Strata schemes and insolvency

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The strata legislation provides that the Corporations Act does not apply to strata corporations. Subsection 8(2) of the Strata Schemes Management Act 2015 provides as follows:

> *An owners corporation is declared to be an excluded matter for the purposes of section 5F of the Corporations Act 2001 of the Commonwealth in relation to the whole of the Corporations legislation.*

The note to the provision states as follows:

> *This subsection ensures that neither the Corporations Act 2001 of the Commonwealth nor Part 3 of the Australian Securities and Investments Commission Act 2001 of the Commonwealth will apply in relation to an owners corporation. Section 5F of the Corporations Act 2001 of the Commonwealth provides that if a State law declares a matter to be an excluded matter in relation to those Acts, then the provisions of those Acts will not apply in relation to that matter in the State concerned.*

This creates a conundrum for insolvency lawyers because the strata legislation simply does not deal with an owners corporation becoming insolvent.

Insolvency can arise when an owners corporation has massive liabilities to fund repairs and cannot collect enough in levy contributions from owners to meet those liabilities. The obligation to repair common property is a strict one under section 106 of the *Strata Schemes Management Act 2015*.

And there is no procedure to wind up an owners corporation.

Under section 237 of the *Strata Schemes Management Act 2015*, the NSW Civil and Administrative Tribunal can appoint strata managing agent to exercise functions of owners corporation, but these agents can do no more than the owners corporation can do to collect levy contributions.

Strata corporations do not conduct businesses. Their only asset is the common property in a strata scheme. They have the power to impose levies and collect contributions from lot owners. It is only when the lot owners cannot pay, that an owners corporation itself can become insolvent.

Of course, an owners corporation can pursue a lot owner for unpaid contributions to levies in the same way that a creditor can pursue any other debtor.

At present, proceedings to bankrupt a lot owner in the COVID-19 environment are being postponed.

Owners corporations have one additional weapon not available to other creditors. Section 86 of the *Strata Schemes Management Act 2015* empowers the Tribunal (or a Court) to make an order that contributions be paid together with interest on them and reasonable expenses of the owners corporation incurred in recovering those amounts. The right to proceed under section 86 depends only upon a demand having been made at least 21 days prior.

The section 86 notice procedure is often used in relation to levies incurred after a bankruptcy notice has been served because a section 86 judgment can be proved after the bankruptcy notice is issued but before a sequestration order is made.

Obtaining judgment before the notice becomes stale however is a challenge, given the speed of the Local Court, even in pre-COVID-19 times. However, obtaining judgment is essential.

In March 2017, the Australian Financial Security Authority (AFSA) stated the view that post-judgment costs cannot be incorporated into a creditor's petition. The reason for this is that section 86 of the *Strata Schemes Management Act 2015* provides that the recovery is for the contributions not paid for over one month after they become due and payable "*together with*" any interest payable and the reasonable expenses of the owners corporation incurred in recovering those amounts. Interest and expenses *not the subject of an order* are excluded.

The authority for that outcome is Owners SP36131 v Dimitriou (2009) 74 NSWLR 370. In that case, the owners corporations made a claim in the Local Court against Ms Dimitriou for outstanding levies. However, before those proceedings were commenced, Ms Dimitriou had commenced proceedings in the Tribunal disputing the validity of the levies. The Local Court proceedings were stayed until the Tribunal dismissed Ms Dimitriou's proceedings. The Tribunal did not make any costs order. (Its powers were very limited in relation to costs.)

The owners corporation sought to recover its costs in the Tribunal proceedings and costs incurred beyond the limits on costs then applicable under the Local Court rules. The Magistrate upheld that claim. Associate Justice Malpass overruled, and his decision in turn was overruled by the Court of Appeal. Handley JA had no difficulty in ordering that the owners corporation could recover its reasonable costs in each of all the proceedings in much the same way as a mortgagee could recover contractual rights to costs which would be cumulative of costs orders made by a court: Gomba Holdings (UK) Ltd v Minories Finance Ltd (No. 2) [1993] Ch 171 at 194-195. All that in a dispute which began as a claim to recover unpaid levy contributions in the sum of $1,214.93.

Hodgson JA said at [49] that an owners corporation could, at the hearing, seek an order reserving liberty to apply subsequently in the same proceedings to claim for expenses incurred in enforcing the judgment. This liberty is too often overlooked.

What if not one owner but all or most owners cannot pay levies; for example, because they relates to millions of dollars of repairs to building defects?

The High Court, in *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* & Anor (2014) 254 CLR 185 unanimously held that a builder did not owe a duty of care to an owners corporation with respect to a claim for 'pure economic loss' relating to latent defects in the common property of a strata-titled development.

The critical distinction is between a person who supplies something which is defective, and a person who supplies something which, because of its defects, causes loss or damage to something else: *Brookfield* (2014) 254 CLR 185 at [67]

The builder in that case owed contractual duties to the developer, but the builder argued that whatever its obligations to the developer, it did not owe the owners corporation a duty of care. The builder successfully distinguished *Bryan v Maloney* (1995) 182 CLR 609 where the High Court found that the professional builder who had been contracted to construct the house owed a duty of care to subsequent purchasers because there was a sufficient degree of proximity between the builder and subsequent owners.

Hayne and Kiefel JJ in *Brookfield* held that the owners corporation had relied on the builder to do its job properly, but said that mere reliance was not sufficient and that, on the facts before them, neither the owners corporation nor the developer was relevantly vulnerable: Brookfield (2014) 254 CLR 185; 313 ALR 408; [2014] HCA 36; BC201408266 at [56]–[58] per Hayne and Kiefel JJ.[1]

Since 2014, the dimensions of the problem have grown considerably.

Residents were evacuated from the 392-unit Opal Tower in Sydney's Olympic Park on Christmas eve 2018 following cracking sounds at the tower. Subsequent investigations by the NSW Government revealed defects at the tower caused by the poor assembly of pre-fabricated panels on several floors were responsible for the cracking. Non-compliant construction and structural design of precast fabricated concrete beams were subsequently found to be the cause of the cracks.

Most but not all of the residents have been allowed to move back in, but the value of their lots is diminished. What bank will lend to buy an apartment in that block?

The owners want compensation for the difference between the actual pre-defect value and their current market value, with many fearing the reputation of the building is now so decimated that apartments could not be sold at any price.

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[1] Iin *Chan v Acres* [2015] NSWSC 1885, McDougall J held that a council acting as a private certifying authority under the Environmental Planning and Assessment Act 1979 owed subsequent purchasers of a residential home a duty of care and was liable for failing to carry out its certifying role with due care and skill.

Opal Tower owners have no recourse under the Home Building Compensation Scheme because the scheme does not apply to apartment building 4 storeys and up. Opal Tower has 36 storeys.[2]

The owners corporation has sued the Sydney Olympic Park Authority (SOPA), the owner of the land on which the Opal Tower sits. In 2014, SOPA had engaged Australia Avenue Developments Pty Ltd to design and construct the Opal Tower. AAD then contracted with Icon Co. (NSW) Pty Ltd to carry out the construction works. The action followed a report by more than 12 independent experts that allegedly found more than 500 common property defects, with residents hit by a $1.1 million insurance premium.

After a year in court, the proceedings are just finishing the pleadings stage.

Residents of Sydney's 132-unit Mascot Towers were also left homeless when their building was evacuated on 14 June 2019 over cracking in its primary support structure and facade masonry. Estimates of the cost of repairs have led some lot owners to flag possible bankruptcy because of unaffordable costs imposed on them.

They are claiming more than $15 million in damages from the developer of a neighbouring building they allege is responsible for the major cracks appearing in the apartment complex they were forced to evacuate almost a year ago.

Even if *Brookfield* can be distinguished, builders can become insolvent, die or disappear, which means a claim against the builder would be worthless and purchasers would have to rely on insurance.

And even for smaller blocks, the six year statutory warranty period under the Home Building Act 1989 for contracts signed on or after February 1, 2012, only applies to "major defects"; all other defects only have a two year warranty.

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[2] Icon, the builder had been funding the accommodation costs of displaced residents with allocations of between $220 and $500 a day, plus expenses. Its parent company, Kajima Corporation, of Japan, has reportedly spent about $40 million to fix defects and insurance premiums for the building over the past 18 months.

Home owners cover is never enough. It is a 'last resort' cover, meaning it will not respond until the builder is insolvent. It does not cover the loss of capital value of the apartment, lost rental income and the loss of confidence that unitholders like those in the Opal building will unfortunately suffer. Nor does it cover the full extent of the costs of convening meetings, engaging lawyers and expert consultants in order to enforce a claim.

The Opal and Mascot Towers cases represent just the tip of a very large iceberg.

The owners of 130 buildings in inner Sydney have been told to replace flammable cladding or reveal more details about the composition of materials used, leaving individual apartment owners facing bills running into the tens of thousands of dollars.

The *Design and Building Practitioners Act 2020* assented to 10 June 2020 seeks to tighten up requirements for design and documentation for those involved in the design and construction of such buildings.

Section 33 empowers Government to issue to developers "building work rectification orders." Pursuant to section 6 the power can be exercised up to 10 years after issue of the occupation certificate. Section 9 allows the Government to intervene and stop the issuance of occupation certificates.

More importantly the *Design and Building Practitioners Act 2020* includes a statutory duty of care which endeavours to overcome the *Brookfield* decision. It is imposed on builders and certain designers, building product manufacturers and suppliers, and supervisors. The duty cannot be delegated or contracted out of. And it works retrospectively to cover losses which became apparent up to 10 years ago.

Part 4 of that Act includes provisions such as §37 and 38 which provide as follows:

> ***37 Extension of duty of care***
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> *(1) A person who carries out construction work has a duty to exercise reasonable care to avoid economic loss caused by defects—*
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> - *(a) in or related to a building for which the work is done, and*
> - *(b) arising from the construction work.*

(2) The duty of care is owed to each owner of the land in relation to which the construction work is carried out and to each subsequent owner of the land.

(3) A person to whom the duty of care is owed is entitled to damages for the breach of the duty as if the duty were a duty established by the common law.

(4) The duty of care is owed to an owner whether or not the construction work was carried out—

- *(a) under a contract or other arrangement entered into with the owner or another person, or*
- *(b) otherwise than under a contract or arrangement.*

38 Economic loss—owners corporations and associations

(1) An owners corporation or an association is taken to suffer economic loss for the purposes of this Part if the corporation or association bears the cost of rectifying defects (including damage caused by defects) that are the subject of a breach of the duty of care imposed under this Part.

(2) The economic loss suffered by an owners corporation or association for the purposes of subsection (1) includes the reasonable costs of providing alternative accommodation where necessary.

(3) Subsection (1) applies whether or not the owners corporation or association was the owner of the land when the construction work was carried out.

(4) Subsections (1) and (2) do not limit the economic loss for which an owners corporation, association or an owner may claim damages under this Part.[3]

Schedule 1 clause 5 is where the retrospectivity arises. It provides as follows:

(1) Part 4 of this Act extends to construction work carried out before the commencement of section 37 as if the duty of care under that Part was owed by the person who carried out the construction work to the owner of the land and to subsequent owners when the construction work was carried out.

(2) Subclause (1) only applies to economic loss caused by a breach of the duty of care extended under that subclause if—

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3 And section 41 provides as follows:

41 Relationship with other duties of care and law

(1) The provisions of this Part are in addition to duties, statutory warranties or other obligations imposed under the Home Building Act 1989, other Acts or the common law and do not limit the duties, warranties or other obligations imposed under that Act, other Acts or the common law.

(2) This Part does not limit damages or other compensation that may be available to a person under another Act or at common law because of a breach of a duty by a person who carries out construction work.

(3) This Part is subject to the Civil Liability Act 2002.

(a) the loss first became apparent within the 10 years immediately before the commencement of section 37, or

(b) the loss first becomes apparent on or after the commencement of that section.

(3) Part 4 of the Act as extended by subclause (1) applies regardless of whether an action for breach of a common law duty of care has commenced before the commencement of section 37 and may be taken into account in those proceedings unless the court considers that it would not be in the interests of justice to do so.

(4) Section 40 extends to a contract, agreement or stipulation relating to the construction work whenever made.

(5) For the purposes of this clause, a loss becomes apparent when an owner entitled to the benefit of the duty of care under Part 4 of this Act first becomes aware (or ought reasonably to have become aware) of the loss.

(6) Words and expressions used in this clause have the same meaning as in Part 4 of this Act.