Damage to property prior to closing

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Purchasers and vendors may face difficult decisions when something unexpected happens to the property between the time that the agreement of purchase and sale is signed and the transaction closes. Events such as a fire, water damage, or the discovery of environmental contamination on or under the property can have costly consequences and it is important for purchasers and vendors to understand what their rights and obligations are when there is damage to the property prior to closing.

The standard risk and insurance clause in agreements of purchase and sale says that the property remains at the risk of the vendor until closing. In the event that there is "substantial" damage to the property prior to closing, the purchaser has the right to either terminate the agreement and have deposit monies returned or take the proceeds of the insurance policy and complete the purchase. Whether damage in a particular transaction is "substantial" will depend on the circumstances of the transaction.

The decision of the Supreme Court of Canada in *Wile v. Cook* [1986] 2 S.C.R. 137 is a very helpful case for purchasers and vendors when they have to assess what their rights and obligations are when there is damage to the property prior to closing. In the *Wile* case, the property had burned down the day before closing. The purchaser and vendor agreed to extend the closing date for two weeks, so that the purchaser could contact the vendor's insurer. Although the purchaser was able to satisfy itself that the vendor had sufficient insurance coverage to allow the purchaser to take the insurance proceeds and close the transaction, there was a possibility that the insurer might deny coverage because the fire may have been deliberately set.

The Supreme Court of Canada held that the purchaser, in such circumstances, was entitled to a reasonable period of time to assess their position and obtain information about the amount of the vendor's insurance coverage. However, the standard insurance clause did not give the purchaser the right to wait and see if the insurer would pay out under the insurance policy. If the purchaser was concerned that the insurer might not pay the insurance proceeds, the appropriate action for the purchaser might very well be to terminate the agreement.

In addition to fire damage, another event prior to closing that can substantially affect the value of the property is water damage. Where there is water damage prior to closing, it is important that there be an assessment of the extent of the water damage and the cost to clean-up and repair the damage caused by the water. It is critical that the vendor advise its insurer immediately about the water damage and that the purchaser make the necessary inquiries of the vendor and its insurer, so that the purchaser can make an informed decision whether to close the transaction with the insurance proceeds or terminate the agreement.

A further event that can have a significant impact on the parties is the discovery of environmental contamination on or under the property prior to closing. In *Sevidal v. Chopra* (1987), 64 O.R. (2d) 169, the vendors discovered, after the purchase agreement had been signed and before closing, that there was radioactive material on the property being sold. They did not disclose this information to the purchaser prior to closing. The court held that there was an obligation on the vendors to disclose to the purchaser the existence of the radioactive material when the vendors learned about this in the interval between signing of the purchase agreement and closing of the transaction.

The standard risk and insurance clause in purchase agreements sets out the rights of the parties and the *Wile v. Cooke* case provides helpful guidance to the parties about the operation of the clause. It is important for purchasers and vendors, and their lawyers, to be aware of the standard clause and the case law dealing with the clause and with the disclosure of certain latent defects that are discovered prior to closing. When damage occurs prior to closing, there is often not much time for the parties to assess their positions and they will need to move quickly to determine whether the transaction should still be completed and who is responsible for the cost of the damage to the property or the clean-up of the contamination.

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