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CASE LAW UPDATE, JUNE 2007

Condominium Board's Deposit of Surplus Funds to Reserve Fund – Not Returned to Unit Owner – was both Reasonable and Correct

April 4, 2007: *Viraf and Mary Baliwalla v. York Condominium Corporation No. 438*, (Ontario Superior Court of Justice, Divisional Court, Court File No. 330/06), [2007] O.J. No. 1673, S. E. Greer J.

FACTS

In August 2002, the board of directors ("Board") of the condominium corporation determined certain repairs were required to the brick masonry cladding on exterior buttress walls and garden walls. Costs were estimated (according to the bids received) to be between about \$186,000 and \$384,000. The Board decided that the repairs would be paid for "50% from the Reserve Fund" and the balance by special assessment. Unit owner were assessed \$7,500.00 to be paid in three installments between September and November, 2002.

One of the plaintiffs was on the Board at the time.

The plaintiffs paid their full special assessment and sold their unit in December, 2002. The status certificate issued for the unit specifically indicated at paragraph 12 that "brickwork replacement on buttress walls and garden walls" could bring about an increase of common expenses.

At year-end, since no work on the project had yet occurred, the Board moved the funds collected through the special assessment to the reserve fund. The Board also received new quotations (through a committee of unit owners) indicating the work could be done for a significantly lower cost than originally estimated.

The plaintiffs had sent a letter to the Board requesting reimbursement of the unused portion of their special assessment. However, the Board received a legal opinion that no funds could be transferred out of the reserve fund (other than to pay legitimate reserve fund expenses) unless the corporation was wound up.

The work was completed for the lower cost. However, the Board paid no reimbursement of the balance to the unit owners. The plaintiffs sued the corporation in Small Claims Court and were awarded damages in the amount of \$5,320.29 plus interest and costs. The condominium corporation appealed this decision to the Divisional Court.

JUDGMENT

The Divisional Court concluded that the Small Claims Court decision was incorrect. The award to the plaintiffs was reversed, their claim dismissed, and costs were awarded in favour of the condominium corporation.

The Court noted that the correct standard for testing the legitimacy of the decisions of the condominium board is the standard of “reasonableness” set out in the statute and not a standard of “correctness”.

It was determined that the Small Claims Court erred in that:

(a) *The decisions of the Board were not unreasonable.*

The Divisional Court disagreed with the conclusion of the trial judge that the decisions of the Board with respect to the handling of the special assessment funds were unreasonable. Rather, the Divisional Court found that the Board’s decisions had been both reasonable and consistent with the *Condominium Act, 1998* (the “Act”).

(b) *The trial judge did not correctly apply section 93 of the Act.*

The trial judge had disagreed with the submission of counsel for the condominium corporation that reserve fund contributions are in the form of common expenses and are to be held by the corporation in the same manner as regular common expenses. The Divisional Court stated the trial judge erred at law in this regard and referred to sub-section 93(4) of the Act which states,

The corporation shall collect contributions to the reserve fund from the owners, as part of their contributions to the common expenses.

(c) *The trial judge disregarded section 84 of the Act.*

The Division Court quoted sub-section 84(2) of the Act, which provides that a common surplus (defined in the Act as “the excess of all receipts of the corporation over the expenses of the corporation”) of the corporation is to be applied against future common expenses or paid into the reserve fund and shall not be distributed to unit owners except if the corporation is terminated.

The Divisional Court noted that since the special assessment was made only for major repair and replacement of common elements, it was reasonable for the board to transfer such funds to the reserve fund of the corporation in accordance with sub-section 84(2) of the Act.

The Divisional Court compared its assessment of this case with *York Condominium Corp. No. 382 v. Dvorchik*, [1997] O. J. No. 378, No. C12466 (Ont. Ct. App.) and *Metropolitan Toronto Condominium Corp. No. 1170 v. Zeidan*, [2001] O.J. No. 2785, Court File No. 000-CV-198913 (O.C.C.J.), which stand for the principle that a court should defer to the rules made by a condominium board of directors when such rules are not clearly unreasonable, and concluded that the actions of the Board were neither unreasonable nor negligent and therefore the trial judge should not have awarded damages against the corporation.

APPLICATION

Overall, the facts in this case are illustrative of correct handling of a common surplus. The Board applied the provisions of section 84(2) of the Act in accordance with their plain language. This case indicates that this was correct and reasonable.

This case extends the application *Dvorchik* and the cases that follow it (including *Zeidan*) and confirms that a court should defer to the board of directors not only in regard to rules reasonably made, but also in respect of all decisions of the board. This is consistent with our legal opinions made prior to this date, and confirms them.

Underlying the case are the following points to be considered:

- (1) *A board of directors can only work with the facts at hand.* It is unfortunate that the board's special assessment was higher than was needed; but at the time it was done, it was not unreasonable given the facts known to the board. A board is not held to a standard of correctness, but of reasonableness. Provided a board acts in accordance with sub-section 37(1) of the Act – in honesty, good faith, and with the care, diligence and skill of a reasonably prudent person in comparable circumstances – the board's conduct and decisions should be deemed to be reasonable.
- (2) *The board in question was willing to receive the input of unit owners.* It should be noted that, according to this judgment, there was a committee of unit owners working in some manner with the board. It was this committee that obtained the lower quote. This suggests that boards and owners can work together to improve the operation of the condominium corporation. Perhaps this is indicative of a creative and communicative board, one that worked with unit owners rather than with the unfortunate "us"-"them" approach and atmosphere that arises in some condominium communities.
- (3) *The board obtained and followed professional legal advice.* The board evidently sought a legal opinion or direction with respect to how it should handle the surplus funds collected. Had it neither obtained nor observed such advice, it is possible that the Board would have been subject to a very different law suit, particularly if, as a result, the surplus funds had been handled in an improper way. Although not stated by the court, it surely added to the evidence of reasonableness of the Board that they sought legal counsel; and, had such counsel been incorrect, the Board could still have been protected from liability by virtue of the fact that such counsel had been obtained (per sub-section 37(3) of the Act).

Michael H. Clifton (June 2007)