Stuck with an Embedded Network? Looking for a Way Out?

Embedded networks are becoming more and more common in strata developments and more and more new lot owners are becoming aware too late what an expensive trap these can be.

Although these arrangements most commonly involve electricity, they can involve a wide range of other services, e.g. solar electricity or heating, gas, heating, air conditioning, potable water, hot water, chilled water for cooling, telephone, internet access, storm water and waste removal systems.

The trap involves a third party installing and owning infrastructure, which would otherwise have been provided by the developer and form part of common property, then seeking to have the owners corporation enter into an agreement (or ratify an earlier agreement with the developer) giving the third part rights such as:

- Ownership of the infrastructure.
- Operation of the infrastructure as an embedded network or management of the owner's corporation's use of the infrastructure as an embedded network.
- Management of supplies of utilities and services to the owners corporation by other suppliers.
- Network use charges and/or management fees.
- Option to sell the infrastructure to the owners corporation for a specified price on termination of the arrangements.

Owners corporations typically fall into this trap because, at the first AGM, they are presented with an agreement involving complex arrangements which they don't really understand and which probably haven't been adequately disclosed before the meeting. The strata manager will likely have been appointed by the developer and be unable to provide proper advice. There will also be a perception that there is no practical alternative, the infrastructure already being in place and services being required urgently.

If you find yourself in this situation, you should obtain urgent legal advice. There are things you can do, but the sooner you begin, the more likely you are to be successful and if you are successful, the sooner you contain the drain on your funds.

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In particular:

- If the agreement involves passing on the cost of providing infrastructure by inflated charges over time, the developer may be breaching its fiduciary duty and be liable to the owners corporation on this basis or under the law relating to secret commissions.

- There is a possibility that, whatever the agreement says, the third party does not actually own the infrastructure and that it has vested in the owners corporation as common property.

- The agreement may infringe prohibitions on transactions during the initial period.

- So far as supplies to the scheme by external suppliers are concerned (i.e. this does not extend to supply of electricity though an embedded network), pending reforms expected to commence later this year will cap terms to 10 years for existing agreements, to the end of the FAGM for agreements signed before the FAGM and 3 years for agreements signed at or after the FAGM.

- So far as supplies of electricity through an embedded network are concerned:

  – You may have rights under the National Electricity Law and the National Electricity Rules, e.g. to require cooperation regarding use of an alternate retailer and appointment of an embedded network manager "to address technical issues presenting barriers to retail competition".

  – You may be able to make a complaint to the Energy and Water Ombudsman NSW.

We have considerable experience and expertise in this area and can help you.

Key takeaways

- Embedded networks can trap owners corporations into costly agreements with third parties.
- Legal advice is crucial for owners corporations facing embedded network issues.
- Developers may breach fiduciary duties through inflated charges in embedded network agreements.
- Pending reforms will limit the duration of agreements related to embedded networks.
- Rights under the National Electricity Law may provide avenues for owners corporations to challenge embedded network arrangements.

****The information contained in this article is general information only and not legal advice. The currency, accuracy and completeness of this article (and its contents) should be checked by obtaining independent legal advice before you take any action or otherwise rely upon its contents in any way.*

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