

## "GOOD WORKING ORDER" — WHAT DOES THIS MEAN IN THE CONTEXT OF A COMMERCIAL REAL ESTATE AGREEMENT OF PURCHASE AND SALE?

by Avi Sugar and Michael Coleman

Including certain representations and warranties in commercial real estate agreements of purchase and sale is commonplace. Although in a hot market, the nature and extent of such representation and warranties become more and more limited. Without representations and warranties, the purchaser is at the mercy of the principle of *caveat emptor*<sup>1</sup> (let the buyer beware). Thus, purchasers include representations and warranties in commercial agreements to hold the seller accountable for false assurances that they cannot, or chose not, to fully investigate on their own.<sup>2</sup>

Recently, we represented a client, the purchaser of a commercial building, on a matter in which we had to determine whether the seller had breached a very common representation and warranty stipulated in the executed agreement of purchase and sale. The main facts of the case were that our client bought a commercial building, and after the purchase, the client discovered that the HVAC system was deficient, as it leaked and failed to provide adequate cooling during the summer months. The representation and warranty at issue stated the following:

The Seller represents and warrants that the chattels and fixtures as included in this Agreement of Purchase and Sale **will be in good working order** and free from all liens and encumbrances on completion. The Parties agree that this representation and warranty shall survive and not merge on completion of this transaction.

To our surprise, there were very few cases that had considered "good working order" and those that did, did not delineate a specific standard in regards to chattels and fixtures. Rather, the case law seems to paint an ambiguous picture of this standard that largely depends on the specific facts of the case. Needless to say, we were unable to provide our client a strong opinion on his potential success in obtaining recourse.

To help inform our opinion, we reviewed two Canadian cases that considered "good working order" in the context of a representation or warranty. The first case, *Rockwood v Srinivasan*<sup>3</sup>, illustrates the Court fashioning its own standard when assessing whether there is a breach of this warranty. In this case, the purchasers of a house relied on the seller's warranty that the woodstove was in "good working order". After the completion of the purchase, the woodstove and chimney failed a fire insurance inspection because there were cracks in the bottom of the clay liner of the chimney. The trial judge held that "a woodstove included in the sale of a house is not 'in good



[Avi Sugar](#)  
Partner

t: 416.965.3717  
[asugar@foglers.com](mailto:asugar@foglers.com)



[Michael Coleman](#)  
Associate

t: 416.864.0110  
[mcoleman@foglers.com](mailto:mcoleman@foglers.com)

<sup>1</sup> *Wallis v Russel*, [1902] 2 IrR 585, 36 ILT (CA).

<sup>2</sup> *Peter D Quinn and Danny C Grandilli*, Real Estate Practice in Ontario, 8th ed (Toronto: LexisNexis) at 261.

<sup>3</sup> *Rockwood v Srinivasan*, [1999] NBJ No 357.

working order' if the chimney which it uses cannot be approved for the purposes of the purchasers' fire insurance without a new flue liner"<sup>4</sup>. Therefore, the sellers were liable to the purchasers for reasonable damages for breach of contract.

The second case, *Wilcox v Felatchian*<sup>5</sup>, appears to delineate a "materiality" threshold. In this case, the purchasers of a house relied on the seller's warranty that the pool was in good working order. After the completion of the sale, the purchaser found defects with the pool. Specifically, there were "huge" leaks in the liner and skimmer that could not be repaired by patching but needed to be completely replaced.<sup>6</sup> The seller tried to argue that there was no breach of the warranty because the pool was in "good working order" and that he did not represent that the pool or its liner was new. However, the judge held otherwise. The judge stated,

To be sure, the warranty in this case is not a guarantee that the pool would be in pristine shape. If there were minor problems with the pool that could have been repaired for a few hundred dollars, the warranty may have been satisfied ... But it was apparent to all three pool companies that inspected the pool that it could not be repaired by simple patching. Even before determining what damage was brewing under the liner, all three companies said that both the liner and skimmer had to be replaced and that this would cost thousands of dollars. Even before the liner was removed, it was clear that the pool was not in "good working order."<sup>7</sup>

Unfortunately, the "good working order" representation and warranty for chattels and fixtures has not been better refined and appears to remain ambiguous and fact specific. Until there are more cases to help guide and give a better sense of this standard, several questions remain, including: (i) Does one look at loss or repairs as a fraction of value or purchase price?; and (ii) Does one look at how incapacitated the chattel or fixture is?

More importantly, it is likely the case that the purchaser and seller will often not have "a meeting of the minds" when forming an agreement as to what threshold they mean to apply when using the term "in good working order." Therefore, without a substantial body of case law and precedent to use as a guide, parties should consider being more specific when drafting representations and warranties relating to chattels or fixtures that are of utmost importance, and defining what they mean when they say that a chattel or fixture is in "good working order" (i.e. does not leak at all **OR** may be used without any need for immediate repairs etc.).

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<sup>4</sup> *Ibid* at para 11.

<sup>5</sup> *Wilcox v Felatchian*, 2008 MBQB 264.

<sup>6</sup> *Ibid* at para 8.

<sup>7</sup> *Ibid* at paras 24 and 25.