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FRAUDULENT CONDUCT IN THE MANAGEMENT OF APARTMENT BUILDINGS - A CASE STUDY

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Abstract. Reflecting on the analysis of the criminal offence of law in terms of criminal law theory, the authors present this article, by which they advance on their previous conclusions and deepen their reflection on the issue of effective apartment buildings management and prevention of fraudulent behaviour. The authors concentrate on the analysis of owners' obligations according to the Act on ownership of apartments and non-residential premises with special focus on the yearly settlement of overpayments and arrears. The previous theoretical approach is being applied on a case study - fraudulent behaviour in the process of division of common costs (expenditures) between the owners in the apartment building and subsequent settlement (in conditions of Slovak republic). The basis for the division of these costs is the proportionality of the use of the common parts and common facilities of the apartment building, which is expressed in the so called *person months* (metric unit for settlement). By not reporting the true number of personmonths to the administrator, an owner may gain material benefit (achieve higher overpayments and lower arrears) and this illegal financial benefit needs to be covered and compensated by other owners in the same apartment building. In terms of criminal law, the owner is committing fraud (a related offence to insolvency crimes). Subsequently the attention is paid to the efficiency of owners' rights protection in relation to the insolvency of an owner and to the provision of recommendations *de lege ferenda*, which would bring a higher level of legal certainty, more effective way of apartment building management, settlement of arrears and overpayments, insolvency issues and sanctioning of perpetrators.

Keywords: apartment buildings management; fraud; criminal liability; insolvency; insolvency and related offences

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1. Introduction

Fraud is a frequently occurring criminal offence, which targets the property of others, that is subjected to the perpetrators attack with the aim of enrichment. It occurs in many forms, some of which are more latent than others, one of the latent forms is a fraud occurring in the processes of apartment building management. The owners need to bears the proportionate part of the common costs of living in an apartment building. The basis for the division of these costs is the proportionality of the use of the common parts and common facilities of the apartment building, which is expressed in the so called *person months* (metric unit for settlement). By not reporting the true number of personmonths to the administrator, an owner may gain material benefit (achieve higher overpayments and lower arrears) and this illegal financial benefit needs to be covered and compensated by

other owners in the same apartment building. The article provides an analysis of selected legal obligations of owners of apartments and is a legal reflection on a more effective system of owner's rights protection, claims management, statutory lien enforcement and aspects relating to insolvency. By the grammatical, systematic and teleological method of legal interpretation the relevant statutory provisions are being approached and after their analysis the authors reach a conclusion, that the legal regulation is ineffective and not fulfilling its purpose. The authors reflect previous research on the topic of fraudulent behaviour, property offences in general or other relevant issues (Čentěš, J., Mrva, M., Krajčovič, M., 2018; Strémy, T., 2010; Šamko, P., 2012; Šamko, P., 2016; Horváthová, Z., Křítková, S., Tcukanova, O., 2016; Strapáč, P., Ďurana, M., Sninčák, T., Sura, S., Takáč, J., Treščáková, D., Skorková, V. 2018). It needs to be emphasized, that sufficient previous attention has not been paid to the problematic of fraudulent behaviour occurring in the apartment buildings management (only to other forms of fraudulent behaviour or fraud in general terms).

2. On the management of apartment buildings and the ownership of apartments Introduction

An apartment building is a building where more than half of the floor space is intended for residential use, which contains more than three apartments, where the apartments and non-residential units are privately owned and where the common parts and facilities of the building are jointly owned by the owners. It is important to note that it is always one building and only the building as a whole can meet all the defining characteristics of an apartment building, even if remaining criteria would be satisfied by one of the entrances to the apartment building. All the owners are considered to share in ownership of the apartment building. The individual apartments are treated as separate assets for the purposes of private ownership and civil law relationships.

To encourage the effective management of apartment buildings (for the essential preservation and improvement of the apartment building), they are managed by a different entity than the owners – either an **apartment building administrator** (a business entity) or an **association of property owners** – that acts as the owners' legal representative. It is a duty of the owners to provide for the management of their apartment building. The administrator or the association of property owners carries out legal acts on behalf of the owners in matters relating to the apartment building, the common parts and facilities, accessories and land and can thus legally bind the owners. The present article will consider primarily the management of apartment buildings by administrators (natural and legal persons). The legal basis is Act No 182/1993 on the ownership of apartments and non-residential premises (“*act on apartment ownership*”). Duties related to management are specified in an obligatory contract on the management of the apartment building, which is a consumer contract. In the event of a conflict between the provisions of the management contract and the act on apartment ownership, the act on apartment ownership prevails (Section 25a(1) of the cited act).

The effective management of an apartment building requires that the owners pay regular contributions (on an ongoing basis) to cover costs for the use, maintenance and repair of the apartment building's common parts (corridors, roof, cellars...) and common facilities (lift, camera system...). The given costs are paid from common funds on the apartment buildings accounts in financial institutions, to which the owners are obliged to pay sums agreed in advance at regular intervals. This is a legal obligation based on Section 10(1) and (6) of the act on apartment ownership, which require owners to make advance payments to the operation, maintenance and repair fund and to make payments for services connected with the use of their apartment or non-residential unit.

The regular payment of funds to these accounts is intended to ensure the proper, stable and timely payment of costs associated with the management of the apartment building and the creation a reserve to cover unexpected costs usually resulting from an accident. The real costs for management of an apartment building cannot be foreseen in advance (only estimated); they are known after the end of the calendar year concerned. For this reason, the legislature stipulates an annual settlement of accounts in which overpayments and arrears of individual owners are settled based on the real costs incurred in the management of the apartment building.

To return to the issue of unlawful conduct of owners, the act on apartment ownership stipulates that building management costs and payments should be allocated between owners and their advance payments should be set based on **the owners' level of use of the common areas and common facilities of the building**. Determining this level of use is a practical question affecting the fair distribution of common costs. In practice, the fair level for the settlement is based on "**person months**" representing the number of persons using an apartment (and the common parts and common facilities of the apartment building) in a given month of the relevant calendar year. This procedure satisfies the legal requirement that the settlement of payments for services should reflect the level of use of the common parts and facilities of the apartment building by the owners of the apartments and non-residential units (Section 7b(2); Section 10(6) of the act on apartment ownership). The owners should bear a fair (proportionate) share of these costs (burdens) based on the use of the apartment building's common parts and facilities by the owner or persons to whom the use right of their apartment was transferred. In practice, it is not unusual for owners motivated by selfishness to seek to avoid the above legal obligation by using various means to influence the allocation of the apartment building's management costs in their favour at the expense of the other owners. If owners engage in such unlawful conduct, it would be appropriate to hold them to account to protect the integrity of the other owners' property.

The question of whether it is appropriate to hold them to account only under private law or whether they also need to be held liable under administrative law or even criminal law is discussed below.

2.1. Selected duties in the management of an apartment building

Section 6(2) (a) to (e) of the act on apartment ownership defines the management of an apartment building as the procurement of goods and services that the administrator or association provides for the owners (1) the operation, maintenance, repair and upkeep of the common parts and facilities of the building, adjacent land and accessories, (2) services associated with the use of an apartment or a non-residential unit, (3) managing the building's bank account, (4) recovering damages, arrears for the operation, maintenance and repair fund and other arrears; (5) other activities directly related to the use of the building as a whole by owners. Where the text uses the word "*administrator*", it refers primarily to an apartment building administrator, but the ideas also apply *mutatis mutandis* to an association of property owners.

The duties of an owner are laid down in Section 8b(2) of the act on apartment ownership. The **main** duties are:

1. to manage the owners' property **with professional diligence** in accordance with the terms of the management contract,
2. to protect the rights of owners and to prioritise their interests over their own,
3. **to represent the owners in claims for damages incurred as a result of the activities of third parties or of the owner of an apartment or a non-residential unit in the building,**
4. to exercise rights over the owners' property only in the interest of the owners,
5. **to monitor payments for services and the payment of advances to the operation, maintenance and repair fund from owners and to recover outstanding arrears,**
6. **file to initiate enforcement proceedings,**
7. provide for all other activities necessary for the proper management of the building in accordance with the management contract and the act on apartment ownership,

The administrator is obliged to comply with the listed obligations and can be penalised if they breach them. In addition to liability under private law in the form of reparations to injured parties, they may also be held liable under criminal law, primarily for the crime of breach of obligations in the management of other people's property. Naturally, the breach of these obligations and the maintenance of a causal relationship must have caused damage in the set amount (depending on fault).

The administrator's record-keeping duty is based on point (5) of the list and is linked to the recovery of arrears. The points that are most relevant to the allocation of the common costs of the apartment building (e.g. costs for waste removal and disposal, cleaning, electricity use in common areas and facilities, insurance costs for the apartment building, water supplies...) are points (1), (3), (5) and (6) of the list.

Regarding point (1), the management contract is an obligatory condition for the administrator to manage the owners' property. The management contract specifies the content of the contractual relationship between the administrator and the owners. The obligations arising from the concluded contract are enforceable. With respect to the performance of duties by the administrator, the asymmetric relationship between the administrator and the owners gives rise to the requirement that the management must be in accordance with professional diligence. Professional diligence can be defined as a requirement that the administrator act professionally in the management of other people's property, in accordance with the current state of their knowledge (especially in the technical and legal areas), with detailed knowledge of the area at issue and preserving the managed property in both a qualitative and quantitative sense. Point (3) obliges the administrator to represent the owners in claims for damages incurred as a result of the activities of third parties or of the owner of an apartment or a non-residential unit in the building. This concerns reparation for damage caused to the integrity of the owner's property. In line with the judicial interpretation, *damages* means an injury in the sphere of the injured party's property that is objectively expressible in pecuniary terms and can be remedied by the provision of financial assets, primarily money (see for example Judgement of the Supreme Court of the Slovak Republic 5 Cdo 126/2009). This is also consistent with the criminal law, which defines damages as harm to property or a real loss of property or rights of the injured party or any other harm caused to them in connection with a crime, regardless of whether the damages affect goods or rights. Damages also refer to benefits obtained in causal connection with a crime. While representation of the owners in claims for damages relates to representation in basic proceedings (as a stage in civil procedure), the administrator's obligations under point (6) relate to the protection of owners' rights in an enforcement procedure, the opening of which is governed by the principle that the subject-matter of proceedings is determined by the parties. Regardless of its form and the means for its implementation, an enforcement procedure involves the influence of public power on the legal situation of the obliged person. The enforced execution of a decision is the final stage in the exercise of the owners' right to judicial or other legal protection. The right to judicial protection guaranteed under Article 46 of the Constitution cannot end with the issuing of a final and enforceable decision of the court but must also include the possibility to enforce fulfilment of obligations laid down in such a decision if they are not fulfilled voluntarily (Finding of the Constitutional Court of the Slovak Republic, I. ÚS 5/2000). The administrator is thus obliged to file, on behalf of the owners, for enforcement proceedings against an obliged person (including persons obliged to pay compensation for damages) attaching a copy of the relevant instrument permitting enforcement.

2.2. Fraud in reporting numbers of person months to the administrator

As mentioned above, owners are obliged by law to share the common costs of their apartment building whose expenditure is necessary to provide proper care of the apartment building. Because of the unpredictability of these costs, payments are made according to an estimate based on comparison with the previous year and other relevant facts. A regular settlement must be carried out in which these payments are balanced against actual expenditure. The law stipulates that this settlement of accounts for use of the operation, maintenance and repair fund and for service payments is calculated for each apartment and non-residential unit in the apartment building on an annual basis. Every calendar year, the retrospective settlement for the previous year must be completed by 31 May of the respective year.

In general, the settlement of accounts for management of an apartment building involves distribution (allocation) of the total costs for the apartment building to individual apartments and the comparison of this amount with the owner's actual payments. A simple mathematical operation determines whether an owner has a debt or a claim based on the accounts.

By influencing the variables that determine the distribution of costs and their settlement, an owner can influence the outcome of the settlement in their favour – thus obtaining a financial advantage. It is difficult for an owner to influence the amount of payments made, only by actual performance. For this reason, owners seeking a financial advantage **manipulate the variables relevant to the allocation of costs to individual owners.**

This is done by a fraudulent pretence of circumstances that reduce the owner's arrears or increase their overpayment in the relevant payments, or which turn arrears into an overpayment. In both ways the perpetrator is enriched at the expense of the other owners in the apartment building, causing damage to their property, because the other owners must share between them the cost of the perpetrator's enrichment. Either the other owners' (victims') overpayments are reduced or there is an increase in the arrears they must pay. The responsible owner often argues that another neighbour or other neighbours are doing the same thing and nobody punishes them for it, or that they are getting compensation for damages caused by other owners. Such arguments are irrelevant. The settlement is based on the level of use of the common parts and facilities of the apartment building (and necessary services), which is measured in practice in "person months". The method most frequently used to allocate costs in a settlement in practice is that a representative of the owners reports to the administrator the retrospective numbers of person months for the previous calendar year. The report states how many persons used an apartment in each month. The result is the total number of person months for each apartment.

The term *person month* is not defined in law and its content corresponds to the definition above. The act on apartment ownership only regulates the question of changes in the number of persons using an apartment – i.e. a change in the number of person months compared to the number recorded by the administrator. Section 11(9) of the act states that *the owner of an apartment must notify the administrator or the association without undue delay of changes in the number of persons using an apartment continuously for at least two months. If the owner is not using the apartment, they must notify the administrator or the association of their address and any change in it.*

Although it may appear that if changes in the number of persons using an apartment are not reported, the number of person months cannot be adjusted retroactively, the opposite is true because the legal norm cited above is imperfect (specifically a regulatory legal norm) and does not specify a sanction for breach of the above obligations. The situation may differ, however, if the owners define a sanction in this area in the management contract (private law may derogate from the act in this matter) and thus make it impossible to change person months retroactively. A separate issue is the verifiability of the data that the owners report to the administrator and the detection rate for incorrectly reported data.

Regarding the allocation of costs, it must be added that after the person months are determined for all apartments in the building, they are totalled and the annual costs for supplies and services are divided by the total number of person months (naturally, except in cases where a flat rate is paid per apartment). The result corresponds to the actual costs per person per month, i.e. how much it actually costs for one person to use an apartment (and common areas) for one month. This amount is then multiplied by the reported person months for the specific apartment, the result is subtracted from the amount paid by the owner under the schedule and the final result represents the difference between the settlement of the costs for the specific flat and the actual situation in the form of arrears or an overpayment.

What constitutes the fraud? The fraud involves concealing one or more persons using an apartment in the apartment building and thereby influencing a variable that is critical to the settlement that affects specific personal property rights for the owner. They thus mislead the administrator as to the level of use of common areas and cause an error in the settlement. The owner thus influences the multiplier (number of person months) that the uses in the settlement to multiply the monetary value of one person month (the multiplicand), the result of which is used to determine the final balance of the payments the owner has made to the common account. As a

consequence, the settlement of accounts results in damage to the integrity of the other owners' property because **the fraudulent reporting of a smaller number of person months reduces the total number of person months for the apartment building, increasing the value of costs allocated to one person month while causing the settlement calculation for the offending owner (perpetrator) to be based on a smaller multiplier.** The other owners are thus unfairly forced to bear a larger share of the common costs than they would be if the owner had not cheated when reporting the data necessary for a proper settlement calculation. By reporting false information, an owner manipulates the variable that determines how the costs are allocated. It must once again be emphasised that such unlawful activity of owners is silent and difficult to detect.

The person with primary responsibility for the correctness of the settlement is the administrator (association of property owners) but it is crucial that they cooperate with the owners' representative, who should be a person familiar with the local conditions in the apartment building. This is without prejudice to the necessity of cooperation with the owners, which is important for transparency about apartment use by owners and other authorised persons. Knowledge of local conditions in an apartment building is important because the persons involved in its management (owners, the administrator, the owners' representative, entrance supervisors, owners and other authorised persons) should be aware of facts relevant to building management including information on persons living in the building (or individual entrances). Active participation in the management of an apartment building is crucial for protecting common rights and interests.

The owners' representative and, if present, entrance supervisors, play a key role in monitoring owners' interests and ensuring that the administrator receives truthful information regardless of relationships between neighbours. In this respect, the qualitative aspect of their independent operational activity in building management is critical. An unprofessional approach, resignation or a lack of interest on the part of these persons weakens the protection of rights. On the other hand, a responsible approach in this area can prevent inaccuracies in the settlement of accounts. In dealing with the unlawful conduct described above, the primary task is to satisfy the victims' claims through compensation for damages. The building management takes the first steps to recover damages such as a request for voluntary payment by the owner and only after the deadline for voluntary payment expires without result can it bring legal action for performance (ideally including an application for a payment order). In this way, methods based on persuasion are preferred over coercion. If this procedure is successful, the court will order the owner to pay a reparative penalty (an obligation to pay a specific sum of money) and such an enforceable decision is a lawful instrument permitting enforcement proceedings. The assignment of such claims is of course possible.

Alongside liability under private law, there may be reason to enforce liability under public law through repressive penalties. Whether a detected fraud by an owner ends "only" with the payment of compensation or also with a public law penalty depends on the aforementioned activity of the administrator and the owners in reporting such matters to the public authorities.

3. The qualification of the owners' misconduct

With reference to the criminal law, the activities described above have the constituent elements of criminal fraud under Section 221 of the Criminal Code. A condition is that the deliberate actions of the perpetrator must have caused damage exceeding 266 Euros and the perpetrator's intent exists not only in relation to the damage but also in relation to all the legal elements of the offence. The perpetrator therefore faces a term of imprisonment of up to two years (if the damages are not higher than 2660,10 Euros or if there is no special qualification element given).

If an owner reports to the administrator (either directly or through the owners' representative) an untrue number of person months with the intention of reducing the share of the common costs that they will be required to bear, they are misleading the other owners and the administrator. As a party to the management agreement for their apartment building and the individual contracts for supplies of goods and services (in which the administrator acts

as their legal representative), the owner must be aware of the conditions under which such services are supplied and also that a fraudulent reduction in the share of the apartment building’s common costs that they are required to bear will inevitably cause damage to the other owners – damage to other people’s property. The perpetrator’s motive in such action is personal gain.

Although the owner obtains any financial gain from this conduct from funds in the apartment building’s account in a financial institution (of which the owner is a co-owner), the paid out funds must be covered by the other owners’ payments to this account in proportions based on their own settlement of accounts, which is less favourable for the integrity of their property as a result of the fraud (the sum of money corresponding to one person month is increased and this increase in the value of one person month, caused by the manipulation of the variable used to calculate it, relative to the real situation multiplied by the number of reported person months is the amount of the damage caused). The damage is ultimately only to the integrity of the other owners’ property, even if the owner’s benefit is paid from the common funds of the apartment building.

The perpetrator’s actions may also have some of the special qualification elements under the special qualification conditions. The most common of these will be commission of an offence **with an aggravating factor** by committing the offence **for a longer period of time**. This special qualification is based on the cumulative consideration of the time factor (time aspect) and the intensity and number of the offences against legally protected interests.

If, however, the damage caused by the perpetrator misleading the administrator does not exceed 266 Euros and the perpetrator does not continue the offence, or if partial offences are not linked by a unifying intent, or if the damage of repeated partial offences still does not exceed 266 Euros, they must be prosecuted in proceedings on misdemeanour for an misdemeanour against property under Section 50 of the act on misdemeanour. The perpetrator can be fined up to 331 Euros or given a reprimand, which is appropriate for first offences or offences involving a low amount of damages.

The qualification therefore depends primarily on the amount of damage caused, which also depends, inter alia, on the duration of the offence and the number of persons whose use of the apartment was deliberately concealed from the administrator for personal gain. Another relevant factor is the size of the apartment building in terms of the number of apartments and non-residential units. Where the number of such owners is smaller, the share, or monetary value, of one person month is greater compared to larger apartment buildings. This factor also affects the amount of damages caused.

In order to calculate the damages caused or attempted by the perpetrator, one may follow the following equation:

$$\text{Damages caused by an owner in a particular year} = x - y$$

, where

$$x = \frac{Ct}{TPr} \times RP \quad ; \quad y = \frac{Ct}{TPf} \times FP$$

, where

- Ct** means the total annual costs of the management of apartment building (that are divided and settled)
- TPr** means the **total real number** of annual personmonths (cumulation of reported personmonths from owners)
- RP** means the **real number** of personmonths reported by an owner (without fraudulent behaviour)
- TPf** means the **total fraudulent number** of annual personmonths (lower than TPr due to the owner’s fraud)
- FP** means the **fraudulent number** of personmonths reported by an owner (by which the administrator is misled)

If a perpetrator engages in unlawful conduct on one occasion and does not intend to continue in it, or they continue such conduct but without a unifying intent, the perpetrator will usually only be liable for an **misdemeanour against property**. If there are multiple partial offences, the conduct will probably be qualified as **criminal fraud** (with basic or qualified constituent elements) and if the conditions described above are fulfilled, it will be classed as continuous criminal fraud. The threat of punishment is a much stronger means of deterrence (prevention) than in the case of administrative prosecution because of the range and severity of the penalties, which it is useful to emphasise both in personal communication with owners and in other forms of communication typically used in apartment buildings. Rational decision-making (consideration) may then ask whether the means of enrichment described above is worth the risk.

Another important consideration in the qualification of the conduct described above is the fact that a perpetrator can commit a partial offence only once per year – in the year-end reporting of numbers of person months to the administrator – or when transferring ownership of an apartment or non-residential unit within the apartment building. These numbers (and changes in them) may be reported at other times in the year but the determinative value is the number of person months reported at the year-end, when the administrator's records are confirmed or adjusted (since the legal norm under Section 11(9) is imperfect). . This limits the frequency with which this type of fraud can be committed. The long period between partial offences also reduces the probability that the perpetrator will be detected and held to account.

Regarding the low visibility of this form of fraud, it is important to note that even when it is detected, it is usually not reported to public authorities. Possible reasons for this include fear of damaging relationships between neighbours, fear of retaliation, irresponsibility or inactivity on the part of the administrator or lack of interest on the part of owners concerning events in the building, as described earlier. Confusion about the number of persons using a specific apartment can be significantly increased by the current situation in the real estate market, where low interest rates on bank mortgages (often without efficient consideration of the debtor's creditworthiness) encourage the more frequent purchasing of apartments as investments. In this regard we point out, that by means of credit the individual legal and physical persons have an opportunity to meet their economic and personal needs by overcoming the limits of financial resources and thus credit may facilitate the economic potential of the society (as well as the potential of the legal and natural persons) (Caplinska, A., Tvaronavičiene, M., 2020). The extensive usage of credit in the economy thus results also in the increase of the proportion of investment apartments in apartment buildings, which is associated with significant fluctuations in the persons using the rented apartments (both legally and illegally - without fulfilling the tax and other obligations associated with renting apartments). The most problematic cases in this regard are short-term rentals. There have also been reports in the media where apartments are let in this way to third-country nationals who come for the sole purpose of doing dependent work. The current epidemiological situation and global recession are also relevant factors.

In the opinion of the authors, although the primary aim in the present case is compensation of the victims, liability under public law should not be dismissed out of hand. The imposition of repressive penalties would really motivate owners to refrain from such conduct in future, being aware of its economic disadvantage since the potential cost savings are out of proportion to the risks associated with fraud. Especially if such an offender were fined.

In our view, a fine is the most appropriate punishment for property crime because it impacts an area of the offender's life where their unlawful conduct had or was intended to have its effect – the integrity of the offender's property. The imposition of a fine punishes the offender in the correct area of their life, deprives them of the benefit gained by unlawful conduct and reminds them that the actual effect of unlawful conduct is the opposite of what was intended (instead of material gain, the perpetrator's property is reduced by at least the amount of the

imposed fine). For more detail, see our previous research on this issue (ČENTĚŠ, J., MRVA, M., KRAJČOVIČ, M., 2018, s. 548-549).

4. Proposals de lege ferenda

4.1. On the method of common costs allocation

Our first recommendation is exact **specification and more exact allocation of the management costs of apartment buildings** between the owners in the management contract (given the imperfection of the provisions under Section 11(9) of the act on apartment ownership). We believe that it would be appropriate if the number of person months for each apartment were based on the residence records kept in the residence register by the competent municipal authorities. Monitoring would report the number of persons having permanent or temporary residence in a given apartment. If an owner wished to exclude such a person from the reported number of person months, they would have to properly demonstrate to the administrator that the person did not reside in the apartment or use it during the year (by presenting proof of work abroad, proof of an internship abroad etc.).

There should be a contractual penalty for failure to comply with these obligations, generally a fine, which would motivate owners to comply with the proposed obligations. The management contract would thus establish a rebuttable presumption that every person with registered permanent or temporary residence in a given apartment was also in fact using it for the full duration of their registration in the relevant residence register. It is also necessary to ensure that any fraudulent conduct is not only dealt with under private law but also reported to the public authorities. Holding the responsible owners to account would signal the economic disadvantage of fraud, which is a prerequisite for the offender to refrain from repeating their unlawful conduct in future.

With reference to the moral level of the issue under consideration, it also appear useful to place a notice about proven fraud by any of the owners in the apartment house in the place where notices are usually displayed in the apartment building (usually on a notice board). This would help to achieve an appropriate level of internal shaming and reintegration of the offender and strengthen the deterrent effect that prevents the offender from repeating the fraud in the future.

We agree with Strémy, who (drawing on Braithwaite's theory of reintegrative shaming) identifies balance in the process of reintegrative shaming (involving a reduction of the social status and human dignity of the offender) as the source of its effectiveness. Effective prevention thus requires zero tolerance for crime and a functional process of shaming (m. m. STRĚMY, T., 2010, s. 22 et seq.)

It would also be useful for the owners to incorporate into the management contract an agreement on professional legal representation by a trustworthy person and the authorisation of a lawyer to represent them in selected proceedings (proceedings for damages, criminal proceedings, insolvency proceedings and the like). Likewise, it is worth considering reducing the scope of the administrator's legal representation in the recovery of arrears and damages caused by owners or third parties.

An explicit contractual provision that owners' financial claims will be recovered from a debtor by a professional legal representative would provide effective protection for the owners as joint and several creditors of a specific owner or third party. Although administrators are obliged to comply with professional standards, their legal knowledge is usually not equal to that of a lawyer. Although there has been some improvement in the professional standards of administrators since the adoption of Act No 246/2015 *on apartment building administrators*, their professional accreditation is based on completion of additional vocational training in an accredited training programme lasting at least 90 hours, which, having regard for the content of their profession, can only cover the basic legislation on apartment building management.

Although the costs of legal representation would be paid from common funds on the apartment building's accounts, the debtor would be obliged to reimburse them if they lost the litigation. Legal representation is also important for insolvency proceedings because it increases the protection for owners and strengthens their ability to exercise their rights (by lodging their claims) in insolvency proceedings.

Another change that would naturally be helpful in this area would be the amendment of the legal rule under Section 11(9) of the act on apartment ownership to make it a perfect norm – secured by a sanction. Incorporating a sanction for the breach of the reporting duty (on changes in the number of persons using an apartment), for example the prohibition of retroactive changes in the number of person months, would appear to be a rational and desirable measure (rather on the level of a rebuttable assumption than a legal fiction).

4.2. On owners' claims in insolvency proceedings

The following recommendations aim to eliminate or minimise violations of the law in connection with possible insolvency and strengthen the enforceability of owners' rights in such proceedings. Since the entry into force of Act No 377/2016 there has been an increase in the effectiveness of the collective settlement procedure for the property relations of natural persons who become insolvent, in which the insolvency debtor is relieved of a part of their debts that are an obstruction to the debtor's normal life and represent an economic burden that is often almost unsustainable for the debtor and also have a substantial impact on the debtor's family. The law introduced two alternative collective settlement procedures – insolvency (*fresh start*) or a payment schedule (*no fresh start*). The result of the debt relief proceedings is the extinction of claims (unenforceability of the creditor's subjective right) for a part of the creditors' receivables against such natural persons. Such proceedings can naturally also affect the other owners of an apartment building who are jointly and severally creditors of an owner with arrears for the previously mentioned management costs of apartment building and for damages caused by unlawful conduct.

Several types of claims are covered by a special regime in such proceedings due to their nature. The claims with a special regime can be divided into those that are untouched (or untouchable) claims and claims that are excluded from satisfaction.

In the case of the first group, the legislature recognises that it is inappropriate and undesirable that a certain group of receivables should become unenforceable through the collective settlement of an insolvent debtor's property relations. For the sake of legal certainty, an exhaustive list of these claims is laid down in Section 166c of the act on bankruptcy and restructuring and the continued enforceability of these claims does not prevent them from being exercised by an application in insolvency proceedings. The list includes:

- **a secured claim in the scope in which it is covered by the value of the subject-matter of the security interest,**
- **a claim resulting from liability for damage caused to health or caused by deliberate action, including the accessories of such a receivable,**

The legislation on debt relief is set up in favour owners and their claims, which can be viewed positively. The security of their claims will be considered in relation to damages caused to the owners (as a result of fraud in the influencing the allocation of costs in the apartment building) and in relation to damages caused by the administrator in the management of the apartment building. In the case of the damages, the owners are joint and several creditors in the resulting liability relationship. As a rule, the creditor side includes a large number of parties that have been negatively affected by the unlawful conduct and who are therefore entitled to compensation. This fact must be borne in mind when considering the position of these claims in proceedings under Part Four of the act on bankruptcy and restructuring and also when considering the substantive aspect of the unlawful conduct that caused the damage to the integrity of the owners' property. Depending on the size of the apartment house, there may be tens or hundreds of injured parties.

The claims of owners arising from obligations are protected under the current law. Claims arising from the owner's **legal acts relating to the apartment building**, the common parts and facilities of the building and accessories and legal acts relating to the apartment or non-residential unit in the building are subject to a **statutory security interest** based on section 15 of the act on apartment ownership. They therefore enter into debt relief proceedings as untouched claims and their enforceability does not expire in the debt relief procedure. The full scope of the claims remains enforceable because they are fully covered by the value of the apartment or non-residential unit and the related share of the common parts and facilities of the apartment building, which is the subject-matter of the security interest. At this point, it is necessary to consider the owners' statutory security interest in more detail.

The statutory security interest in the context of the insolvency of an owner - insolvency debtor

In the case of claim resulting from legal acts relating to a building, the common parts or facilities of the building and its accessories, the claim is (as previously mentioned) secured by a statutory security interest for the benefit of the other owners based on Section 15 of the act on apartment ownership.

Although the purpose of this provision may appear clear at first sight as being intended to secure the obligations of the owner of an apartment or non-residential unit in a building, the language used for this purpose is more than problematic. The law states that the statutory security interest applies to **claims having their basis in legal acts**. The failure to comply with obligations related to payments connected with the use of an apartment is not, however, a legal act but (in terms of the differentiation of legal facts) unlawful conduct. Excluding unlawful conduct and unlawful states and the claims that they give rise to from the statutory security interest established by Section 15 of the act on apartment ownership would be illogical. On the other hand, their inclusion under this statutory security interest is manifestly contrary to the wording of the hypothesis of the legal norm as defined in the relevant legislative provision. A legal opinion according to which this statutory security interest covers not only claims arising under Section 9(2) of the act on apartment ownership but also claims arising from illegal acts, illegal situations and contractual and non-contractual liability can also be found in the professional literature (Strapáč, P., Ďurana, M., Sninčák, T., Sura, S., Takáč, J., Treščáková, D., Skorková, V., 2018, P. 318). This Interpretation Of The Act On Apartment Ownership Is, However, Very Extensive, Which Could, In Certain Circumstances, undermine the legal certainty of the addressees of the legislation and thus also reduce the effectiveness of the legislation (E.g. in the event of a dispute between the owner of an apartment or non-residential unit and the other owners). In the event of the insolvency of a debtor that is the owner of an apartment or a non-residential unit, this relative lack of clarity in legislation could lead to unnecessary delays in the proceedings as a result of the threat of litigation.

If other owners have claims (for the reasons set out above) and insolvency proceedings are opened relating to the debtor's assets, the creditor is entitled to lodge their claim in the insolvency proceedings regardless of whether the apartment owner against whom they have their claim is a natural person (by far the more common case) or a legal person. Since the owners' claim against a neighbour in insolvency proceedings is secured by a statutory security interest, they should always lodge the claim within 45 days from the opening of insolvency proceedings. Otherwise, although they would not be deprived, as a matter of law, of their entitlement to satisfaction of their claim(s), their position would be weaker because after this deadline, it is no longer possible to lodge a claim as a secured claim but only as a claim to be satisfied from the general estate of the insolvency debtor. This procedure is logical and provides for a more equal status of all the creditors with claims against the insolvency debtor. Although this issue may seem clear at first sight, there are a number of issues in the application of the legislation regulating the satisfaction of owners' claim(s) against a debtor in insolvency proceedings that cause practical problems, namely:

1. by whom and by what means can a claim be lodged in insolvency proceedings relating to the debtor's assets and in what order should the claim be satisfied?

2. given that a claim in insolvency proceedings does not expire but only becomes unenforceable, in the event of the incomplete satisfaction of the owners' claim, can the administrator or the chair of the association of property owners issue confirmation to the insolvency trustee for the auction of the apartment or non-residential unit stating that the owner of the apartment or non-residential unit in the building has no arrears for payments for services relating to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund? And is the issuing of such confirmation at all relevant and can the insolvency trustee transfer ownership of the apartment or non-residential unit in the building to a person who acquires it (usually through auction) in the insolvency proceedings even without such confirmation of the non-existence of arrears?

The answer to the first question is not at all simple even though it may appear banal at first sight. It is true that an association of property owners or an administrator is obliged, under the act on apartment ownership to monitor the debts of individual owners and to enforce their payment. Where the law is unclear is on the point of whether they do so in their own name and for the owners' account or in the owners' name and for their account. Section 9(7) of the act on apartment ownership stipulates that an association or administrator act in their own name and for the owners' account when representing the owners before courts and other public authorities.

Under Act No 8/2005 on trustees and amending certain acts, however, acting as a trustee in debt restructuring and insolvency proceedings is not acting as a public authority (as is the case in enforcement proceedings, for example).

The above means that the association of property owners or administrator should probably exercise claims against a debtor in insolvency proceedings in the owners' names and for their account and act only as their legal representative in accordance with the first sentence of Section 9(7) of the act on apartment ownership.

This conclusion unfortunately leads to clearly completely unnecessary complications because then the creditors lodging an application should be all the owners in whose name and for whose account the association of property owners or the administrator is acting, although it is the latter who submits the application to the insolvency trustee. This is an absolutely unnecessary complication that imposes an unreasonable burden on the association of property owners or the administrator and subsequently also on the insolvency trustee and even the court (which should always issue a decision whenever the person of one of the creditors changes, permitting the entry of a new creditor in place of the previous one, which is an occurrence that happens (by direct operation of law) whenever ownership of an apartment or non-residential unit in the building changes). Given that even the application form (specified by Decree of the Ministry of Justice of the Slovak Republic No 665/2005) does not permit the entry of all the owners, the procedure tends to be simplified in practice by only the association of property owners or the administrator appearing in a claim lodged in insolvency proceedings. This procedure, which insolvency trustees usually accept (thus not denying the lodged claims), is not lawful, however. Proceeding otherwise, however, would cause completely unnecessary complications that would have no effect on the practical outcome of the exercise of the rights associated with the claim lodged in the insolvency proceedings.

In what order should a claim lodged in this way be satisfied? The relevant statutory security interest is recorded in the real estate cadastre regardless of the real existence of a secured claim. It thus serves as security primarily for future obligations of the apartment owner. If another security interest is subsequently registered on the apartment (e.g. under a contract), the claims should be satisfied in the order of their origin.

After the association of property owners or the administrator lodges a claim in insolvency proceedings related to the assets of an insolvency debtor, the claim is satisfied in the insolvency proceedings. The insolvency trustee liquidates the apartment or non-residential unit owned by the debtor as part of the same proceedings using one of two variants.

The first method, which is defined in Section 167n(1) of the act on bankruptcy and restructuring, applies only for the liquidation of an apartment with a smaller value, i.e. a value not exceeding 5,000 Euros as specified in Section 48b of Decree of the Ministry of Justice of the Slovak Republic No 665/2005, and cannot be used for an apartment to which the unenforceable value of the debtor's home has been applied. The method involves selling the apartment as a moveable asset by tender. When applying this liquidation procedure, as part of the drafting of the contract for transfer of ownership of the apartment or non-residential unit, the insolvency trustee must provide confirmation issued by the association of property owners or the administrator that the owner of the apartment or non-residential unit in the building has no arrears for payments for services related to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund. The law requires the association of property owners or the administrator to issue confirmation that they cannot issue because a claim is not extinguished by the bankruptcy of the debtor. Since only the claim's enforceability expires, the administrator or the chair of the association of property owners cannot issue confirmation to the insolvency trustee for the transfer of ownership of the apartment or non-residential unit stating that the owner of the apartment or non-residential unit in the building has no arrears for payments for services relating to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund. Such confirmation would be evidently untruthful and therefore impossible to issue, and if it were issued it would automatically constitute reason to suppose that the administrator had committed a crime (or been a participant in a crime). It must be added that *"the absence of such confirmation is not an obstacle to the authorisation of the registration of ownership of an apartment or non-residential unit in the real estate cadastre, nor is registration of the transfer of ownership of an apartment in the real estate cadastre blocked by confirmation that the owner of an apartment has arrears"*. (SOPKO, H., 2020) It must however be noted that potential apartment buyers are not interested in buying apartments where there is a risk that the association of property owners or the administrator will seek to make them pay the arrears of a previous owner who has been declared bankrupt and against whom the claim is unenforceable even though it still exists. It is difficult to imagine a person interested in buying an apartment or non-residential unit who (unless they were a complete speculator) would buy such an asset under such conditions.

The second method for liquidating an apartment or non-residential unit in insolvency proceedings related to the property of a natural person (and the method that is much more frequently used) is sale by auction making use, *mutatis mutandis*, of Act No 527/2002 on voluntary auctions. It must be applied for the liquidation of an apartment or non-residential unit of larger value, or for the liquidation of an apartment that is the debtor's home under Sections 167n and 167o of the act on bankruptcy and restructuring. When an apartment or non-residential unit is auctioned, as a rule, a notarial deed is made on the auction, to which is attached, as a rule, a confirmation identical to that mentioned previously that is issued by the association of property owners or the administrator stating that the owner of the apartment or non-residential unit in the building has no arrears for payments for services related to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund. This is a logical course of action because the successful bidder might not be interested in acquiring an apartment or non-residential unit to which liabilities of the previous owner are attached. This issue not only raises uncertainty as to whether the administrator or the association will subsequently seek to recover the claim from the new owner on behalf of the other owners (which ought not to be possible after claims against the insolvent debtor become unenforceable) but has particularly important consequences for the subsequent disposition of the acquired apartment or non-residential unit.

Regardless of the unenforceability of the claim against an insolvent debtor, the claims continue to exist. If the acquirer wants to transfer the apartment or non-residential unit to another person, they must have confirmation issued by the association of property owners or the administrator that the owner of the apartment or non-residential unit in the building has no arrears for payments for services relating to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund, and such

confirmation will not be issued or else confirmation will be issued from which it is clear that the premises are linked to arrears, in which case the premises will be difficult to sell in the real estate market.

In such cases, the association or administrator often proceed incorrectly by appearing to link the debts of individual owners to the ownership of an apartment or non-residential unit (the assets) and not to the person of the specific owner that caused the debt by breaching their legal obligations, and by this incorrect procedure they effectively force owners (regardless of whether they are the insolvent debtor or a person who acquires an apartment from an insolvent debtor) to pay debts for other persons (previous owners who were declared bankrupt). Such behaviour of administrators or associations is incorrect and unlawful but relatively common. It is not limited to claims that become unenforceable as a result of insolvency proceedings. It can also occur when enforceability expires due to possible limitation periods. *“An administrator often only declares a debt without being willing to prove and document it, which is contrary to good morals. If the administrator treats a purchaser at auction as a guarantor (from whom to claim payment of a debt), they are obliged to prove, on request, the amount and structure of the secured claim as they see it. The same applies if the purchaser at auction is regarded as a bond obligor. The refusal to present the accounts for a debt and concurrent claims to enforce a security interest are frequent practices of administrators that are contrary to good morals and professional standards and turn the exercise of a security interest into a form of coercion and bullying.”* (SOPKO, H., 2020).

It is thus evident that an insolvency trustee may sell an apartment or non-residential unit to a third party as part of the liquidation of an insolvency debtor’s property even if the insolvency debtor had arrears as the owner of an apartment, which may result in the non-issuing of confirmation that the owner of the apartment or non-residential unit in the building has no arrears for payments for services relating to the use of the apartment or non-residential unit in the building or for contributions to the operation, maintenance and repair fund, or the issuing of a confirmation indicating the existence of such arrears. This procedure is, however, often linked to incorrect conduct on the part of administrators and associations of property owners, who subsequently seek payment of the debts of previous owners from the acquirer (despite this being against the law) using arguments appealing to the statutory security interest established by Section 15(1) of the act on apartment ownership.

In relation to the problems described earlier, it would be reasonable to amend the current provisions of the act on apartment ownership to state that associations and administrators **represent owners in their own name and for the owners’ account in all matters related to the exercise of their claims against other owners**. This step would rationalise and clarify the procedure of associations and administrators, who have already been acting in this way for some time even though such action is evidently not in accordance with the current law of the Slovak Republic (even though this procedure is already accepted by the majority of trustees because proceeding otherwise would create an unreasonable administrative burden while producing exactly the same result). As regards the problem of the unenforceability of claims lodged in insolvency proceedings that have not been fully satisfied (or not fully satisfied before the sale of the apartment or non-residential unit in the insolvency proceedings) which nevertheless remain in existence despite their unenforceability, it would be useful to consider amending the act on bankruptcy and restructuring to state that after the completion of the debtor’s insolvency proceedings, such debt would not remain as a natural obligation but would be extinguished. Their continued existence as a natural obligation has no practical significance because it is hard to imagine a debtor who, after their discharge from bankruptcy, would start paying their creditors’ unenforceable claims. Another step that it would be useful to consider would be to amend Section 15 of the act on apartment ownership, so that the statutory security interest would not *expressis verbis* secure only claims resulting from legal acts relating to a building, the common parts or facilities of the building and its accessories, but also claims resulting from a breach of obligations by the owner of an apartment or non-residential unit in their building, etc.

Notwithstanding the last recommendation of amendments of the law, it must be noted that damages caused through an offence, including the fraudulent conduct described in the present article, is an untouched claim for its

full amount if the insolvent debtor is a natural person. The law requires that the claim must result from liability for damage caused by deliberate unlawful conduct. In our view, a disadvantage of this provision from the viewpoint of protection of the rights and legally protected interests of owners is that it does not extend untouchability to the claims resulting from liability for damage caused by negligent conduct. Amendment of the list of untouched claims to add damage caused by culpable negligence (or a separate item making untouchable all claims related to the management of apartment buildings) would extend the legal protection of owners legal protection in debt relief proceedings to less serious unlawful conduct where intent is sometimes impossible to prove objectively. It is vital to recall that all such damages are initially covered from the common funds of the apartment building. The provision of increased protection of such claims would be justified by the number of injured parties and the effects of the unenforceability of such claims.

Their unenforceability would negatively affect the management of the apartment building because the purpose of its funds are to provide for the proper renovation and maintenance of the apartment building and to pay the claims of the suppliers of various goods and services necessary for the proper use of the apartments and the apartment building. If these receivables are unenforceable, it may affect the required monthly payments of the owners (since it will be necessary to increase advance payments to the maintenance and repair fund).

We therefore recommend that culpable negligence should be added to the grounds for an untouched claim for liability, which would mean that protection would be provided to claims for all culpably caused damages.

Conclusions

The present article has been concerned with the issue of the fraudulent conduct of certain owners in apartment buildings involving the infringement of the legal obligation to bear a proportionate share of the common costs of the apartment building. This issue has not previously received enough attention. In order to minimise expenses, many apartment owners do not properly report to the administrator or association of property owners for their apartment building the true number of persons using the apartment. Such conduct enables them to save a part of their costs by manipulating the mathematical formula used in the settlement of accounts. The authors' main focus were the practical issues related to the qualification and consequences of such fraudulent conduct including reflection on how the issue affects insolvency proceedings and the rights and standing of owners in proceedings where the insolvency debtor is the owner of a flat or non-residential unit in their apartment building.

The authors draft several proposals *de lege ferenda* to improve and streamline current Slovak legislation. One of the potentially most important changes would be to link the residence records kept by municipal authorities to the records kept by the administrators of apartment buildings and associations of property owners, but it would also be useful to strengthen contractual and other penalties for breaches of reporting obligations that infringe the rights of other owners. The proposed legislative changes could establish a truly effective regime for the prosecution of the perpetrators of such antisocial activities and the protection of owners' property with regard to the insolvency of an owner..

Additionally, the authors consider the enforcement of owners' claims against persons who have not properly fulfilled their obligations and not paid the set contributions to the account of the administrator or the association of property owners for use of an apartment in the apartment building, when such persons enter into debt relief proceedings (as a insolvency proceeding). An analysis of current law reveals several practical problems resulting from inconsistencies in the act on apartment ownership. The authors present several proposals for changes to the law that could improve the protection of the rights and legitimate interests of owners who properly fulfil their obligations related to apartment ownership.

The reader should consider this article in relation to the article *Fraudulent conduct in the management of apartment buildings - a legal perspective* (Krajčovič, M., Čentěš, J., Mrva, M., 2020) published in the *Security and Sustainability Issues journal*, as it contains the legal theory applied to this particular case study.

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