IN FACT AND IN LAW

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Damage Insurance

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THE WARRANTY OF QUALITY DID NOT COVER JUST THE FIREPLACE!

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ON APRIL 20, 2009, THE COURT OF APPEAL ISSUED ITS JUDGMENT IN THREE RELATED CASES[1] CONCERNING A DEFECT IN A FIREPLACE THAT CAUSED A FIRE RESULTING IN THE PARTIAL LOSS OF THE BUILDING OWNED BY ALPHA'S INSUREDS. ALPHA SUED THE IMMEDIATE SELLER TO ITS INSUREDS, BASQUE, AS WELL AS THE PRIOR OWNERS, CARON AND PELLERIN, UNDER THE RULES GOVERNING THE WARRANTY AGAINST LATENT DEFECTS.

THE THREE DEFENDANTS MAINTAINED THAT ALPHA, WHICH HAD PAID ALL THE DAMAGES SUFFERED BY ITS INSUREDS, COULD NOT CLAIM MORE THAN THE COST OF REPAIRING THE FIREPLACE BECAUSE THEY WERE IN GOOD FAITH AND COULD NOT BE HELD LIABLE FOR ANY OTHER DAMAGES. THE COURT OF APPEAL HELD THAT THE OBJECT OF THE SALE WAS THE ENTIRE HOUSE AND THAT THE FIREPLACE COULD NOT BE DISSOCIATED FROM IT; THE FIRE HAVING CAUSED THE LOSS OF USE OF THE HOME OF THE INSUREDS, THE WARRANTY EXTENDED TO THE COSTS OF REPAIRING THE BUILDING EVEN THOUGH THE INSUREDS WERE IN GOOD FAITH.

LAVERY REPRESENTED ALPHA IN THIS MATTER.

THE FACTS

In November 1975, François Pellerin, then the owner of the house, had a fireplace installed however it was not possible to precisely establish who did the installation. In 1985, Pellerin sold the house to Caron for $89,000 and in June 1988, Caron sold the house to Basque for $115,000. Lastly, in June 1999, Bélanger and Gagné, Alpha's insureds, acquired the house for $99,500.

It was acknowledged that all the sellers involved in the various transactions were in good faith and were unaware of the presence of any defect whatsoever at the time they sold the property.

On November 13, 2000, a fire substantially destroyed Bélanger and Gagné's residence and household furniture.

The parties did not put in issue the finding of the first judge as to the origin and the cause of the fire, which were established as being a defect in the construction of the chimney.

Alpha therefore indemnified its insureds in the following amounts: $78,945.89 for the building, $13,778.26 for its contents and $1,860 for their additional living expenses. The amount of $78,945.89 included the cost of repairing the fireplace, which was determined to be $1,570.22.

[1] *Basque* v. *Alpha Compagnie d'assurances*, 2009 QCCA 739; *Caron* v. *Alpha Compagnie d'assurances*, 2009 QCCA 740 and *Pellerin* v. *Alpha Compagnie d'assurances*, 2009 QCCA 744.

The insureds received partial payments and signed a release in September 2001, in which they assigned by subrogation all their recovery, salvage and other rights to the insurer and authorized it to exercise these rights in the name of the insured.

Alpha then instituted proceedings against all the former owners since the fireplace was installed and, relying on the legal warranty of the seller, more particularly articles 1726, 1727 and 1728 C.C.Q., claimed from them the total of the amounts it had paid.

"[1726] The seller is bound to warrant the buyer that the property and its accessories are, at the time of the sale, free of latent defects which render it unfit for the use for which it was intended or which so diminish its usefulness that the buyer would not have bought it or paid so high a price if he had been aware of them.

The seller is not bound, however, to warrant against any latent defect known to the buyer or any apparent defect; an apparent defect is a defect that can be perceived by a prudent and diligent buyer without any need of expert assistance.

[1727] If the property perishes by reason of a latent defect that existed at the time of the sale, the loss is borne by the seller, who is bound to restore the price; if the loss results from superior force or is due to the fault of the buyer, the buyer shall deduct from his claim the value of the property in the state it was in at the time of the loss.

[1728] If the seller was aware or could not have been unaware of the latent defect, he is bound not only to restore the price, but to pay all damages suffered by the buyer."

At trial, Alpha acknowledged that article 1728 did not apply because the sellers were unaware of the latent defect at the time of the sale.

THE JUDGMENT

WHICH IS THE SUBJECT OF THE WARRANTY: THE FIREPLACE OR THE HOUSE?

The sellers asserted that the warranty of quality does not extend to the loss of use of the residence but rather only to that of the property that proved to be defective, in this instance, the fireplace. For its part, Alpha maintained that the subject of the sale was the residence in its entirety and that one cannot dissociate the fireplace from the residence itself.

The Court agreed with Alpha:

[*Our translation*]

"[23] Now, the vision of the appellants is far too narrow and fails to take into account the true subject of the sale. Obviously, the contract binding the parties is the contract by which the residence was sold and not the contract by which the fireplace was sold.

[24] Admittedly, the fireplace is an accessory of the residence according to article 1726 C.C.Q. It follows that both the main subject of the contract of sale and its accessories are covered by the warranty of quality. This does not mean, however, that there is a separate warranty of quality for each accessory of the residence. It is a warranty for the whole. If one of the accessories of the property is defective and that prevents the property from being used, the seller is bound to indemnify the purchaser for this loss of use and not only for the loss of use of the accessory."

The Court thus followed the position it had stated in the case of *Axa Assurances inc.* v. *Immeuble Saratoga inc.*[2], which involved a total loss.

IS THE PRINCIPLE OF ARTICLE 1727 C.C.Q. APPLICABLE TO A PARTIAL LOSS OF PROPERTY?

This issue was important. Indeed, when the property is a total loss, the assessment of damages is easily made by reimbursing the sale price, but when the loss is partial, the recourse should instead be for a reduction of the sale price, which, in the present case, may be transformed into a financial indemnity. The Court acknowledged the paucity of doctrine and case law on the issue but concluded its analysis as follows:

[*Our translation*]

"[42] Article 1727 C.C.Q. therefore applies to the partial loss of the property, irrespective of the good or bad faith of the seller. The depreciation of the property caused by the appearance of the defect must be indemnified by the seller but the indemnity must be less than the sale price."

[2] [2008] R.D.I. 35 (C.A.)

CAN THE INSURER CLAIM THE COST OF REPAIRING THE FIREPLACE?

The sellers invoked article 2465 C.C.Q., which stipulates that the insurer is not liable to indemnify for injury resulting from an inherent defect in the property and that it could not be subrogated for the cost of repairing the fireplace. For its part, Alpha invoked contractual subrogation. However, the subrogation granted by the insureds had not been signed at the time they received a specific payment for the fireplace and the Court held that article 1654 C.C.Q., which provides that subrogation must be granted concurrently with payment, had been breached. Therefore, the contractual subrogation could not be made use of in the case under review.

THE ASSESSMENT OF THE FINANCIAL INDEMNITY

As previously mentioned, the partial loss of use of the property sold gives rise to a financial indemnity but, as stated by the Court, the indemnity must be less than the sale price. The Court then applied by interpretation the doctrine and case law, the principle whereby the judge hearing such a claim must exercise some discretion to ensure that the amount allowed for the repairs is not unreasonable in comparison with the purchase price of the property.

The evidence having revealed that the purchase prices over the years were all higher than the damages claimed, that such damages were substantial and, lastly, that at the time of the fire the building alone was insured for $153,000, the Court concluded that the amount of the judgment, that is, $70,614.44 (excluding the cost of repairing the fireplace) constituted an indication that the amount of the claim was reasonable, all the more so since the trial judge had noted that the repairs made to restore the house to its former state did not increase its value.

COMMENTS

This decision, which expands on the judgment in the *Immeuble Saratoga inc.* case, puts an end to the controversy concerning the scope of the damages that can be claimed following the loss of a building resulting from a latent defect affecting one of its components while the seller is in good faith. It is now clear that when the subject of the sale is a building, the measure of the damages is the loss of use of the building and not only of the defective component.

When there is a total loss, the claim made against a seller who is in good faith cannot exceed the price paid for the building. Where the loss is partial, it is also established that the indemnity must necessarily be less than the sale price and that it must be reasonable, taking into account the scope of the loss in relation to the value of the building.

Furthermore, insurers seeking to obtain a contractual subrogation, to the extent that they have agreed to indemnify for the total damages, including the cost of repairing the defective component, would be well advised to make a separate payment for such component and obtain a contractual subrogation concurrently with the payment, so as to comply with the requirements of article 1654 C.C.Q.

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