THE
Claims Wise Bulletin

Nova Scotia Barristers' Society

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Note From The Loss Prevention Committee

This is the first issue of *The Claims Wise Bulletin*. For the ease of members, we have compiled into our first Bulletin all of the Claims Wise articles published in the *Society Record* since March 1991. The next Bulletin will consist of new articles relating to claims experiences of the Liability Claims Fund, and claims avoidance tips to assist you in your daily practice.

This is your insurance fund. A mandate of the Loss Prevention Committee is to provide you examples of claims experienced by the Fund, not as a scare tactic, but as a tool to better enable you to avoid claims. Your comments on this issue, as well as ideas for future articles, are welcomed by our Committee, and Susan Sander, Director of Insurance.

Catherine S. Walker, Chair.

Claims Wise No. 1: Occupancy Permits

There has been an increasing number of liability insurance claims made against lawyers who have acted for purchasers of residential income properties without checking for valid occupancy permits from the municipality authorizing the existing use of the rental units. Typical examples can be found in recent purchases of rooming houses and four-unit apartment houses where it is discovered after the closing of the transaction that the existing use of the property violates the municipal Land Use By-law and/or the municipal Building Code.

In one recent example, an income property was represented by the vendor and understood by the purchaser to be a rooming house consisting of a downstairs apartment unit and three rented rooms upstairs. The purchaser's lawyer in preparing the agreement of purchase and sale stipulated a condition that the property be zoned R-2 (which can permit up to four dwelling units) but did not stipulate a further condition for the provision of occupancy permits authorizing the existing use of the premises. In the course of dealing with the matter, the purchaser's lawyer did obtain confirmation that the property was zoned R-2 but did not obtain occupancy permits to confirm the authorized use of the existing units.

Following the closing, it was discovered that the existing units were in fact illegal under the municipal Land Use By-law as they were adjudged by the City to constitute four apartment units (having their own kitchenettes) which were substandard. The existence of kitchen facilities in the upstairs units was further considered by the City to be contrary to the authorized R-2 uses of the property. In the result, the City made formal demand upon the purchaser to make necessary conversion of the property so as to conform with its authorized use, all at considerable expense. Needless to say, the purchaser then made a claim against his lawyer alleging that the lawyer was being relied upon to ensure that his interests were being protected in being able to use the property for the income purpose intended.

In such claims, the client usually seeks to recover both the construction costs of effecting the required building conversion and the diminished value of the property resulting from its reduced income producing potential. This often makes for a sizable claim to be contended with and lawyers should be alerted to add occupancy permits to the checklist when acting in such transactions.

Claims Wise No. 2: Location Certificates

Although Location Certificates are now routinely and regularly obtained with respect to residential property transactions, claims are still made arising out of them. Some areas of potential concern are:

1. Surveyors are quite precise as to the meaning of a "Location Certificate". Lawyers seem, however, to use a number of terms interchangeably when referring to Location Certificates, such as plot plans, survey certificates or simply a survey. A Location Certificate is a distinct certificate and lawyers should be familiar with exactly what is obtained with a

Location Certificate. A Location Certificate is of little use to a client with respect to determining the location of boundaries.

2. Location Certificates are intended to disclose any encroachments into or out of the property. Any such encroachments should be dealt with prior to closing and appropriate agreements sought from adjacent land owners.

3. The set-back requirements of local municipal by-laws should be reviewed in light of the set-backs as disclosed on a Location Certificate. If these are inappropriate, it is likely that a lawyer is faced with an undefendable claim arising therefrom.

4. Although the practice of "trading" in Location Certificates had diminished in recent years, it still does occur. This arises out of the need by every lawyer to be loved. In order to save the client the reasonably moderate fee associated with a Location Certificate, the lawyer endangers the client and, notwithstanding the client's thanks, assumes the risk themselves with respect to any error or omission to be found in the Certificate. The intention of a Location Certificate is to establish the location of buildings and encroachments as at the time of purchase or mortgaging. A Certificate which pre-dates such occurrence by even a few years creates a risk. Although houses seldom shift their location, decks, carports and driveways have a habit of being built without building permits.

5. Review the terms of reference of a Location Certificate with your client at the time of original retention and, also, at the time of closing such that the client is aware of exactly what they will be getting and what they have received.

Claims Wise No. 3: Restrictive Covenants

It is a very common practice in residential subdivisions for the subdivider to attach restrictive covenants. Such restrictive covenants are generally attached in the original Deed from the subdivider to the first purchaser but are not attached thereafter. If the subdivider has been successful in setting up the restrictive covenant scheme, these will run with the land and will obviously affect your client's use thereof.

The client should obviously be advised of the existence of the restrictive covenants and a copy of them provided to them prior to closing. Your Certificate of Title should also be qualified in this regard.

There have been several claims against the Insurance Fund by purchasers who have claimed not to have been advised of the existence of the restrictive covenants and who have claimed that their intentions on purchasing the property were to expand the building or to participate in a use which is prohibited. In these cases, the purchaser has often not advised the lawyer of such intention.

Claims Wise No. 4: Statements of Adjustments

Statements of Adjustments are often prepared by secretaries or paralegals. It goes without saying that, as the lawyer bears the ultimate responsibility, the statements should be checked carefully by a lawyer, not only for errors with respect to addition but with respect to errors or omissions relating to items.

In recent months, two claims have been submitted to the Fund arising out of errors made by very experienced practitioners. In the first case, the lawyer failed to carry the payout figure for the existing mortgage from the front of his Statement of Adjustments to the back. As a consequence, the proper adjustment was made as between the vendor and purchaser but having reserved the payout from the vendor, the purchaser's solicitor did not then pay out the mortgage and, in fact, remitted to his client that sum of money thinking that it was surplus. Fortunately, those monies were recovered several weeks later when the error was discovered. In the second case, we may be less fortunate. This case involved a re-mortgaging. It was assumed that the funds advanced by the mortgage lender would be a net amount after deducting a small existing first mortgage. In fact, the lender did not do that and the full amount of the mortgage was advanced to the Mortgagor and funds were not reserved to pay out the existing first mortgage. In this case, the client

did not disclose this error to the lawyer and the client who is now in receivership and bankruptcy is not in a position to repay that amount and, if the sale proceeds from the foreclosure of the property are not sufficient to pay out two mortgages, there will be a loss.

Both errors occurred understandably, but nonetheless, through failure to properly prepare and attend to a Statement of Adjustments.

Claims Wise No. 5: Postponement Agreement

It is discovered at the time of Foreclosure that a mortgage has other charges or encumbrances in priority to it which, in two incidents, resulted from re-financing without obtaining proper postponement documentation. In one recently reported incident a lawyer discussed the possibility of postponing a second Vendor take-back mortgage in order to permit the client to re-finance the existing first mortgage and then proceeded to carry through with the re-financing and record the release for the original first mortgage without ever obtaining a postponement agreement. As a result the Vendor take-back mortgage becomes a first charge.

Claims Wise No. 6: Deeding Equity to Mortgagee

In an effort to save the embarrassment of going through a Foreclosure, a mortgagee agreed to take a Quit Claim Deed from a mortgagor which in turn would permit the mortgagee to sell the property and forego the necessity to foreclose and incur the necessary expense to do so. The lawyer acting for the mortgagee not only obtained and recorded the Quit Claim Deed but also had the mortgagee sign a release of its mortgage and recorded the release at the Registry of Deeds. When it was subsequently discovered on the sale of the house that a Judgement had been recorded after the initial mortgage was granted but before the Quit Claim Deed was granted by the Mortgagor it became necessary to pay out the Judgement in order that the sale could proceed. Obviously if the mortgagor is suffering from financial difficulties to the extent that he or she is giving up their home to the mortgagee, one must be mindful that other debts are likely going unpaid and will shortly give rise to Judgements. One might also consider not recording the release under similar circumstances until the time of closing which may well, notwithstanding the doctrine of merger, preserve the mortgagee's priority if necessary.

Claims Wise No. 7: Guardians/Mortgages

In two separate instances reported recently, mortgages were signed by individuals in the capacity as guardians for the owner or owners of the property being charged by the mortgage without any proper authorization or appointment. In one instance the guardians appeared to be acting on behalf of an infant who owned the real estate and in the second instance the parties were acting on behalf of an incompetent adult person. In neither case were there proper applications made to a court nor is any documentation available to support the guardianship appointment.

Claims Wise No. 8: Sales Tax Clearances

During hard times, so-called, many businesses neglect to pay their ongoing business obligations and in particular various and sundry taxes. While many practitioners recognize the need to obtain a clearance certificate from the Provincial Tax Commission, it is often difficult in the shortness of time to put off a closing pending the receipt of such a clearance. Many practitioners believe that the Purchaser of such a business is protected by withholding a certain percentage of the inventory value on the understanding that the Purchaser's liability for payment of tax in connection therewith would not exceed that amount. Unfortunately, the legislation providing for the payment of Health Services Tax appears to be wide enough so as to require an unsuspecting purchaser to pay not only tax on the inventory which he is purchasing but can include all unpaid taxes for previous reporting periods. If a client insists on closing before the Clearance Certificate is to be a written acknowledgement from the client to the practitioner accepting the risks involved. *See* Department of Finance Bulletin 63-88.

While the above are but a few of the approximately two hundred and forty incidents reported since July 1, 1990, it will give you the flavour of the types of claim which might not otherwise come to light except during recessionary times.

Claims Wise No. 9: Preserving Easements

Recessions invariably produce a high incidence of professional liability insurance claims, particularly in the real estate field. We have seen a steady flow of claims of late which commonly arise out of imperfections in security instruments or failure to ensure that security instruments attain the necessary priority between encumbrancers. The commission of such mistakes will sometimes go undetected in non-recessionary times because security instruments more often are retired and less often have to be enforced. When they do have to be enforced, as is more prevalent in recessionary times, otherwise latent professional errors inevitably become exposed.

There have been a couple of recent claims with a little different twist from the more common claims above noted. These can generally be described as situations where lawyers who, after being retained to procure and record an easement in their clients' favour, have done so without first obtaining the consent or a postponement agreement from a prior mortgagee of the land to which the easement pertains.

An illustrative example is a claim file in which a lawyer, on the client's instructions, prepared and recorded a right-of-way which permitted the use of a driveway and parking area in a residential setting. The lawyer did not obtain the consent or a postponement agreement from the prior mortgagee of the neighbour's land. Once the easement was in place, the client expended a considerable amount of money in resurfacing the driveway and parking area, which the easement permitted the client to do.

The misfortune struck later when the neighbour defaulted on his mortgage and it was foreclosed upon. The result of the foreclosure, of course, was the extinguishment of the easement which made for a very unhappy client. Needless to say, a claim was made against the insured lawyer.

Without the recession, there is a good chance that the mortgage would eventually have been paid out and the professional error thereby neutralized. In any event, the example serves as a reminder that in creating any proprietary interest in land, lawyers must be alert to the consequences if there should happen to be a foreclosure by a prior mortgagee.

Claims Wise No. 10: Practicing out of the Jurisdiction

A lawyer was retained by a client for whom he performed other services with respect to a motor vehicle claim arising out of an accident which occurred in New Brunswick. The lawyer sought instructions and corresponded with the insurers but failed to commence an action. In recent years in Nova Scotia, the Courts have been quite lenient in waiving the provisions of the *Limitation of Actions Act*. Not so elsewhere. In the Province of New Brunswick, there is no such provision within their Rules or legislation and the failure to commence the action in this case has proven to be fatal. The time delay was only a few months.

Claims Wise No. 11: Securities Act

The *Securities Act* can apply to a simple transaction involving the purchase and sale of a company. The Act and the regulations are not simple and practitioners are cautioned to familiarize themselves with the Act at any time when they are involved in the purchase or sale of shares. A recent claim involved a practitioner who received instructions to incorporate a company and to issue shares to a series of stated individuals. The lawyer did not inquire nor was he made aware of the fact that the parties instructing him had been out openly soliciting the subscription for shares. The solicitation clearly violated the provisions of the *Securities Act*. Fortunately for us, there were other matters out of sorts and the claim did not develop. The *Securites Act* and the regulations thereunder are very complex and can apply to even the simplest share transaction. Practitioners should keep the Act in mind whenever shares are being issued or transferred.

Claims Wise No. 12: Mechanics Lien Holdback

A vendor's solicitor undertook to hold monies with respect to uncompleted work and for the purposes of the *Mechanics Lien Act*. The monies were released upon the expiry of the mechanics' lien period as measured from the date of closing. The work was not substantially completed on the date of closing and work continued well after, such that the mechanics' lien period was extended and liens were filed within the limits of the Act but more than 45 days from the date of closing.

Claims Wise No. 13: Representations

Generally, in a solicitor/client relationship, the solicitor is acting as the agent for his or her client and any information which is received or disbursed by way of representation to the other side occurs on this basis. Regrettably, this is not always so.

A lawyer was retained by client A to act on his behalf in the purchase of property. The terms of that transaction called for client A to give a second mortgage on the property being purchased to secure a portion of the purchase price. Shortly before closing, it became apparent that, for one reason or another, the second mortgage needed to be increased and client A offered to the vendor collateral mortgage security on other property owned by client A. Client A's lawyer was instructed to confirm the equity value in the other property and to provide, not only the collateral mortgage security, but also certificates of title to the vendor. The solicitor received information from client A as to value and simply passed that on to the vendor. That information was incorrect and there was in fact no equity in the other properties, such that the collateral mortgages were worthless. The worthlessness of those collateral mortgages was established as a result of several foreclosures. The solicitor, through making representations to the vendor, in conjunction with providing the certificates of title and the collateral mortgages, is now facing a claim from the vendor that basically is that the solicitor failed to make any inquiries whatsoever to confirm the representations as to value. Be careful out there.

Claims Wise No. 14: Reliance on Earlier Conveyancing Work

The demands on a lawyer's time create all manner of temptations to take shortcuts to meet the deadlines of the day. One of these temptations which has given rise to a number of recent claims is for a lawyer who is retained by a purchaser or mortgagee of real property to blindly rely on earlier conveyancing work performed in his or her office concerning the same property. The lawyer *assumes* that the title must have been certifiable at the time of completion of that earlier transaction. The shortcut which is then regrettably taken is the decision to restrict the title investigation to a subsearch of title only from the date of the previous transaction, without any review of the previous title abstract or investigation otherwise. Title is then certified with only a subsearch having been carried out, and without an examination of the previous title abstract. All too often this leads to a later day of reckoning when pre-existing title deficiencies inevitably come to light.

In one recent example, the lawyer was retained on the purchase and mortgage financing of a commercial property. A few years previously, one of the lawyer's partners had acted on the purchase of the same property on behalf of a different client. A full title search had been conducted on that earlier occasion which disclosed a flaw in the title. This had been reported to the earlier purchaser whose decision it was to accept a qualified certificate of title from the law firm. The transaction was concluded on that basis.

In the later transaction, the insured lawyer noted from the office records that her partner had represented the previous purchaser of the property. She thereupon assumed that the title had been certified in the usual manner at that time without carrying out any review of the office file itself. Had she done so, the flaw in the title and the qualification to the earlier certificate of title by her office would easily have been disclosed. The title deficiency did not show up, of course, in the subsearch. In the result, the Liability Claims Fund is left with having to underwrite the cost of a quieting of title action to resolve the title deficiency.

A second recent example involves a lawyer who had been retained several years ago to prepare and record a conveyance of property to his clients who instructed him that in the circumstances, they did not need or want a title search performed. It was a simple matter of preparing and recording a deed of conveyance.

Several years later, the same lawyer was retained by the same clients in connection with mortgage refinancing on the same property. The lawyer thereupon assumed that his office had conducted a full title search in connection with the earlier conveyance and therefore arranged for a subsearch to be carried out only from that point onward. On the conclusion of the mortgage transaction, title was certified to the mortgagee in the usual way on the basis of the subsearch which had been done.

It was only later discovered that three judgments had been recorded against the borrower/client prior to the earlier conveyance of the property to them. Obviously, had the lawyer checked for an office title abstract or the back file itself, the need for an immediate full title search would have been apparent. In the result, the Liability Claims Fund is left with having to now deal with these three outstanding judgments.

It is recognized, of course, that lawyers will often rely on back title information documented in abstracts of title prepared and maintained in their own offices. The temptation to be resisted, however, is to place blind reliance on the earlier conveyancing work performed within the office in respect of the same property, without proper examination of that back title information.

Claims Wise No. 15: Restrictive Covenants

Problems are occurring on a fairly regular basis with respect to restrictive covenants. Some examples are as follows:

(a) Notwithstanding prohibition against further subdivision of a lot, large lots are often subdivided into smaller ones in accordance, however, with municipal subdivision regulations;

(b) Most residential restrictive covenants prohibit the construction of more than one dwelling on a lot. In those cases where lots are further subdivided, there are, of course, now two dwellings on the original lot. This is an ongoing problem since many lots in areas, prior to the installation of sewer and water services, were large in size in order to accommodate on-site disposal systems. With the installation of sewer and water services, it has become common to subdivide lots in half and to build a second house;

(c) Many restrictive covenants contain setback requirements which prohibit construction within a certain distance of adjacent lots or streets. These setbacks are often not consistent with the setback requirements of the municipality. Where such setback requirements are to be found in a restrictive covenant, these should be compared to the surveyor's location certificate to determine that the building does not offend the set-back requirements. This is also another example of where using an outdated location certificate can cause problems. Often the addition of a porch, veranda, chimney or carport may be within the "no-build" area; and lastly

(d) Prohibitions against certain uses such as the keeping of animals are often found in restrictive covenants. This is not an inquiry which you need to make as a lawyer but your client should be advised of the existence of such prohibitions in the event that they intend to build a stable and keep a herd of cattle in the back yard.

It is recommended that in residential property transactions, a lawyer should, when reviewing title to the property, review the abstract, a copy of the restrictive covenants, together with a copy of a current location certificate. It is only with all of that documentation in hand at the same time that a full review can be conducted which enables you to issue your certificate. Certificates of Title should also always be issued with a copy of the restrictive covenants attached thereto. Although it is not generally the practice in the conveyancing community, it would also make most sense to present your Certificate of Title (unsigned) with all of the qualifications and restrictions prior to the closing so that the client is fully aware of the certification which they will be receiving.