



FEATURES THIS MONTH

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NEED GOOD SITES FOR STRATA CORPORATION INFORMATION?

Here are some sites you can access:

Strata U. - Continuing Education Department web site links of interest:

- Canadian Condominium Institute: <http://www.cci.ca>
- Condominium Home Owners Association: <http://www.choa.bc.ca/index.html>
- Clark, Wilson, Barristers & Solicitors: <http://www.cwilson.com/stratafaq>
- *Strata Property Act* information web site: http://www.qp.gov.bc.ca/statreg/stat/S/98043_01.htm
- Vancouver Condominium Services: <http://www.vancondo.com>



1. YOUR RESPONSIBILITY AND LIABILITY AS A COUNCIL MEMBER

Irrespective of the calendar term of office that you represent your strata corporation as a council member, it strikes us that January is a good month to give you all a heads up as to your conduct as a council member. Our lead article this month which follows, therefore, not only brings you a fascinating story of what one strata council did, but also alerts you to the pitfalls of knowingly making the wrong decisions.

The vast majority of VCS clients (councils) operate strata corporations which are either residential or mixed residential-commercial complexes. The story that we bring you here this month is about a strata corporation which is neither of these types. It is a hotel which was built for investment and business opportunity; however, the strata corporation concept was used, ingeniously, as a means of securing investors (as opposed to a conventional business enterprise with shareholders). Do not, however, be dissuaded from reading this fascinating story because, the hotel objective aside, it is still a strata corporation and subject to the law, i.e., the *Strata Property Act* of B.C. (In another unrelated case presently before the Courts, the lawyer for one of the defendants has urged the Court to consider the concept of a “hotel strata corporation” as having differing obligations. There is no such thing as a “hotel” strata corporation. All strata corporations are equal in the eyes of the law.)

So, our advice here is read the attached article which requires some concentration because there are many players and many twists and turns (like a good mystery movie). The bottom line, as you will see, is that a council member (you) has a legal duty to act honestly and in the best interest of his/her strata corporation. If not, heads up.

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2. WHEN COUNCIL MEMBERS CAN BE HELD PERSONALLY LIABLE

“...I find the Respondent Strata Council Members acted in a reprehensible manner deserving of rebuke by the court through the award of special costs. The Respondent Strata Council Members will be jointly and severally liable for the repayment to the Strata Corporation of the \$190,338.99 [legal fee paid by the Strata Corporation but which provided it with no benefit] and the petitioner’s cost.” Thus concluded the Reasons for Judgment of the B.C. Supreme Court Judge in the case of *Dockside Brewing v. LMS-3837 and others* (Vancouver Registry No. L042671, August 23, 2005).

‘But we acted on the advice of lawyers and a property manager’, the Respondents had argued, and therefore should be found to have done so *“honestly and in good faith with a view to the best interests of the strata corporation”* (as required by SPA s. 31(a)). The judge agreed that the censured council members were in fact encouraged by the advice they received from their lawyers to pursue the strategy they undertook. However, that did not excuse them, because they had been expressly warned against their course of conduct repeatedly by their opponents in this litigation. The law firm that recommended the strategy they pursued was found to be in a conflict of interest in an earlier court ruling, but they failed to get independent legal advice, and in all the circumstances it should have been clear to them that the strategy they were pursuing was replete with conflicts.

Those are strong words and the Respondents received a severe penalty. Not too strong or too severe, though, you may think as you read the facts which lead to the court’s rebuke. The Reasons for Judgment summarize those facts as follows:

The subject strata corporation was built and operated as a hotel. When the developer and the initial hotel operator “ACS” got into financial difficulty, a group of owners (the “Respondent Owners Group”) embarked on a strategy to take over operation of the hotel. They initiated this by authorizing a hotel management company called “Executive” to bid for the assets of ACS, the main value of which was in leases of the lobby and parking areas of the strata corporation. However, Executive was outbid by “Sunbelt”. Unfortunately for the Respondent Owner Group, they had apparently already entered into an agreement with Executive to manage the hotel, so they were now facing a \$600,000 lawsuit if they failed to deliver the leases that Sunbelt had won. The Respondent Owner Group then decided to try to have those leases set aside on the basis that

they had been entered into by ACS, as developer, in breach of its fiduciary obligations to the strata corporation. A second group of owners, including the Petitioners in this case, opposed that strategy.

To do so, according to the Reasons for Judgment, at the next AGM (in 2002) they took control of the strata council, by electing members of their group to fill 8 of the 9 seats. They also approved an operating budget which included \$93,772 for legal fees to challenge the leases. This was challenged by other owners who correctly noted at the AGM, and again thereafter, that a one-time non-recurring expense such as this should not be included in the operating budget. Those objections were ignored.

The Respondent Owner Group controlled a majority of votes, but not $\frac{3}{4}$; thus the need to proceed in this manner to achieve their objectives. For the same reason, they later decided, on their lawyer's recommendation, to terminate the lobby and parking area leases in order to try to get Sunbelt to sue the strata corporation. As our readers will know, a strata corporation cannot pursue litigation of that kind without a $\frac{3}{4}$ vote, but it can always defend an action brought against it without owner approval.

What our readers will also know, is that council members must openly disclose potential conflicts of interest. They must also clearly differentiate between what is in the best interests of the strata corporation as a whole and their personal interests. This group of council members did not do so. They did not inform the other owners that they had entered into a deal with Executive to manage the hotel, a deal that they now could not live up to. They also did not disclose that as owners/investors they had hired the same lawyer to advise them on their strategy to take over control of the hotel management, as they subsequently hired as members of council to advise the strata corporation on termination of the leases. The latter objective was to further the prior and was not found by the court to be of any direct benefit to the strata corporation, but they nevertheless used strata corporation funds to pay for it.

As noted above, following their lawyer's advice, wearing their council member hats they voted (8 to 1) in favour of giving Sunbelt notice that the strata corporation was terminating the leases, on the expectation that Sunbelt would then sue the strata corporation, leaving them the opportunity to litigate the issue without having to seek $\frac{3}{4}$ vote approval. Unexpectedly, however, Sunbelt did not take the bait. So, they (the council) then arranged for one of their group to sue the strata

corporation alleging that the leases should be set aside because they had been entered into by the developer in breach of its fiduciary duties to the strata corporation.

Now they found themselves in the interesting situation of both instructing the law firm that was challenging the validity of the strata corporation's lobby and parking lot leases on their behalf, and at the same time instructing the law firm that was acting for the strata corporation. This too they did not disclose, but another party to the action raised the issue and succeeded in having the second law firm prevented from taking instructions from them, which prevented them from instructing their lawyer to support the application as they had intended, and resulted in the strata corporation having to take "no position". In the result, the application to invalidate the leases was dismissed when the court found that "only the Strata Corporation could challenge the leases in an action properly constituted and approved pursuant to the SPA."

At the 2003 AGM the Respondent Owner Group presented a resolution to approve, by the required $\frac{3}{4}$ vote, an action by the strata corporation to challenge the leases. It failed. Nevertheless, they included another \$100,000 in the *operating* budget for legal expenses. Thereafter, in 2004 the strata council, which the Respondent Owner Group dominated, hired another law firm to commence an action in the name of the strata corporation to challenge the leases, notwithstanding the fact that the owners had voted that course of action down. In this case, they did not even bother with a strata council resolution. That prompted this action which resulted in a preliminary injunction being obtained that prohibited the strata council from spending strata corporation funds on unauthorized litigation until after the 2005 AGM.

Though the strata council knew there was no appetite on the part of the required $\frac{3}{4}$ majority of owners for such litigation, they still proposed a budget for approval at the 2005 AGM which included yet another \$150,000 for legal fees, and which they acknowledged was earmarked for the purpose of challenging the leases. Then, and notwithstanding the injunction, they instructed their property manager to pay a \$50,000 retainer to yet another lawyer to proceed with the unauthorized litigation. The property manager refused.

By now the Respondent Owner Group no longer controlled a majority of the votes within the strata corporation, so at the next AGM a new council was elected and they instructed the lawyer to discontinue the unauthorized litigation. This action was then commenced by the petitioners to recover from the Respondent Owner Group's representatives on the strata council the nearly

\$200,000 of strata corporation funds they had fruitlessly spent on lawyers and litigation to advance their own personal interests, and which the court concluded resulted in no benefit to the strata corporation. Not surprisingly, those council members were found by the court to have failed to comply with sections 31, 32 and 33 of the SPA. They had failed to disclose conflicts of interests on a number of occasions, they had not acted honestly and in good faith with a view to the best interests of the strata corporation, they had failed to meet the standard of care of a reasonably prudent person in comparable circumstances, they had authorized contracts and transactions which were unreasonable and unfair to the strata corporation, they knowingly circumvented the requirement to get $\frac{3}{4}$ vote approval to commence litigation and knowingly used operating funds to pay for expenses that also should first have been approved by $\frac{3}{4}$ vote.

The Judge noted in respect of the Respondent Owner Group's representatives of council that *"There is ample evidence they ignored their opponents' warning of conflict of interest and went to remarkable lengths to resist their opponents' attempts to hold them to account for a litany of irregular and unauthorized actions as members of the Strata Council. I note that this is not a situation where the Respondent Strata Council Members were elected to the Strata Council and then unwittingly drawn into developments not of their own making. They sought election to the Strata Council to effect the very strategy which has exposed them to liability."*

The foregoing are a rather extreme set of circumstances admittedly, but not unprecedented in our observations, except by degree. Situations in which strata councils make decisions that are influenced by personal considerations are certainly not rare, so the lessons taught by this case warrant repeating. This decision makes it very clear that strata council members can be held personally liable where they disregard their statutory obligations to act honestly and in good faith with a view to the best interests of the strata corporation, rather than their own, and to avoid, or to at least openly disclose, potential conflicts of interest.

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3. WHOSE BUDGET IS THIS ANYWAY?

The *Strata Property Act* of B.C., as you know, requires a strata corporation to prepare an annual budget for approval by the owners at the Annual General Meeting. This must be done not later than two months following the fiscal year-end of a strata corporation. The vast majority of VCS client budgets are routinely approved although occasionally a budget is rejected by the owners at the AGM. (If the budget cannot be agreed upon at the AGM, the *Act* has a provision for holding another Special General Meeting within 30 days.)

Budgets which contain no increase in strata fees are easy to pass. Conversely, budgets with increases are more difficult to obtain owner approval particularly if the increase is substantial. These AGMs do cause council members (and the property agents) some angst. At one recent Annual General Meeting, such a budget was presented to the owners for approval. The increase in strata fees was about five percent, which is not the end of the world but still enough to get several owners quite riled up. The more vocal owners moved into “attack mode” and council felt the heat. The Treasurer stood up and said to the owners “Don’t blame council, the budget was prepared by VCS.”

Ha ha. Nice move.

In fact, their budget had been initially prepared by VCS (as it is our responsibility to do so) and council had worked on refining it over no less than three council meetings prior to the AGM. So whose budget was it? VCS? Or the strata council’s?

Well, this should not be a “blame game”. In reality, the budget belongs to the strata council since council has the last word on the working draft and the *Act* directs the strata council and not the management company. All that aside, telling the owners at an AGM to point the finger at VCS is not a very good strategy. It may give some immediate relief to the incoming missiles but it really does not get to the heart of the issue - that being the need for the strata corporation to remain financially solvent.

Indeed, there are some opportunities for a council (and VCS) to prune the projected operating expenses, but for the most part the vast majority of operating expenses are hard to control and curb. We can fool ourselves and project unrealistically low expenses only to end up with a deficit at the fiscal year-end. Then what? While it is, admittedly, difficult to take the heat at an AGM, we urge you not to be afraid of the owners if your budget, with increased strata fees, is premised on recognizing historic expense patterns and acknowledging that your property must be kept in good working order, and look good, if your investment value is to be retained and enhanced. It is our observation that most owners understand this concept and the hot heads are the minority. If a proposed budget is properly researched and prepared, if council and the agent confidently explain the expenses and answer questions, you should not have to worry too much and certainly avoid having to point the finger.

To the hot heads who only criticize council at the AGM, we suggest you urge them to join council so that they can bring and share their expertise in a leadership role.

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4. EARTHQUAKE PREPAREDNESS

We thought you might be interested in some feedback, or should we say “the lack of”? Recent strata corporation minutes, both council and AGM, have contained the bluntly worded message to owners that, in the event of an earthquake, they are “on their own”. Fair enough; not everyone reads the minutes but just the same you would think that there would be some reaction, eh? Maybe you as a council member heard directly from some of your owners but at VCS we did not hear from a single person on the topic. Considering that we serve 200 strata corporations containing some 16,000 individual strata lots, we find the response to be amazing.

Oh well, they have been advised so that is the good news. Nevertheless, the message ought to be repeated periodically. The recent circulation was the second year we have done this and will diarize the matter for the fall of 2006 to raise it again. If you wish your owners to receive it mid year (i.e., June), or even as a special, separate bulletin, please advise your strata agent.

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5. THE INSURANCE REPORT

While there are a number of strata corporations that do not have fiscal year-ends corresponding with the calendar year-end, the majority of you have recently attended your Annual General Meeting, or soon will. A very important item on the agenda is the Insurance Report, at which time either your strata agent or the Chairperson will provide detail regarding the strata corporation's insurance policy. The provision of a report on the insurance of the strata corporation is mandated by Section 154 of The *Strata Property Act*, which states:

Review and report on insurance

154 The strata corporation must

(a) review annually the adequacy of the strata corporation's insurance, and (b) report on the insurance coverage at each annual general meeting.

The Insurance Report will include such detail as the Replacement Cost (amount for which the building is insured in the event that total replacement is required, as determined by an annual insurance appraisal) of the building(s), the Annual Premium Cost (as expensed to the Insurance code on the Annual Operating Budget), the various insurance deductibles associated with damage to the building, re-keying, etc., and the liability coverage as provided by the policy.

As noted above, the Replacement Cost of the building(s) is determined by an annual insurance appraisal which allows the management company to communicate the required information to the brokers to ensure that there is accurate and up-to-date coverage for the building for its total replacement cost. During these days of rising construction and material costs, this means the Replacement Cost has likely increased, and the insurance coverage must be "topped up". This is, in fact, not only common sense and good business practice, but also requirement of The *Act* per Section 149 (4)(a), which states:

The property insurance must be on the basis of full replacement value

Note that Section 149 (1) details the requirements of strata corporation insurance as follows:

Property insurance required for strata corporation

149 (1) The strata corporation must obtain and maintain property insurance on

(a) common property,

(b) common assets,

(c) buildings shown on the strata plan, and

(d) fixtures built or installed on a strata lot, if the fixtures are built or installed by the owner developer as part of the original construction on the strata lot.

The “fixtures” referred to in Section 149(1)(d) above are defined in Regulation 9.1(1) to mean “items attached to a building, including floor and wall coverings and electrical and plumbing fixtures, but does not include, if they can be removed without damage to the building, refrigerators, stoves, dishwashers, microwaves, washers, dryers or other items.” You will note the absence of coverage for the contents of a strata lot or any betterments/improvements undertaken by current or previous owners. This is underlined in the Insurance Report, at which time the ownership is advised that the strata corporation’s insurance policy does not provide coverage for individual contents, betterments or improvements (i.e. storage locker contents, clothing, furniture, decorating, upgrading of carpets, flooring, etc.). Owners and residents are reminded that they must carry their own “Owner Package” insurance for this coverage, including any improvements and it is suggested that individuals should contact their home insurance company to determine if they have this coverage or not. This information is also provided in the minutes of the Annual General Meeting for the benefit of those non-resident owners and other individuals who may not have been able to attend.

As you can see, there is a substantial amount of information that should be provided to the ownership via the Insurance Report. Owners have a right to hear this information and need to be made aware of the parameters covered by the strata corporation policy so that items falling outside of the coverage can be addressed with their own home insurance company.

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