Shifting Services Costs and Secret Profits – Owners Getting Shafted

It has become increasingly common for developers to pursue a development in such a way that owners corporations and lot owners are locked in to using various service providers or paying what amount to deferred development costs. This article will consider the most common scenarios and measures which can be taken to address them.

We have considered the special case of embedded electricity networks in strata schemes in our previous article Embedded Network in your Strata Scheme – Things you Need to Know and this article will focus on other supplies. Such supplies have also become common in other situations, e.g. commercial buildings, retirement villages and caravan parks, but this article will focus on strata buildings.

The most common scenarios we see are:

- Private networks with strata buildings for provision of utilities and services such as gas, hot water, heating, air conditioning and internet access. Typically, these involve a third party supplier leasing common property areas from the owners corporation to site infrastructure and equipment owned by the supplier, which is used to supply customers, with charges either billed directly to customers or billed to the owners corporation, with the owners corporation on billing customers on some agreed basis. This need not been done via levies, as section 117 of the Strata Schemes Management Act 2015 ("SSMA") provides that an owners corporation may enter into an agreement to provide amenities and services to a lot.

- Construction of infrastructure, such as storm water pipes and associated equipment such as storm water filtration and waste removal. Typically, these involve substantial ongoing maintenance costs and early termination fees, which could be seen as transferring part of the initial cost of installing the infrastructure from the developer to the owners corporation and/or lot owners.

This can have many advantages for developers, including lower infrastructure costs, those relating to such services typically being borne by the service provider and the marketing benefits flowing from the availability of these services.

However, customers in such schemes often have the perception being that they have become captive customers paying excessive charges or are bearing costs which should have been borne by the developer at the time of construction of the building and are being disadvantaged in terms of price competition and consumer protections, as compared with other customers.

In contrast with embedded electricity networks, there is limited statutory regulation in this area. There is some in relation to certain utilities, e.g. gas and water, but no across the broad protection.

One area of law which may assist involves common law and equitable principles relating to secret profits and secret commissions, as considered by the NSW Supreme Court in *Community Association DP 270180 v Arrow Asset Management Pty Ltd [2007] NSWSC 527*. In that case, the Supreme Court

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found that a developer owed fiduciary duties to a community association and prospective lot owners, analogous to those owed by the promoter of a company and had breached those duties by committing the association to a management agreement which was not on commercial terms and in relation to which the developer received a large secret fee, which was not disclosed to community association and prospective lot owners. The developer was ordered to account to the association for the secret fee.

An arguable implication of that is that a developer who receives a benefit from a prospective supplier to the scheme, whether a payment or assumption of part of the infrastructure construction costs associated with the development, must disclose that benefit to the owners corporation and prospective purchasers of lots, failing which the owners corporation may be able to recover, from the developer, an account of profits (the benefit), equitable compensation for the amount by which cost of the services exceed market rates and compensation for unfunded debts incurred during the initial period.

It does not follow that an owners corporation will be able to terminate the arrangements, i.e. any contractual arrangements between the owners corporation and the service provider and the lease of common property under which the service provider has installed its infrastructure and equipment. It may be possible in some cases, e.g. where there has been fraud or misleading conduct by the service provider.

Another important consideration is that Section 26 of the SSMA prohibits an owners corporation from incurring, during the initial period "a debt for an amount that exceeds the amount then available for repayment of the debt from its administrative fund or its capital works fund" going on to provide for recovery of the amount from the original owner (developer) in the case of breach.

If you are having difficulties with such arrangements for supply of services in your scheme, you have options and we can help you with those. In particular:

- There may be legislation giving you rights, which could be enforced.
- You may be able to resolve disputes through the service provider's dispute resolution procedures or a reference to an external dispute resolution body.
- It may be possible to terminate or restructure the arrangements.
- It may be possible to pursue the developer for an order to account for any secret profit, an order for equitable compensation and/or compensation for unfunded debts incurred during the initial period.

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