warranties (and compensation scheme) applicable to the respective dwelling units and common elements pursuant to the provisions of the ONHWP Act, the ability to have all common element deficiency claims administered and processed exclusively by Tarion, rather than being resolved through expensive and protracted litigation, is an extremely welcome prospect, and for many condominium developers, far preferable than the courts.

Section 13(1) of the ONHWP Act provides that every vendor of a new home warrants that the home is constructed in a workmanlike manner, in accordance with the Ontario Building Code, is fit for habitation, is free from defects in material, is free of major structural defects (as defined by the regulations), and is also subject to such other warranties as are prescribed by the regulations (eg. a delayed occupancy/closing warranty). Section 14(3) of the ONHWP Act also confirms that a home owner has a right to make a claim against the Tarion guarantee fund where the owner has a cause of action against the vendor or builder for damages resulting from a breach of any of the aforementioned statutory warranties. Section 13(6) of the ONHWP Act expressly stipulates that the statutory warranties apply despite any agreement or waiver to the contrary, and are in addition to any other rights that the owner may have, and to any other warranties agreed upon.

In MTCC No. 1352 v. Newport Beach Development Inc. (2012) 113 O.R. (3d) 673 (hereinafter referred to as the "**Newport Beach Case**"), the Ontario Court of Appeal confirmed that proceedings with Tarion under the ONHWP Act for common element deficiencies do not automatically preclude a subsequent civil action against the declarant by the condominium corporation seeking damages for construction deficiency claims, and that Tarion decisions do not necessarily give rise to issue estoppel or *res judicata* that would otherwise thwart such subsequent litigation. In light of the foregoing, can a condominium declarant legitimately limit its risk exposure for common element deficiency claims by way of a limited recourse agreement with the condominium corporation, so long as the declarant doesn't seek to contract out of the statutory requirements of the ONHWP Act?

The case of Toronto Standard Condominium Corporation No. 2095 v. West Harbour City (1) Residences Corp. (hereinafter referred to as the "**West Harbour Case**") was the first (and is currently the only) reported decision involving the enforceability of a limited recourse agreement entered into between the declarant and the condominium corporation, and which agreement purported to: (i) limit

the declarant's warranties in respect of the common elements to only those statutory warranties provided by the ONHWP Act; (ii) limit the condominium's recourse for common element deficiency claims solely and exclusively to Tarion (and subject to the corresponding monetary limits and applicable limitation periods) outlined by the ONHWP Act; and (iii) prevent the condominium from initiating or pursuing any warranty claim in respect of the common elements, except through the processes and time lines established and administered by Tarion. In short, the limiting recourse agreement effectively precluded the condominium from pursuing civil proceedings against the declarant for any common law claims pertaining to any outstanding, incomplete or deficient construction items involving the common elements.

In the West Harbour Case, the post-turnover board of directors challenged the enforceability of the limited recourse agreement, and the corresponding by-law which expressly authorized the condominium's execution of same. The condominium's application for a declaration confirming that the agreement and associated by-law were void, and of no force or effect, was heard by Justice Corbett, and his decision is reported at 2013 CarswellOnt 13544. The application Judge concluded that the impugned by-law and agreement were *intra vires* the jurisdiction of the board of directors to so authorize and execute, and were not inconsistent with the provisions of the *Condominium Act S.O. 1998,* and the regulations thereto (hereinafter collectively referred to as the "**Condominium Act**").

The decision of Justice Corbett was appealed to the Ontario Court of Appeal, and ultimately Justice Rouleau rendered a decision on behalf of a unanimous appellate court that was released on October 22nd, 2014, upholding the decision of the application judge. The purpose of this paper is to review and analyze the decision of the appellate court, which validated the enforceability of the limited recourse agreement and the corresponding by-law which authorized same.

2. **THE FACTS OF THE CASE**

West Harbour was the declarant (hereinafter referred to as the "**Declarant**") of a residential high-rise condominium project that was developed in downtown Toronto, and registered on July 23rd, 2010 (hereinafter referred to as the "**Condominium**"). In the agreement of purchase and sale entered into by the Declarant with each of the respective unit purchasers, the contract confirmed that:

a) the vendor expressly made no representation, warranty, guarantee or collateral agreement with respect to workmanship or materials relating to the construction of the Condominium, except for those warranties deemed to be given by a vendor of a residential dwelling pursuant to Section 13 of the ONHWP Act;

b) the purchaser agreed that the Condominium shall have no rights as against the vendor beyond those that are specifically granted to it under the Condominium Act or the ONWHP Act, and that the Condominium's only recourse against the vendor for a final and binding resolution of any outstanding, incomplete or deficient items (and any other matters relating to the Condominium) shall be through the processes established and administered by Tarion under the ONWHP Act, who both parties to the agreement of purchase and sale appointed as the sole and final arbiter of all such matters; and

c) the purchaser expressly agreed to indemnify and save the vendor harmless from and against all actions, causes of actions, claims and demands for damages or loss which are brought by the Condominium in contravention of the foregoing provisions.

In addition, the condominium disclosure statement issued by the Declarant made reference to a proposed by-law no. 2, which by-law expressly authorized the condominium corporation (hereinafter referred to as the "**Corporation**") to enter into a limiting recourse agreement with the Declarant (hereinafter referred to as the "**Warranty Agreement**") stipulating, amongst other things, that:

i) the Corporation shall have no rights against the Declarant beyond those which are specifically granted to the Corporation under the Condominium Act, the ONHWP Act and by Tarion;

ii) the Corporation's only recourse against the Declarant for a final and binding resolution of any outstanding, incomplete or deficient construction items (and any other matters relating to the Condominium and/or the Corporation) shall be through the process established for (and administered by) Tarion; and

iii) the Warranty Agreement shall neither be terminated nor be terminable by the Corporation following the Condominium's turnover meeting.

The proposed by-law and the draft Warranty Agreement were included as part of the disclosure statement issued by the Declarant to each of the respective unit purchasers. Shortly after the registration of the Condominium, the first board of directors of the Condominium so appointed by the Declarant proceeded to enact the aforementioned by-law no. 2, and the Corporation thereafter entered into the Warranty Agreement with the Declarant authorized by said by-law. Both the by-law and a draft of the Warranty Agreement were then registered on title to each of the respective units within the condominium project, to give notice to all prospective unit purchasers that the liability of the Declarant to the Corporation would ultimately be on a limited recourse basis.

The turnover meeting for the Condominium was held on October 28th, 2010. The post-turnover board identified certain alleged construction deficiencies that it claimed may not be warrantable within the purview of the Tarion process, however the Declarant disputed same. Nevertheless, on May 15th, 2012, the Corporation filed a notice of application, through which it sought a declaration that by-law no. 2 and the Warranty Agreement were void and of no force or effect. The application judge dismissed the Corporation's application, by concluding that nothing in the Condominium Act, the ONHWP Act or any other provincial legislation precludes a condominium developer from limiting its liability in respect of the common elements, and there was no basis for ruling that by-law no. 2 or the Warranty Agreement were *ultra vires* the board of directors or unreasonable within the meaning of the Condominium Act.

3. THE ISSUES ON APPEAL

The issues on appeal boiled down to two specific points:

a) Is the impugned by-law *ultra vires* and therefore unenforceable, either because it's not within the enumerated subject matters of permissible by-laws provided for in section 56 of the Condominium Act, or because it's inconsistent with the Condominium Act and/or the Condominium's declaration?; and

b) Is the impugned by-law unreasonable and therefore unenforceable?

4. THE COURT'S RULING AND ANALYSIS

Section 56(1) of the Condominium Act provides the board of directors with broad authority to enact or adopt by-laws governing the management and operation of the Condominium, so long as same are not contrary to the provisions of the Condominium Act or the declaration, and specifically allows the enactment of by-laws to:

(l) govern the management of the property;

(m) govern the use and management of the assets of the corporation;

(n) specify duties of the corporation in addition to the duties set out in the Condominium Act and the declaration; and

(p) govern the conduct generally of the affairs of the corporation.

The Corporation argued that the powers listed in section 56(1)(l), (m), (n) and (p) of the Condominium Act are far too general or generic to support the impugned by-law authorizing the execution of the Warranty Agreement. However, the Court of Appeal saw no reason not to give effect to the very broad authority granted to boards of directors by the words of the governing legislation, nor any legitimate reason to endeavour to limit or circumscribe the by-law making powers so conferred on boards.

Justice Rouleau confirmed that the purpose behind by-law no. 2 and the Warranty Agreement was to provide a framework within which the Condominium shall deal with outstanding or incomplete work and/or construction deficiencies affecting the common elements, and that the decision of the board to limit the Corporation's recourse to Tarion for common element deficiencies, to the exclusion of all other civil claims or remedies against the Declarant, is clearly an exercise in the governance of the affairs of the Corporation. If the Corporation has the authority to advance a claim, or to resolve

any claim it might choose to advance, then the Court of Appeal reasoned that it must surely have the authority not to pursue a claim, or to determine in what manner or venue (and against whom) it will initiate or pursue any particular claim. A by-law governing the way in which the Corporation is to advance any claims that it has or is entitled to pursue, including the forum in which such claims will be advanced, such as through Tarion's auspices, is part and parcel of conducting the affairs of the Corporation, irrespective of whether the by-law is enacted by the Declarant-appointed board or the post-turnover board, and is therefore authorized by section 56(1)(p) of the Condominium Act.

The Corporation submitted that because by-law no. 2 effectively disposed of the Condominium's right to sue the Declarant for any construction deficiencies, it thereby impaired the Corporation's ability to meet its maintenance and repair obligations imposed by sections 89 and 90 of the Condominium Act, and as mandated by certain provisions of the registered declaration. As a result, even if the impugned by-law was authorized by section 56(1)(p) of the Condominium Act, the Corporation argued that it is nonetheless *ultra vires* because it is otherwise contrary to the Condominium Act or the declaration. However, the Court of Appeal clearly rejected this argument, because the impugned by-law and the Warranty Agreement did not prevent or restrict the performance and fulfilment of the Corporation's maintenance and repair obligations, but rather imposed limits on the options that the Corporation might otherwise have to pursue the Declarant in order to seek recovery of any costs incurred in carrying out the Corporation's maintenance and repair obligations, and therefore simply circumscribed, to a certain extent, the manner in which the Corporation will have to manage its resources in order to fund any future maintenance and repair costs.

The Corporation argued that the impugned by-law and the Warranty Agreement contravened section 23 of the Act, which essentially provides that in addition to any other remedies that a corporation may have, a corporation may on its own behalf (and on behalf of any unit owners), commence, maintain or settle an action for damages and costs in respect of any damage to the common

elements, and before commencing any such action the corporation shall be obliged to give written notice of the general nature of the action to all unit owners and mortgagees whose names appear in the corporation's record. However, Justice Rouleau confirmed that section 23 is permissive in nature, and that there is no statutory requirement that any claim must actually be made by the Corporation, nor that the unit owners need to receive any notice should the Corporation decide not to advance such a claim.

The Corporation further argued that by enacting the impugned by-law which effectively disposed of an asset of the Condominium (namely the potential to pursue causes of action against the Declarant for common element deficiencies), the directors so appointed by the Declarant to the pre-turnover board breached their statutory (and fiduciary) obligations to the Corporation, because no careful or diligent director, acting honestly and in good faith as mandated by the requirements of section 37(1) of the Condominium Act (and cognizant of the Condominium's obligation to maintain and repair the common elements) would ever enact such a by-law. However, Justice Rouleau pointed out that no case was ever cited in which a breach of section 37(1) of the Condominium Act committed by any director formed the basis for ruling that a particular by-law should consequently be held *ultra vires*.

More importantly, the appellate court confirmed a fundamental condominium principle that was first espoused by the Court of Appeal in the case of PCC No. 417 v. Tedley Homes Ltd. (1997) 35 O.R. 257, namely that it's the declarant as the developer of the condominium property who defines the content, character and structure of the condominium project through the declaration and the initial by-laws (and the corresponding agreements authorized by such by-laws), which are initially disclosed to all unit purchasers in the disclosure statement and ultimately enacted by the pre-turnover board of directors. In implementing the structure designed and orchestrated by the declarant, and specifically by enacting the by-laws so disclosed in the disclosure statement, the first board of directors are not

acting *per se* as fiduciaries for the unit purchasers, and their role is not to try and obtain the best possible agreement for the condominium corporation or for the unit purchasers. Rather, their role is to organize the affairs of the condominium in the manner anticipated by the declaration and the initial by-laws so disclosed, and correspondingly agreed to by the purchasers of the individual units, so long as the directors are otherwise acting within the limits and constraints imposed by the Condominium Act. By-law No. 2 and the Warranty Agreement were disclosed to all unit purchasers, and the by-law was ultimately registered on title to give notice to the world of its terms. By enacting the by-law and entering into the Warranty Agreement which were so disclosed, the directors did not act in violation of their fiduciary duties under the Condominium Act, nor was the by-law *ultra vires* as a result thereof.

The Corporation further argued that by-law no. 2 and the Warranty Agreement did not meet the reasonableness requirement in sections 56(6) and (7) of the Condominium Act, because the Corporation received no consideration in exchange for entering into the Warranty Agreement with the Declarant. However, the Court of Appeal agreed with the application judge's finding that the consideration for same was part of the overall arrangement in respect of the Declarant's transfer of title to the respective dwelling units, and that the Corporation relinquished its potential causes of action against the Declarant (for common element deficiency claims) as part of the overall structure of the condominium project imposed by the Declarant, through the provisions of the respective agreements of purchase and sale, and the proposed declaration and by-laws included within the disclosure statement. Justice Rouleau noted that the degree to which a declarant would, at common law, be exposed to potential deficiency claims over and above those imposed by the ONHWP Act, will invariably factor into the price at which the declarant is prepared to sell each of the respective units in the project for, and the corresponding price that each unit purchaser is prepared to pay for same. Simply put, all of the unit purchasers in the West Harbour Case were fully informed of the terms of

the bargain being proposed, in terms of the limited warranties that came with their purchase. The fact that the warranties relate to the common elements administered by the Corporation, does not mean that separate consideration must flow to the Corporation itself. The unit owners as a group own all of the common elements, and their purchase from the Declarant includes both the purchase of their respective units and, in the aggregate, the purchase of the common elements, as outlined by the registered declaration and the initial by-laws adopted by the pre-turnover board.

The Corporation also argued that the disclosure of the by-law and the Warranty Agreement had been inadequate, and therefore rendered same unreasonable and unenforceable. However, the Court of Appeal confirmed that there is nothing in the Condominium Act, nor any other jurisprudence, that supports the submission that inadequate disclosure somehow renders a by-law (or the agreement authorized by such by-law) unreasonable, and therefore unenforceable. Justice Rouleau confirmed that both the by-law and the Warranty Agreement were disclosed in both the Declarant's disclosure statement and in the agreements of purchase and sale, and that by-law 2 was registered on title to give notice to all prospective unit purchasers. If there was a legitimate issue regarding the adequacy of disclosure, then there are other provisions in the Condominium Act which offer specific remedies to the affected and aggrieved unit purchasers.

In the end, Justice Rouleau concluded that the by-law was valid, and that the Warranty Agreement was authorized, lawful and valid, and was consequently binding on the Corporation, irrespective of whether the Corporation subsequently chose to amend or repeal the by-law. The Court of Appeal confirmed that there is nothing inherently unreasonable in a declarant limiting its liability for construction deficiencies in the manner proposed and implemented by the Declarant in the West Harbour Case, and none of the provisions of the Condominium Act prevent a declarant from doing so. The issue of whether developers should be prevented from limiting their liability to the statutory

warranties provided by the ONHWP Act is really a matter of policy for the provincial legislature to consider and address, and not one for judicial determination.

5. MY CRITIQUE OF THE DECISION

I have to formally declare my personal bias regarding the decision in the West Harbour Case, since I personally participated on the appeal with my colleague Richard Hoffman on behalf of the Declarant, and therefore, as you can well imagine, I wholeheartedly agree with the decision of the appellate court in upholding the validity of the limited recourse agreement, and I found the Court of Appeal's ruling to be exceedingly clear and well-reasoned. If a board of directors of a condominium has the authority and jurisdiction to assert, prosecute and/or settle a claim against a third party (including the declarant) for common element deficiencies, then it logically follows that the converse should also be within the purview of the board's authority, namely to decide not to pursue any claim (or certain claims) against the declarant, and to embody such a decision in a limiting recourse agreement.

Builders of freehold homes are entitled to limit their risk exposure to construction deficiency claims by clear and explicit contractual language, and there is no logical reason why builders of condominium dwellings should not be entitled to do likewise, absent any specific legislative provision to the contrary. In Ontario, the provincial government has quite properly imposed minimum standards for warranties applicable to all new homes and condominiums, pursuant to the provisions of the ONHWP Act. Section 13(6) of the ONHWP Act confirms that the statutory warranties applicable to new homes and condominiums, including common elements, cannot be abridged, annulled, varied or obviated, despite any agreement to the contrary. In my respectful opinion, there would be no need, reason or justification for a provision such as section 13(6) of the ONHWP Act, which expressly

precludes contracting out of the statutory warranties, if the Condominium Act somehow already precluded the avoidance or derogation of the declarant's common law liabilities for common element deficiencies. Moreover, if one is expressly prohibited from contracting out of the statutory warranties, pursuant to section 13(6) of the ONHWP Act, then the corollary must surely be permissible, namely the ability to exclude or contract out of all other warranties at common law, through clear and specific contractual exculpatory language. Since the Court of Appeal in the Newport Beach Case affirmed that Tarion decisions do not, *prima facie,* give rise to issue estoppel or *res judicata*, the only effective mechanism for implementing such an exclusion of common law warranties with respect to the common elements is a limiting recourse agreement to this effect, entered into between the declarant and the condominium corporation, which is disclosed in advance to all prospective unit purchasers, and ultimately registered on title so that all subsequent purchasers will be deemed to have actual notice of same.

The paucity of reported decisions involving common element deficiency claims against declarants, despite the ever increasing numbering of condominium projects registered in the province of Ontario, is anecdotal evidence in support of the argument that by and large Tarion is satisfactorily processing and administering common element deficiency claims to the satisfaction of most condominium corporations, and that Tarion's detailed prophylactic Bulletin 19 process (which requires every high-rise condominium project to undergo third party field review investigations at different milestone stages of the overall construction process, in an effort to locate and correct all common element deficiencies, if not avoid same altogether), as well as Tarion's $2.5 million dollar monetary limit in respect of common element deficiency claims, is more than adequate to cover most condominium projects. There is really no hardship or inequity imposed on any unit purchasers in such a scenario, because they all know (or ought to know) the bargain they've made with the declarant, in

terms of being relegated to pursue common element deficiencies exclusively through Tarion's administered warranties, claims process, time lines and monetary limits respectively. In my view, the condominium corporation created upon the registration of the declaration should not be treated like a "holder in due course" of a negotiable instrument and entitled to have any greater or more expansive rights to pursue common element deficiency claims against the declarant, than any of the unit purchasers, who all become unit owners in the condominium, and who willingly and knowingly gave up those rights contractually as part of their respective purchase and sale transactions. In short, the Court of Appeal's decision in the West Harbour Case essentially gave effect to the reasonable expectations of the contracting parties, and correspondingly avoided conferring an unintended and unfair windfall benefit upon the condominium corporation, to the detriment and prejudice of the declarant who relied upon the efficacy of the limited recourse agreement.

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