Focus BANKRUPTCY & INSOLVENCY

Questioning warranty on home bought from receiver

David Preger

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When a residential project reaches a relatively advanced stage of construction and then becomes insolvent, the project's secured lenders face the question of whether it should be sold in its existing state, or whether to finish the build-out and sell the units.

Tarion, Ontario's regulator of the new home building industry and administrator of the *Ontario New Home Warranties Plan Act* (the act), will be a factor in the calculus. Its primary purpose is to protect consumers of new homes, including new condos, by ensuring that builders and vendors abide by the provincial legislation.

Anyone who builds or sells new homes or condos in Ontario must be registered with Tarion and all new homes and condos must be enrolled in accordance with the act. A "vendor" is defined as "a person who sells, on his, her or its own behalf, a home not previously occupied to an owner and includes a builder who constructs a home under a contract with the owner."

Tarion requires security from builders and vendors to mitigate losses from warranty claims. Security requirements are assessed on registration and renewal, based on a registrant's size, tenure and history as a registrant, business and technical skills, creditworthiness and the type of project in question.

When the decision is made to finish a partially completed insolvent project instead of selling it "as is where is," the project's senior secured lender will typically apply to court for the appointment of a receiver pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act* (Canada) and s. 101 of the *Courts of Justice Act* (Ontario).

If there are construction liens, the receiver may also be appointed as construction lien trustee pursuant to s. 68 of the *Construction Lien Act* (Ontario).

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> **David Preger**
> Dickinson Wright

Given the registration and enrollment regime under the act and Tarion's requirements for the provision of security, the legal question arises whether a court-appointed receiver with a mandate to complete a partially constructed project and sell homes, must become registered as a vendor. Section 15.1 of the act appears to answer the question, at least in part. It provides that a person, who has registered as a vendor with Tarion with respect to a home, for which a Tarion registered builder of the home has complied with Tarion's requirements prior to construction, and has "*substantially completed the construction,*" shall be deemed to be a vendor of the home even if another person sells the home to an owner. Therefore, if construction of a project is substantially completed at the time of the receiver's court appointment, the receiver would be deemed to be a vendor, presumably without having to register.

The bedeviling question is what "substantially completed" means. The expression is not defined in the statute nor in the regulations and there are no reported decisions on point. The *Construction Lien Act* (Ontario) offers no guidance. It deals with "substantial performance" of contracts; not substantial completion of construction.

Does this mean a court-appointed receiver will run afoul of the act by finishing a less than substantially completed project and selling the finished units? Courts have said no.

In *Romspen Investment Corporation v. 6176666 Canada Ltée.* 2009 O.J. No. 5031, the most recent decision on point, the developer of a residential condo project that was not yet completed, defaulted under its obligations to its senior mortgagee. The mortgagee sought to register with Tarion as a vendor so that it could complete the project and sell the units under power of sale.

Tarion was concerned that the project was rife with construction defects. The mortgagee and Tarion could not agree on terms of the mortgagee's registration and the mortgagee applied to court to appoint a receiver.

To compound matters, the developer had reportedly withdrawn its vendor registration with Tarion prior to the mortgagee's court application. The court was asked to determine whether the proposed receiver would be required to register as a vendor under the act in order to sell the units. Tarion asserted that the receiver would be exercising the powers of the developer, and that the developer, whose vendor registration had been withdrawn, would be required to reregister as a vendor through the receiver. Tarion was prepared to reregister the developer if adequate security was posted, which would have to be provided by the mortgagee.

Justice Sarah Pepall (as she then was) rejected Tarion's position on the basis that the receiver would not be selling the units on "its own behalf" as principal, nor as agent of the developer or the mortgagee. Rather it would hold the units for the court and effecting sales through vesting orders.

The lingering concern is whether the buyers of new homes from a court-appointed receiver in a project that was not substantially completed when the receiver was appointed are beneficiaries of the Tarion warranty.

Inevitably, general contractors engaged by court-appointed receivers to finish new projects are registered as builders with Tarion. As a matter of policy, it would be entirely contrary to Tarion's consumer protection mandate if such buyers are without a warranty, notwithstanding that the project's original developer was a registered vendor from whom Tarion presumably continues to hold security. Whether warranty coverage flows as a matter of law, is a question for a judge to decide at a later day.

David Preger is a partner with the cross-border firm Dickinson Wright. His primary focus is acting in real estate insolvencies for secured lenders and court-appointed receivers.

Contract: If source code important to licensee, copy should be placed in escrow

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Often, intellectual property licences are wrapped up into larger contractual arrangements, perhaps involving ongoing technical support, the sharing of improvements, or ongoing maintenance of the intellectual property. If only the portion of the contract relating to the "use of the intellectual property" is covered by the legislation, this may leave the licensee in an undesirable situation if other aspects of the contract are disclaimed. Also, it may leave the parties unclear as to what is required to "perform its obligations under the agreement in relation to the use of the intellectual property" if, for example, the royalty payment covers multiple aspects, only one of which is the intellectual property.

For companies entering into licence agreements, particularly where there is a concern of an insolvency by one of the parties, these sections of the BIA and CCAA should be reviewed having regard to the licence and contractual terms. According to the jurisprudence, if ownership in the intellectual property has been transferred, the transfer cannot be disclaimed during the insolvency. Therefore carefully structuring the intellectual property ownership is one way to provide additional certainty in the event of an insolvency. If access to source code is important to the licensee, it may be advisable to have a copy placed into escrow as part of the licence arrangement.

Insolvency, restructurings and proposals always involve uncertainty but for third party licensees who have relied on a long-term licence arrangement, the effects can be devastating. Intellectual property licence agreements have been recognized as being different than other contracts giving some reassurance that the licences will be recognized during an insolvency.

Alan Macek practises intellectual property law and litigation at DLA Piper in Toronto.