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LEGAL ACTION APPROVAL - SUPREME COURT CORRECTS STRATA PLAN ERROR

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LEGAL ACTION APPROVAL – SUPREME COURT CORRECTS STRATA PLAN ERROR

The Supreme Court has closed the door on executive committees approving minor stages of legal action without general meeting approval. The message from the Court is clear. The estimated cost of taking legal action cannot be artificially minimised by asking a lawyer to provide a costs estimate for only part of the legal action.

The Bakkante Case

On 19 July 2013 the NSW Supreme Court handed down its decision in The Owners – Strata Plan No. 70798 -v- Bakkante Constructions Pty Ltd [2013] NSWSC 848. The case involved a claim by an owners corporation against the builder and others associated with the construction of its building for compensation arising out of building defects.

The owners corporation started the legal action on 13 February 2009 in the Consumer, Trader and Tenancy Tribunal (“CTTT”). On 21 May 2009 the owners corporation amended its claim to considerably enlarge the number of defects claimed against the builders and others. This had the effect of increasing the compensation claim from about \$147,000 to \$1.4 million which meant that the case had to be transferred to the Supreme Court.

The driving force behind the legal action was the chairman of the executive committee, Mr Groom. The legal action, and the amendment of the claim, was never approved by lot owners at a general meeting. Some of the lot owners were connected with the builder and developer. One of those owners, Dr Zankin, argued that the legal action, and the amendment of the claim, were incompetent because they had never been approved by owners at a general meeting. Dr Zankin applied for the entire legal action brought by the owners corporation against the builder and others to be dismissed on this basis. He was successful.

The Legislation

Section 80D of the Strata Schemes Management Act 1996 (“Strata Act”) relevantly says that an owners corporation or executive committee must not initiate legal action for which any payment may be required unless a resolution is passed at a general meeting of the owners corporation approving the taking of that legal action.

Clause 15 of the Strata Schemes Management Regulation 2010 (“Strata Regulation”) relevantly states that the taking of legal action is exempt from the operation of section 80D of the Strata Act if the reasonably estimated cost of taking the legal action would not exceed \$1,000 for each lot in the strata scheme (excluding utility lots) or \$12,500 whichever is the lesser.

The purpose of section 80D is to prevent executive committees from starting legal action on their own initiative (with limited exceptions) to remove the possibility that owners will claim that executive committees have not acted in their interests and added to existing conflicts rather than dissipating them.

The Facts

The chairman of the executive committee then started the legal action on behalf of the owners corporation by lodging the claim with the CTTT. About two weeks later the owners corporation held an annual general meeting. At the meeting it was resolved to defer the appointment of a lawyer to act for the

owners corporation to make a building defect claim. The owners resolved to revisit the issue at a subsequent general meeting but that was never done.

The strata manager, quite properly, voiced his concern that legal action had been taken without formal executive committee approval. The strata manager warned the executive committee that a failure to observe the requirements of the Strata Act for approving legal action could result in the action being rejected.

Subsequently, the executive committee passed a resolution to instruct the lawyer to amend the building defect claim to expand the scope of the defects included in the claim. This decision was in direct conflict with the decision made at the annual general meeting by the lot owners to defer the appointment of a lawyer to act for the owners corporation to make a building defect claim. The decision transformed the claim from one to recover \$147,000 for certain defects to a larger and more substantial claim seeking to recover approximately \$1.4 million for defects across the entire strata scheme.

The Court's Decision

The Court held that in commencing the proceedings in the CTTT on 13 February 2009 the owners corporation did not comply with the Strata Act or the Strata Regulation. This is because there was no resolution of either the executive committee or owners at a general meeting to authorise the commencement of the legal action. The only resolution that had been passed at that stage was one to seek legal advice concerning certain defects. But this was not a resolution to start legal action.

This meant that the exemption to section 80D in the Strata Regulation could not apply because there was simply no decision by the executive committee to take legal action. The Court said that Regulation 15 can only meaningfully apply where there has been an actual decision of the executive committee to take specified legal action and the executive committee not only applies its collective mind to the taking of the legal action but also obtains a reasonably estimated cost of taking that action (typically from a lawyer). In this case, that did not occur.

Importantly, the Court went on to say the following:

"...the reasonably estimated cost of taking action by commencing proceedings cannot be artificially minimised by requesting the solicitor to provide a costs estimate up to some arbitrary point, such as the filing of points of claim, the filing of points of defence or the service of experts' reports. Litigation does not work like that. Once proceedings are commenced, they continue until dismissed or discontinued or judgment is obtained. In the usual case, the reasonably estimated cost of taking the action will be the estimate of the costs that the owners corporation will incur in the proceedings until their final resolution and determination.

...

It may be possible for an executive committee to make a decision to take limited legal action, stopping the action at some artificial point before final disposition. However this will present considerable practical difficulties in arriving at 'the reasonably estimated legal cost of taking the legal action'. The reasonably estimated cost of such a limited and unusual legal action would have to take into account the likelihood that, by stopping at some point before final determination, the owners corporation might well incur an additional liability to the defendants for their costs. In the usual case, once proceedings have been commenced they will continue until finality and the estimate should reflect that fact."

The Court also held that the executive committee's decision to amend the claim to expand the scope of the defects claimed, and increase the amount of compensation claimed to \$1.4 million, was not valid. This was because, firstly, no resolution had ever been passed to authorise the commencement of the legal action and, secondly, by the time the executive committee made the decision to amend the claim, the annual general meeting had already decided to defer the appointment of a lawyer to take legal action for building defects. The Court said that because of section 21(4) of the Strata Act the decision of the owners corporation prevails in the event of a disagreement between the owners corporation and the executive committee. This meant that the executive committee could not decide to enlarge the claim where owners had decided in general meeting to defer the appointment of a lawyer to make such a claim.

The Result

The Court concluded that because the CTTT proceedings had been commenced, and then expanded, in contravention of the Strata Act, the proceedings should be treated as invalid and unauthorised and therefore dismissed. The Court went one step further than it had previously done in the case of *Owners SP4652 -v- Hall* [2009] NSWSC 278 by deciding that any legal action taken by an owners corporation in contravention of section 80D of the Strata Act should be dismissed irrespective of who that action is taken against. In *Hall* the Court said that the action would only be dismissed in those circumstances where it had been taken against a lot owner, but not a third party such as a builder. The *Bakkante* decision says otherwise.

The Wash Up

The outcome of the case was disastrous for the owners corporation. The case was dismissed. The owners corporation was ordered to pay the costs of the builder and Dr Zankin. And the owners corporation (presumably) still has to pay its own legal costs which according to the Court were \$260,728.

Legal Costs Spiraling Out of Control

The Judge was extremely critical of the owners corporation's lawyer and the manner in which the owners corporation's legal costs had spiraled out of control. The lawyer's initial fee estimate was for \$5,000 - \$6,000 to carry out "Stage 1" work in the building defect action. Within six months the lawyer had billed the owners corporation \$11,224. Two years after the lawyer's initial fee estimate was given, the lawyer had billed the owners corporation \$71,200 without revising the original estimate. By the date of the hearing the lawyer had charged the owners corporation \$260,728 for which estimates had been provided totaling only \$39,000.

Conclusion

The message from the Supreme Court is clear. An executive committee cannot authorise minor stages of legal action, where the total cost of the action will exceed the statutory threshold of \$1,000 per lot or \$12,500 (whichever is less) without general meeting approval. This means the door has effectively been shut on executive committees approving fee estimates from lawyers for piecemeal components of significant litigation. An executive committee simply cannot approve "Stage 1" of legal action (such as filing a statement of claim for, say, \$1,500) where the total cost of taking the entire legal action would be, say, \$50,000.



The Bakkante case sends a clear message to all owners corporations. Make sure you properly authorise the taking of legal action otherwise you run the risk that the action will be dismissed with costs.

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About JS Mueller & Co Lawyers

JS Mueller & Co Lawyers has been servicing the strata industry across metropolitan and regional NSW for almost 40 years. We are a specialist firm of strata lawyers with in depth and unmatched experience in, and comprehensive knowledge of strata law and levy collection.

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