Strata and Community Title in Australia for the 21st Century 2011 Conference

What are the Practical Options to Regulate Long Term Contracts?

Presented by:

Dr Gary Bugden OAM

Chairman

mystrata.com

Contents

1. Introduction

The discussion on long term contracts, and management rights in particular, leading up to this conference has convinced me that there is a need for governing legislation to allow strata or community title bodies corporate to create long term contracts, subject to certain restrictions and safeguards.

Framing these restrictions and safeguards in a way that does not unduly inhibit the ability of bodies corporate to take advantage of long term contracts where they are clearly beneficial to lot owners is the challenge for Government.

In this paper I will canvas the options available to Government in the hope that this may lead to a better legislative response to what is clearly a demand from unit owners and some sectors of the industry for reform in this area of the law. No doubt there will be a legislative response, despite any denials and tactics of the management rights and real estate development sectors by way of opposition. And legislative response there should be, because there are abuses and excesses out there and people are suffering under arrangements that should never have been made.

2. The starting point

Before considering how best to regulate long term contracts it is necessary to understand the problems that are being experienced in relation to them. This includes the problems of all stakeholders, not just unit owners.

Although this topic covers all long term contracts by bodies corporate, the reality is that when one comes to consider the problems they are almost exclusively related to management rights in the traditional Queensland form. Almost all other forms of long term contracts appear to receive little attention from either owners or the regulators. It follows that the problems to be addressed will be substantially related to management rights, although there will always be the potential for them to occur where other long term arrangements are put in place.

So far as the problems are concerned, unit owners may complain about the following matters:

- The imposing of long term management rights where they are clearly inappropriate (e.g. where the units are designed and sold for owner occupation as permanent residences).
- The creation of long term management rights in Class 2 buildings[1] where the building standard should be to a Class 3 standard[2].
- The extension of management rights during the term of existing contracts, so as to extend the expiry date.

[1] Class 2 buildings are those involving 2 or more sole occupancy units (i.e. a standard residential apartment building).

[2] Class 3 buildings are those comprising a common place of long term or transient living (e.g. boarding houses, hotels and motels).

- Developers profiting from the sale of management rights which, some owners say, are "owned" by the body corporate.
- Developers profiting from other long term contracts (such as hot or chilled water outsourcing where a supplier installs equipment to produce a service which owners pay for on the basis of usage, thus reducing capital costs for the developer).
- The terms and conditions of management rights contracts being too biased in favour of the caretaker/manager. In particular:
    - Un-necessary lengthy terms (e.g. 25 years when a substantially lesser term is commercially realistic).
    - The duties are too "soft" and imprecise.
    - A lack of key performance indicators and/or accountability for non-performance.
    - The level of remuneration is too high for the nature of the duties to be performed.
    - No ability to vary the duties and/or remuneration to take change of circumstances into account.
    - Inadequate termination rights for non-performance or other breach.
- Caretaker/managers marshalling the support of investment owners to defeat initiatives of resident owners.

In contrast, developers may complain that:

- In some jurisdictions (e.g. New South Wales) restrictions on long term contracts during the formative stages of a scheme limit their ability to deliver innovative projects, particularly in the tourism space.
- They have a right to profit from selling or trading in all aspects of a development and the application of any fiduciary relationship between the developer and an Owners Association or unit purchasers is inappropriate.[3]
- If they are unable to sell management rights packages many projects will not be economically feasible and may not proceed.

Caretakers/managers may argue that:

- Long term management rights are necessary in order for them to raise the finance they need to acquire the management rights or re-sell the rights.
- Extensions of terms are necessary to enable sale of their management rights because of lending criteria imposed by financiers.
- Long terms promote long term strategies that benefit all owners and give caretakers/managers a financial incentive to perform and present a property in its best light.
- Their investments need to be protected from bodies corporate who unreasonably seek to terminate their contracts.

[3] This relates to the decision of the New South Wales Supreme Court in *Community Association DP No. 270180 v. Arrow Asset Management Pty Ltd & Ors* [2007] NSWSC 527 where the Court ordered a developer who sold management rights to hand over the proceeds of the sale to the Owners Association due to a breach of fiduciary duty the developer owed to the Owners Association.

Finally, financiers of management rights may argue that:

- Long terms are necessary in order to provide them with adequate security for the funding on-site managers require.
- They need to be able to exercise their rights on default by the caretaker/manager without undue interference from bodies corporate.

These are but some of the issues and complaints involving long term contracts and management rights in particular. They need to be expanded and properly analysed before any decisions are made as to which options are most appropriate for the regulation of long term contracts.

3. The options

Before deciding which regulatory options are the most practical it is best to list them all (or as many as possible) and then examine their individual practicability. Also, practicability needs to be considered in the context of desirability, otherwise beneficial long term contracts may fall victim of the chosen regulatory solution.

The options that come to my mind include the following -

(1) Total prohibition of any contract exceeding a specified maximum term (e.g. 3 years or 5 years), which would essentially be a short term.

(2) Total prohibition on developers procuring bodies corporate to enter into long term contracts.

(3) Introducing a pre-approval requirement for long term contracts (including their terms and conditions) by an independent administrative or quasi-judicial body.

(4) Mandating by statute minimum contract terms and conditions.

(5) Introducing a statutory requirement for minimum terms and conditions.

(6) Imposing responsibility on developers for the impact of long term contracts that prove un-commercial for bodies corporate.

(7) Prohibition against an extension of the term of a contract before that term expires.

(8) Prohibition against developers benefiting financially from a long term contract (i.e. a legislative extension of the principle in *Community Association DP No. 270180 v. Arrow Asset Management Pty Ltd & Ors*).[4]

(9) Introducing restrictions on the use of proxies on motions relating to long term contracts.

(10) Imposing a requirement for a special resolution on any matter relating to the execution, variation or termination of a long term contract.

(11) Imposing a requirement for a resolution to be decided by means of a secret ballot.

(12) of restrictions (if necessary by way of offence) on contractors interfering in body corporate decisions relating to their contracts.

(13) Introduction of "contract review" rights in relation to long term body corporate contracts.

[4] [2007] NSWSC 527. Also, see note 1 above.

(14) Imposition of a requirement for all long term contracts to be tendered.
(15) Introduction of obligations for complete disclosure to all purchasers of information (including the full terms and conditions) relating to long term contracts.
(16) Amending existing governing legislation to facilitate and encourage an employment approach in lieu of certain long term contracts (such as management rights).
(17) Introducing a prohibition on permanent occupation of units in buildings designed and intended for short term accommodation.
(18) Prohibiting the creation of management rights in Class 2 buildings.
(19) Introducing a statutory right for a body corporate to "move on" a contractor where the relationship between the contractor and the body corporate has broken down.
(20) Introducing a statutory termination right for bodies corporate where a contractor is not performing.
(21) Introducing a prohibition on "self-renewal" or "evergreen" clauses.

For completeness, each of these options needs to be considered (even if only briefly) before deciding on those that warrant more serious consideration.

4. Total prohibition

This option involves a statutory prohibition on any form of long term contract, which would be defined with reference to a fixed term of say 3 years or 5 years. It would not only prevent the creation of management rights, but would also impact lift service and other maintenance contracts. It would also have the potential to limit opportunities that may arise in the future for bodies corporate to participate in environmental initiatives (e.g. solar electricity generation and carbon trading).

5. Total prohibition during developer control

This option involves a statutory prohibition on developers influencing a body corporate to enter into a long term contract before owners are able to influence the decision. This is the type of prohibition that is already in place in New South Wales where developers are restricted from putting certain management related contracts in place during the "initial period" which extend beyond the holding of the First Annual General Meeting of the body corporate.[5]

There are 2 potential problems with this particular option:

- The developer may be able to circumvent the intent of the restriction. For example, in the case of the NSW provision, at the time of the First Annual General Meeting the developer may still have control of the body corporate and may still be able to procure the body corporate to enter into a long term commitment. Proxies, powers of

[5] The restriction is in section 113(1)(c) of the *Strata Schemes Management Act 1996* (NSW) and the "initial period" is defined in the Dictionary of that Act to mean the period commencing on the day on which the owners corporation is constituted and ending on the day on which there are owners of lots the subject of the strata scheme concerned (other than the original owner) the sum of whose unit entitlements is at least one-third of the aggregate unit entitlement.

attorney and voting covenants may also be used by developers to circumvent a prohibition.

- It may prevent developers from delivering projects that are specifically designed and marketed as special use projects (e.g. strata title hotels or serviced apartments). The prohibition therefore inhibits innovative projects that may otherwise be highly desirable.

6. Pre-approval of long term contracts

This option would require a developer or body corporate (depending on the point in time that the contract is being entered into) to obtain prior approval of an independent body before the body corporate could resolve to enter into the contract. The independent body could be an administrative body, such as a Commissioner, or a quasi-judicial body, such as an adjudicator or tribunal. The relevant legislative provisions should provide guidelines as to the criteria to be taken into account by the approving authority.

This approach is similar to that taken by the Australian Capital Territory where a body corporate cannot enter into a service contract with a period longer than 3 years unless the contract is authorized by special resolution after a "control period" expires **or** each of the following applies[6]:

- The ACT Civil and Administrative Tribunal ("**ACAT**") is satisfied that the contract is reasonably required for the purpose for which the units plan is intended and authorises the contract before any unit in the units plan is sold, or any agreement for sale has been entered into.
- The contract is disclosed by the developer in each sale contract entered into after the contract is made (*stet* – should be after the ACAT authorisation).

The legislation requires ACAT to take the following into account when considering applications for authorisation[7]:

(a) the layout of each building making up the units plan;
(b) whether the units plan is to be used for residential, commercial or other purposes;
(c) the kind of people likely to purchase units in the units plan; and
(d) how management of the units plan is intended to operate.

It would be worth considering one additional factor; namely, the commerciality and general fairness of the terms of the service contract from the point of view of the body corporate.

While this option imposes another approval process for developers, it does have the following advantages:

[6] See section 55K of the *Unit Titles Act 2001* (ACT) and note that "control period" is defined as the period that starts on the day the owners corporation for the units plan is established and ends on the day people other than the developer hold [1]/3 or more of the unit entitlements for the units plan.
[7] Section 55K(5).

- It allows developers to come up with a particular development concept (e.g. a strata title hotel or serviced apartments) and implement that concept, subject only to the required authorisation.
- It provides a degree of oversight for the body corporate.
- It ensures that purchasers are fully aware of the special concept and the contractual arrangements necessary to give effect to it.

7. Minimum contract terms and conditions

This option involves the governing legislation implying particular terms and conditions in all long term contracts. These terms and conditions would supplement the terms of the written contract and contracting out of them would be prohibited. A similar approach has been taken by Queensland where a number of provisions are similar to implied contractual terms. For example:

- Financiers are given protection against management rights contracts being terminated without prior notice, along with an opportunity for exercise of their rights of entry into possession.[8]
- A party to a service contract may require that the terms of the contract relating to functions, powers and remuneration be reviewed and then varied.[9]
- A body corporate may force the holder of management rights to transfer those rights (including any ancillary unit) to a third party.[10]

The above examples are detailed statutory provisions, although the same could be achieved by embodying those provisions in the wording of an implied condition that would be read into every contract.

8. Statutory requirement for minimum terms and conditions

Under this option the legislation specifies the type of provisions that must be included in a contract. It allows the parties to choose the wording of the clauses but imposes the risk of invalidity if the wording is inadequate to meet the requirements. There are no Australian examples of this option, although the option described in paragraph 9 (below) is related to this type of requirement.

In one overseas consultancy I worked on recently I adopted the approach of requiring **<u>all</u>** agreements for the supply of services to a body corporate to include clauses dealing **in every respect** with the following matters:

(a) a detailed description of the services to be provided;
(b) the fee to be charged for those services, which must be a fee competitive with fees obtainable on the open market for similar services;
(c) a means of monitoring and assessing the performance of the service provider;

[8] Section 126 of the *Body Corporate and Community Management Act 1997* (Qld).
[9] Division 7, Part 2 of the *Body Corporate and Community Management Act 1997* (Qld).
[10] Division 8, Subdivisions 1 – 3 of the *Body Corporate and Community Management Act 1997* (Qld).

(d) provision for termination of the agreement for non-performance or other default;
(e) provision allowing the body corporate, on reasonable terms, to vary the services or service levels to be provided, subject to a corresponding adjustment of the fee; and
(f) a prohibition on the service provider seeking or accepting secret commissions or incentives in relation to goods or services to be procured from third party providers.

If the agreement is a long term agreement (which requires prior approval) then additional requirements were applied. A long term agreement is one exceeding 3 years and the additional requirements relate to:

- Clear performance levels and critical performance indicators ("CPI's").
- Ability for a body corporate to terminate if CPI's are not met.
- Any fee escalation provision must be related to market and must not be in the form of a "ratchet clause".
- Where fees are based on a margin over cost, there must be a transparent annual budgeting process with body corporate input.
- Where the contractor sub-contracts, the subcontracting must be by way of tender and any "mark-up" must be reasonable (with any relationship between the contractor and sub-contractor being relevant to what is reasonable).
- Inclusion of a fair dispute resolution process.

Where a supply agreement does not comply with those requirements the body corporate was given the right to make a judicial application for an order:

(i) invalidating the agreement; or
(ii) varying the terms of the agreement.

This provision ensures that a service provider keeps a very keen eye on the need to fully comply with the requirements. Any attempt to exclude or limit the operation of the requirements was invalidated.

9. Imposing responsibility on developers

Under this option the legislation makes developers responsible for any commercial inadequacies in the contractual arrangements. This technique has been used in Queensland[11] where a developer putting contracts in place with service contractors or body corporate managers during a "control period" is under a statutory obligation to exercise reasonable skill, care and diligence and act in the best interests of the body corporate by ensuring each of the following:

(a) the terms achieve a fair and reasonable balance between the interests of the contractor and the body corporate;
(b) the terms are appropriate for the scheme;
(c) the powers able to be exercised and functions required to be performed by the contractor:

[11] Section 112 of the *Body Corporate and Community Management Act 1997* (Qld).

(i) are appropriate for the scheme; and
(ii) do not adversely affect the body corporate's ability to carry out its functions.

Sanctions used in the Queensland provision include an offence under the Act, as well as potential liability for damages.[12]

10. Prohibiting developers from benefiting financially

The *Arrow Asset Management* case[13] is authority (at least in New South Wales) that developers should not profit from sale of management rights or from any other arrangements that impinge on their fiduciary duties to purchasers and/or the body corporate. However, it is possible for developers to get around that problem by making appropriate disclosure to purchasers. It is also possible that the case has limited application in other jurisdictions (although this is unlikely, with the possible exception of Queensland). Therefore, this option involves a legislative provision that prohibits a developer from gaining financially out of such transactions. The provision would be absolute and not capable of being avoided.

A similar provision exists in Queensland where bodies corporate are prohibited from gaining financially or otherwise from the grant of management rights or service contracts.[14]

11. Restrictions on use of proxies

This options involves the imposition of statutory restrictions on the use of proxies for voting on matters related to long term contracts (e.g. grant, extension or modification). Such restrictions were introduced in Queensland many years ago, at least partly in an attempt to curb the power of on-site managers and their supporters at meetings of the body corporate.[15] For example, the restrictions can relate to:

- Limiting the number of proxies a person can hold.
- Limiting the duration (life) of a proxy.
- Disqualifying some people (e.g. building manager or body corporate manager) from holding a proxy.
- Limiting the types of matters a proxy can be used for.

These restrictions can be determined by the legislation itself or left for determination by the body corporate on a case by case basis or generally.

---

[12] Sub-sections (2) and (3) supra.
[13] *Community Association DP No. 270180 v. Arrow Asset Management Pty Ltd & Ors* [2007] NSWSC 527, supra at
[14] Sections 114 & 115 of the *Body Corporate and Community Management Act 1997* (Qld).
[15] See, for example, sections 107, 109 & 110 of the *Body Corporate and Community Management (Standard Module) Regulation 2008 (Qld).*

12. Decision making by special resolution

This option involves the moving of the decision up the chain of decision making, the usual chain being:

1. Body corporate manager.
2. Committee.
3. Ordinary resolution of a general meeting.
4. Special resolution of a general meeting.
5. Unanimous resolution (in some defined form) of a general meeting.
6. Resolution (e.g. special resolution) followed by administrative or judicial type approval.

One has to be very cautious about using a form of unanimous resolution, because they are very rarely procurable. They also give one unit owner an absolute right of veto over a decision irrespective of whether or not that unit owner has a valid reason to exercise their veto.

Generally speaking, a special resolution is difficult enough to obtain to be appropriate for most decisions. However, where something more restrictive is required it is most important to provide a safety valve to guard against misuse by a "rouge" unit owner.

Back to this option; it involves say moving the decision from the committee or ordinary resolution category into the special resolution category. This ensures that the matter is fully considered by an appropriate number of unit owners and inhibits minority groups from pushing the matter through.

13. Secret ballots

This options involves the introduction of a requirement that a particular type of matter can only be decided at a general meeting by secret ballot. Again, the Queensland legislation has used such a requirement; for example where a "code contravention notice" is to be served on a letting agent, body corporate manager or caretaking service contractor it must first be authorised by ordinary resolution decided by secret ballot.[16]

Personally, I do not favour secret ballots because of their complexity. For example in Queensland it takes 4 sections spread over 6 pages[17] to deal with secret ballots and the process is so complex that one almost needs to have a Queens Counsel present at the meeting to ensure the motion is validly passed. And as for the poor voter, they must be totally perplexed as to why so many envelopes have to be involved (other than for the purpose of supporting the stationary providers).

However, I think secret ballots can be considered in the future when technology provides a simple and secure way for them to be conducted.

---

[16] Section 139 of the *Body Corporate and Community Management Act 1997* (Qld).

[17] For example, see sections 88-91 (spanning pages 88-93) of the *Body Corporate and Community Management (Standard Module) Regulation 2008 (Qld).*

14. Restricting contractor interference

Under this option contractors would be prohibited from interfering in relevant decision making processes by unit owners. For example, they could not "campaign" among owners for a particular outcome, the most effective sanctions being a monetary penalty and invalidation of the process.

15. Contract review rights

This option involves a statutory process for review of the terms of contracts. While traditionally the common law has not been keen to interfere in the terms and conditions of freely negotiated contracts, in recent times such interference by the legislature has become more common. Initially, this took the form of implied terms or prohibited conduct. But more recently, mechanisms have been used to allow Courts to examine the terms of a contract and, under certain circumstances, to change those terms. For example, contracts review legislation has been in force in New South Wales since 1980 under which Courts may review "unjust" contracts or unjust provisions in contracts.[18]

Most recently, the Australian Parliament in 2010 introduced *The Australian Consumer Law* that allows review of certain standard form contracts.[19]

This option would be particularly appropriate where the contract has not been freely negotiated, as is the case with most management rights contracts.

Again, Queensland has already used this approach in its body corporate legislation.[20] Service contracts between a body corporate and a letting agent are subject to review. However, the review is a private review process that can result in the terms of the contract being changed, subject to appeal to a specialist adjudicator or tribunal.

16. Tendering requirement

This option involves compulsory tendering of all long term contracts. While it will usually ensure that the body corporate obtains the best commercial terms, on its own it does not necessarily ensure that the general terms of the contract are satisfactory. In this respect the body corporate is dependent upon the competency of its own legal adviser (if any).

It is also difficult to "fit" this option into any situation where the developer seeks to secure a long term contract through provisions in off-the-plan unit sale contracts. This is because the point of time at which the sale contract is entered into is well before the time for tendering of the long term service contract. This creates an unresolvable conflict between any purchaser disclosure requirements and the tendering requirements.

---

[18] *Contracts Review Act 1980* (NSW).
[19] Schedule 2 of the *Competition and Consumer Act 2010* (C'wlth), which is the new name of the *Trade Practices Act 1974* (C'wlth).
[20] Sections 144 & 147 of the *Body Corporate and Community Management Act 1997* (Qld).

17. Purchaser disclosure

This options involves statutory obligations for a seller of a unit to make certain disclosures to the purchaser about the long term contract a body corporate has entered into or will enter into under the influence of a developer. A number of jurisdictions already require such disclosure.[21] However, the disclosure is substantially limited to developer disclosure and this means that re-sales of units in schemes where there are long term contracts do not attract disclosure obligations. Ideally, any disclosure regime should include a requirement for all sellers to disclose details of long term contracts.

It is also important to note that disclosure in itself will usually not be sufficient to protect purchasers. This is particularly the case where a range of material has to be disclosed and the information disclosed is substantial. In those circumstances purchasers will often fail to read or absorb the information being disclosed. This is no more evident than in the product disclosure materials banks and financial institutions have to give their customers. It is so lengthy and complex that few if any customers read it let alone understand what they do read.

Any disclosure regime therefore needs to be carefully designed to ensure only the essential information is provided and that it is set out in a way that the purchaser is most likely to absorb and understand it.

18. Encouraging employment option

In the case of management rights and building caretaker roles, an alternative to a long term contract would be for the body corporate to employ a person to undertake the relevant duties. If the person is to be on-site, the options are:

- The caretaker's apartment and facilities could be part of the common property.
- The body corporate could require the caretaker to reside in a unit in the building and pay or subsidise the rent as part of the employment package.
- The caretaker could be required to man the office during specified minimum hours and be available for emergencies outside those hours (an alternative to an on-site residential presence).

Governing legislation throughout Australia is generally not conducive to this type of arrangement, although in most jurisdictions it is not prohibited outright. More to the point, the legislation could actively encourage or facilitate this type of arrangement. For example, it could allow a body corporate to lease a unit within its building (this being prohibited in some jurisdictions). Alternatively, it could require, in certain circumstances, on-site management facilities (including the manager's unit) to be part of the common property.

---

[21] Examples: Section 213 of the *Body Corporate and Community Management Act 1997* (Qld) requires developers selling a "proposed lot" (i.e. a sale off-the-plan) to disclose a range of information, including the terms and certain implications of some long term contracts. Section 206 of that Act also requires disclosure of a range of information by the seller of an existing lot, but the terms of a long term contract are not included in the information. Also, section 31A of the *Unit Titles Act 2001* (ACT) requires a developer selling off-the-plan to disclose information about certain long term contracts.

19. Prohibiting permanent occupation

This option involves the imposition of a restriction on permanent occupation of units within a building. For example, if a building is intended for holiday letting there would be a prohibition on owners and others from permanently occupying the units. Permanent occupation would need to be clearly defined (e.g. occupied by the same person(s) for more than 6 straight weeks or for more than 10 weeks in any one year).

The restriction could be imposed as part of the development approval process. There are examples where this has been done in an attempt to create tourist accommodation.[22] However, monitoring and enforcement becomes a critical factor in ensuring the success of this approach.

This type of restriction ensures that unit purchasers are genuine investors and their units are made available for holiday or short term lettings. If management rights are created in such buildings, then there is a substantially reduced likelihood that conflict about the management rights will develop within the building.

20. Restricting management rights to Class 3 buildings

Class 3 buildings are those designed to standards befitting short term accommodation, such as hotels, motels and boarding houses. In particular, they are better equipped from a fire safety perspective. In contrast, Class 2 buildings are the more conventional residential apartment buildings. Almost without exception, management rights operations are permitted within Class 2 buildings and, arguably, this results in the mixing of permanent resident with transient occupiers. It is this mixing that tends to generate conflict.

The theory is that if management rights were restricted to Class 3 buildings, then it is likely that this mixing of permanent and casual occupiers will be minimized and, thus, the potential for disputes will be minimized. It is arguable that this option in itself may not be all that effective and it may be preferable to combine it with a prohibition on permanent occupation (vide item 19 above).

21. Contractor "move on" rights

This option involves the conferring of a statutory right upon a body corporate in the event of a serious dispute with a long term contractor to "move on" that contractor (i.e. force the contractor to assign their interest in the contract to a third party reasonably acceptable to the body corporate). The presence of this right can be valuable because:

- It incentivises the contractor to perform and avoid a dispute with the body corporate.
- In the event of a dispute, it incentives the contractor to resolve that dispute promptly.

[22] Peppers Resort in the Salt Village, on the Far North Coast of New South Wales.

One difficulty with this option is that it is weighted in favour of the body corporate and can operate unfairly against the contractor. To avoid this the provision must specify a fair process before the right can be invoked by the body corporate.

Again, Queensland has introduced this type of provision in relation to management rights contracts.[23] However, it is only applied in relation to contraventions by the contractor of a statutory Code of Conduct and before the right can be exercised a Code Contravention Notice must be issued by the body corporate and the contractor must have failed to remedy the breach specified in the notice.[24]

22. Statutory termination rights

This option involves the conferring of a statutory right of termination by the body corporate in certain circumstances. This statutory right would operate in addition to any right conferred by the contract itself. The right is usually framed in the same terms as a balanced contractual default and termination clause. This option would not be necessary if all long term contracts contained fair default and termination clauses.

Yet again, Queensland has adopted this option in relation to management rights contracts. The Queensland provisions are very extensive and cover termination in a range of circumstances, namely[25]:

- By agreement of the parties.
- For conviction of certain offences (e.g. fraud, dishonesty, assault).
- For failure to comply with a Remedial Action Notice (which is similar to a contractual notice requiring rectification).

23. Prohibiting "evergreen" clauses

An "evergreen" clause is a clause in a contract that effectively ensures that the contract is perpetually renewed. They are sometimes used as a technical device to overcome term limitations (i.e. restrictions on the duration of a contract). For example, the contract may be for a term of 5 years with provision for it to be automatically renewed at the end of the term until such time as it is terminated. The termination provisions are usually drafted in favour of the contractor to ensure that there is no termination unless the contractor agrees.

There is an argument that, at common law, such agreements are terminable upon reasonable notice. However, the law is not certain in this regard and in the rare number of cases where these clauses have existed the issues are most likely resolved by negotiation rather than by litigation.

In some overseas jurisdictions, particularly in some of the United States jurisdictions, the law prohibits such agreements. I am only aware of one such agreement having been put in

[23] Section 138 of the *Body Corporate and Community Management Act 1997* (Qld).
[24] See section 139 of the *Body Corporate and Community Management Act 1997* (Qld).
[25] See sections 126 to 129, inclusive, of the *Body Corporate and Community Management (Accommodation Module) Regulation 2008* (Qld.).

place in Australia and that related to an integrated resort in Queensland where the body corporate managers agreement (which pre-dated term restriction provisions) was perpetually renewable. After many years that matter was resolved by negotiation. However, this approach to long term contracts is contrary to good public policy and should be avoided. Where it is likely to be a problem it should be prohibited.

24. An interesting observation!

It is interesting to note from reading the above options for regulating long term contracts that in a substantial number of cases Queensland has previously adopted the option in some form or another in relation to management rights contracts. Furthermore, the options have been adopted progressively, obviously in an attempt to resolve particular problems that have arisen periodically in relation to management rights contracts.

This suggests that many of the options have not been effective in overcoming those problems, with the result that some other option is then adopted in a further attempt to find solutions.

This highlights the need to ensure that a legislative option is going to be effective to resolve the particular problem before it is introduced, otherwise it has the potential to add complexity and uncertainty to the day to day operations of the body corporate without adding value. An objective examination of the Queensland legislation may lead one to conclude that this has been the case in relation to a substantial number of the changes made by the legislature in an attempt to overcome problems relating to management rights contracts.

25. Protecting existing rights and obligations

The final point that needs to be made in relation to legislative options for control long term contracts concerns the need to protect existing rights. This means that legislation having a retrospective effect should generally be avoided if it interferes with existing and valid contractual rights and obligations. That is not to say that it should be entirely avoided – it really depends upon the extent to which existing rights are impacted. This is best explained using two examples:

1. The implying of a fair default and termination provision in an existing contract that does not limit the operation of any existing such provision would not generally be objectionable.
2. The removal of an option to renew from an existing contract where that option was validly included at the time the contract was made, would be objectionable.

Each case of proposed retrospectivity would need to be examined on its merits, preferably with the objective of reasonably preserving existing rights to the maximum extent.

26. Concluding remarks

In conclusion, the following points are worth contemplating:

1. There is a wide range of options available to Government to regulate long term contracts and they need to be selected carefully to ensure that they:
    a. will resolve the problem being experienced; and
    b. do not add un-necessary complexity to the legislation and/or the administration of the body corporate.
2. In determining "practicability" my tests would be:
    a. the likelihood that it will solve existing problems and minimize future problems;
    b. the extent to which it impacts on existing rights and obligations;
    c. its impact on the day to day administration of the body corporate (i.e. the complexity it adds to the legislation); and
    d. the broader impact that the provision will have (i.e. the broader public interest).
3. A combination of two or more options may be necessary to achieve the desired outcome.
4. An option that I believe should be avoided is an absolute prohibition on all forms of long term contracts, because this will, in time, prove to inhibit the strategic management opportunities available to bodies corporate.
5. In my opinion, of all the options identified the ones that can truly be described as "practical" are the following:
    a. Item (3) - Introducing a pre-approval requirement for long term contracts (including their terms and conditions) by an independent administrative or quasi-judicial body;
    b. Item (5) - Introducing a statutory requirement for minimum terms and conditions;
    c. Item (8) - Prohibition against developers benefiting financially from a long term contract;
    d. Item (13) - Introduction of "contract review" rights in relation to long term body corporate contracts;
    e. Item (15) - Introduction of obligations for complete disclosure to all purchasers of information (including the full terms and conditions) relating to long term contracts;
    f. Item (16) - Amending existing governing legislation to facilitate and encourage an employment approach in lieu of certain long term contracts (such as management rights); and
    g. Item (17) - Introducing a prohibition on permanent occupation of units in buildings designed and intended for short term accommodation.
6. In a "Greenfield" situation, in my opinion, the approach that warrants careful consideration would involve a combination of the following:

a. Item (3) - Introducing a pre-approval requirement for long term contracts (including their terms and conditions) by an independent administrative or quasi-judicial body;
b. Item (5) - Introducing a statutory requirement for minimum terms and conditions;
c. Item (8) - Prohibition against developers benefiting financially from a long term contract; and
d. Item (15) - Introduction of obligations for complete disclosure to all purchasers of information (including the full terms and conditions) relating to long term contracts.

7. As regards the prohibition of permanent occupation of units in buildings designed and intended for short term accommodation, in my opinion this is an option that warrants serious consideration. While this would make it more difficult for developers to market the units (because the range of potential buyers would be reduced) it would ensure that like minded people become owners, which is likely to result in a more harmonious community. It is interesting to note that this was the intention behind the four modules in the 1997 Queensland legislation.

The Accommodation Module[26] was designed to apply to buildings where permanent occupation was prohibited, so that the building could operate as a dedicated short term accommodation facility. During the course of public consultation this concept was watered down and the principal adopted was that permanent occupation would be "discouraged". Hence, the original Warning Statement that told potential purchasers that the building was not intended for permanent occupation. Over time, the Module was further watered down and eventually it because virtually the same as the Standard Module[27] and the direction in the Warning Statement about permanent occupation was totally removed.

With the benefit of hindsight, had the original intention behind the Accommodation Module been implemented back in 1997 the likelihood is that:

- Many of the management rights problems experienced in Queensland in the past 20 years would not have occurred.
- Most, if not all, of the detailed and complex amendments to the Queensland legislation would not have been necessary and that legislation would be more workable than is currently the case.
- The standard of holiday apartment accommodation in Queensland would be of a higher standard (because the common interest of investment owners would most likely have ensured uniformity in offerings within buildings and appropriate levels of maintenance and renewals).

Gary Bugden
1 August 2011

[26] *Body Corporate and Community Management (Accommodation Module) Regulation 2008* (Qld.).
[27] *Body Corporate and Community Management (Standard Module) Regulation 2008* (Qld.)