Management Rights – Fiduciary Duties – Developers

Management rights issues

There have been a lot of enquiries about community associations and strata schemes being dissatisfied with caretaking/building management rights arrangements put in place by the developer and what the association or scheme can do about these arrangements.

There are a wide range of possible remedies that need to be considered when determining what an association or scheme should do. A Supreme Court decision suggests that a claim for damages against the developer relating to secret commissions may be possible.

Landmark case

In *Community Association DP No 270180 v Arrow Asset Management Pty Ltd & Ors [2007] NSWSC 527* the Supreme Court ordered that Australand Consolidated Investments Pty Ltd, the developer and third defendant, pay to the community association an amount of $190,000 it had received by way of profit from the site manager for the sale of the association's management rights.

If the expert evidence had been accepted by the Supreme Court, the developer could have been ordered to pay damages being the difference between the amounts paid by the community association under the site management agreement and the amounts that would have been paid under an arm's length transaction.

The decision is a detailed and lengthy one and some of the facts and findings are set out below:

- Australand was the developer of the community association known as Balmain Cove.
- Australand sold to Arrow Asset Management the management rights for the community association being a 10-year agreement with two five year options for a sum of $190,000.00.
- Australand using its voting rights appointed Arrow Asset Management as site manager pursuant to its site management agreement at the association's inaugural general meeting.
- The community management statement did not comply with the requirements of section 24(2)(a) of the Community Land Management Act 1989 regarding disclosure and the site management agreement terminated at the end of the first annual general meeting, unless ratified at that meeting.
- The community association did not expressly ratify the site management agreement, nor did the Supreme Court find that there was implied ratification.
- Arrow Asset Management transferred/novated the rights and obligations under the site management agreement to Bondlake, with the consent of the community association.

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- The community association was estopped from seeking to assert that the site management agreement had terminated because it had conducted itself in a manner which led Arrow Asset Management and Bondlake to believe the agreement was in force and they would be detrimentally affected if the community association was entitled to assert that the agreement had terminated.

- Australand as developer of the community association was found to be in a position of promoter of a company: Re Steel and Other and the Conveyancing (Strata Titles) Act 196188WN (PT 1) (NSW) 467.

- Australand as promoter of a company failed to comply with its fiduciary duties to: "…*Not to place self in a position of conflict or to profit from contracts entered into between the Association and Arrow, without proper disclosure*;" and "... *Not to act to the detriment of the Association*…"

- *"There was a clear conflict between Australand's interest and its duty. Australand's interest was to extract the maximum price from Arrow. That conflicted, or might conflict, with its duty to the Association: to get the benefit of management services at the most reasonable terms commercially available."*

- Australand did not disclose the payment of $190,000 and failed to attract the defence of disclosure which is available for a *prima facie* breach of fiduciary duty.

- As an alternative to having to pay $190,000 to the community association Australand could have been ordered to pay damages, but the expert evidence was not accepted by the Supreme Court.

Due to the evidentiary issues regarding damages, the Supreme Court ordered that Australand pay to the community association $190,000 for breach of its fiduciary duty finding: "Thus, in my view, the appropriate remedy is an account of profits. That is a remedy appropriate to secret commission cases (see e.g. Reading V Attorney General [1951] AC 507); the present case is in many ways similar to the secret commission cases."

Implications

This case and subsequent cases following it suggest that community associations and strata schemes may have claims against developers who have obtained undisclosed benefits from causing the association or scheme to enter into uncommercial agreements with third parties, emphasising the importance of proper disclosure.

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Updated 23 October 2017

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