Protecting Your Investment from Costly Building Code Violations Following Galvan Ruling

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In a breach of warranty deed claim, the Michigan Supreme Court ruled in favor of the sellers of a condominium unit and unanimously decided on July 12, 2023, in *Galvan v Poon* that a building code violation discovered after the closing that had not been subject to any official enforcement action at the time of the conveyance does not constitute an "encumbrance" under MCL 565.151.[1]

Plaintiff buyers received a warranty deed from the defendant sellers for a condominium unit that covenanted against encumbrances and a disclosure form from the defendant sellers reporting no issues. After the plaintiffs began renovating the unit, they discovered leaks in the drywall and that the adjacent unit encroached onto the upstairs bathroom. When contractors were engaged to fix these issues, the plaintiffs discovered that there was no proper firewall between the condominium units.

The municipality sued the plaintiffs and the other unit owners to install a fire wall and the plaintiffs had to vacate the unit while the work was being done. The plaintiffs sued the sellers alleging breach of warranty deed and other claims. [2] The trial court granted the defendants' motion for a directed verdict on the breach of warranty claim, agreeing with the argument that building code violations were not encumbrances. On appeal, the Court of Appeals found that the code violations "subjected plaintiffs to the threat of litigation and made the home unmarketable and uninhabitable" and reversed the directed verdict. The defendants filed an appeal with the Michigan Supreme Court to address whether the covenant of title under MCL 565.151 "includes a covenant that the structure of the premises conforms to currently applicable building codes." [3]

The Supreme Court reversed and found in favor of the defendants because the building code violations were not the subject matter of any enforcement proceedings at the time the deed was executed. The Court held: (a) an encumbrance has traditionally related to rights to, or interests in, the land itself, rather than the material condition of the property; (b) governmental regulations in and of themselves do not constitute encumbrances because there is a difference between the economical lack of marketability, which concerns conditions that affect the use of land, and title marketability, which relates to defects affecting legal recognized rights and incidents of ownership, noting that "clear title to a property can be held despite the fact that the land is subject to laws restricting use"; (c) to claim a breach of warranty against encumbrances pursuant to MCL 565.151, the breach must exist when the warranty is made; [4] (d) acknowledging the split in case law as to whether violations of governmental regulations generally may constitute encumbrances, the *Galvan* Court noted that a violation of building codes, which, in contrast to zoning codes, "almost always involve obscure or technical details pertaining to the condition of the buildings that would not be apparent to the parties"[5] and "almost no courts hold that a violation of a building code that is not the subject of an enforcement action is an encumbrance"; and (e) therefore, without ruling on the issue of whether generally building code violations are encumbrances, the *Galvan* Court ruled that the building code violations before them are not encumbrances because they were not the subject matter of any enforcement proceedings at the time the deed was executed. In reaching its conclusions, the Court observed that to hold otherwise would "force the seller to 'become a warrantor that the building complied in all respects with the building laws or ordinances in force in the locality.'" [6]

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Although the Michigan Supreme Court did not expand breach of warranty claims under MCL 565.151 for building code violations that are not subject to enforcement proceedings at the time of conveyance, the defendant sellers still had to compensate the plaintiffs based on the fraud claims. Assuming that the seller is not engaging in fraud, there are measures that a purchaser can take to reduce losses and/or damage for such building code violations that are discovered after the closing. As pointed out by the *Galvan* Court, "parties to land transfers are free to allocate the risk of such violations by contract." In other words, the purchase agreement may be negotiated to contain specific representations, warranties, and/or indemnifications from the sellers relating to latent building code violations that survive the closing and/or sufficient due diligence period to allow buyer enough time to obtain a report relating to compliance with municipal building code and laws.

If you have questions about this case and how it impacts your future acquisitions, contact your Miller Canfield attorney or the authors of this article.

[1] MCL 565.151 governs the effect of and covenants included in a warranty deed, which include a covenant by the seller that the premises are free from all encumbrances.

[2] The plaintiff buyers were awarded damages for the fraud claim at the trial court level when the jury reached a verdict that the sellers had withheld material facts. This award was not the subject matter of the case before the Michigan Supreme Court.

[3] Citing *Galvin v Poon*, 509 Mich 938, 938 (2022).

[4] Citing *Reed v. Rustin*, 375 Mich 531, 535 (1965), and *Smith v. Lloyd*, 29 Mich 382, 385 (1874).

[5] Opinion at p. 11.

[6] Citing *Berger v. Weinstein*, 63 Pa Super 153, 158 (1916). The Court further stated that a contrary ruling would cause confusion, given that title searches and physical examination of the premises would not necessarily reveal code violations.