Impact of Recent Amendments on the Preparation of Community Title Sale Contracts

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Gary Bugden[1]

PART A - PRELIMINARY

1 Introduction

1.1 This paper deals with the difficulties of preparing a contract for the sale of a lot or proposed lot in a community titles scheme since the commencement of the substantive provisions of the *Body Corporate and Community Management and Other Legislation Amendment Act 2003* ("**Amendment Act**") on 4 March 2003. The Amendment Act amended the *Body Corporate and Community Management Act 1997* ("**BCCM Act**") and certain other Acts.

1.2 For the sale of existing lots, it is assumed that the current version (Fourth Edition) of the standard REIQ sale contract ("**Contract**") is being used. That version was recently replaced by new "split" versions of commercial and residential community title sale contracts. However, those versions were withdrawn shortly after their release and, as at today, the current version is still the Fourth Edition. That Fourth Edition will eventually be replaced by the 2 split contracts. However, from what I have seen the new contracts appear unlikely to affect the content of this paper.

1.3 The focus will be on the community title aspects of contract preparation rather than other matters, such as the *Property Agents and Motor Dealers Act 2000* ("**PAMDA**").

1.4 At the outset it should be appreciated that the primary objective in preparing a community title sale contract on behalf of a seller is to ensure, so far as possible, that the buyer will be bound by it and will not be able to cancel it or make a claim for compensation from the seller. This objective is particularly important where the seller of an existing lot is entering into an unconditional concurrent purchase contract.

1.5 On the other hand, a buyer needs to know exactly what they are buying into. Of course, this involves the property (or lot), the common property and the automatic "membership" of the body corporate. It is the membership of the body corporate and the implications of that membership that are critical for the buyer of an existing lot in a community titles scheme. Therefore, before proceeding to look at the contractual issues in any detail, it is important that we have a clear understanding of the implications of body corporate membership.

2 Body corporate membership

2.1 Most lawyers would be concerned if they were asked to act for a client who wanted to acquire membership of an unlimited liability company. Indeed, most clients would not proceed with such an acquisition if they were aware of the implications of such membership. Yet, the reality is, that a person buying a lot in a community titles scheme is effectively acquiring (in addition

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to their interest in the lot and common property) membership of an unlimited liability company – the body corporate. I will explain briefly how this arises.

2.2 The common property is owned by the lot owners as tenants in common in shares proportionate to their interest schedule lot entitlements.[2] Body corporate assets are owned beneficially by the body corporate.[3] The body corporate must administer the common property and body corporate assets for the benefit of the lot owners.[4] In doing this it can enter into contracts, deal with property (including the common property) and employ staff.[5] It can sue and be sued for rights and liabilities related to the common property as if it were the owner of the common property and, in some cases, as if it were the occupier of the common property.[6] The body corporate can also be the subject of an order by an adjudicator under Chapter 6 of the BCCM Act.

2.3 Clearly, the body corporate needs to be funded in order to function in the intended way. The financial arrangements set out in the BCCM Act start with the preparation of a budget to 2 funds, an administrative fund (for recurring expenses) and a sinking fund (for expenses of a capital nature).[7] The body corporate then uses these budgets to fix the contributions to be levied on lot owners[8] and then levies the contributions on the owners.[9] Those contributions (together with penalties and interest) are recoverable by the body corporate as a debt.[10] The body corporate is entitled to continue to levy contributions until it has sufficient funds to pay its debts (e.g. in circumstances where only some lot owners are paying their contributions). If the body corporate does not raise sufficient funds to discharge a liability, the creditor can apply to the Court for appointment of an administrator to perform the body corporate's functions.[11]

2.4 This means that a lot owner must, out of their personal financial resources, contribute to discharge the unfunded liabilities of the body corporate. Furthermore, the contribution may not be restricted to their share. In the event of some owners being unable to contribute, the wealthier owners may be confronted with the prospect of having to contribute more than their fair share because of the need for additional contributions to be levied.

2.5 So, what can an owner do to escape this liability? They could sell their lot, if they can find someone who is prepared to buy it. But that may not achieve the desired result because they will be liable jointly and severally with the new owner for contributions payable at the time of change of ownership.[12] They can influence the body corporate to do nothing in the hope that the problem will go away, but the creditor will then apply for the appointment of an administrator. They can, in conjunction with the other owners, bring about a termination of the scheme and dissolution of the body corporate, but the liabilities of the body corporate will then be vested jointly and severally in the former owners, subject to certain contribution rights.[13]

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[2] Section 35(1) of the BCCM Act.
[3] Section 45(1) of the BCCM Act.
[4] Section 94(1)(a) of the BCCM Act.
[5] Sections 35(6) and 95(1) of the BCCM Act.
[6] Section 36.
[7] Section 152(a) of the BCCM Act and section 94 of the Standard Module.
[8] Section 95(1) of the Standard Module.
[9] Section 96 of the Standard Module.
[10] Section 99 of the Standard Module.
[11] Section 300 of the BCCM Act.
[12] Section 99(2) of the Standard Module.
[13] Section 81 of the BCCM Act.

2.6 The net effect of all these provisions is to roughly equate the status of the body corporate (from a members perspective) as equivalent to that of an unlimited liability company. And that justifies the earlier statement that a person buying a lot in a community titles scheme is effectively acquiring (in addition to their interest in the lot and common property) membership of an unlimited liability company.

2.7 It is on that basis that we now proceed to consider the contractual issues associated with the sale of an existing community title lot. We are in a better position to understand why some of the legislative provisions (which at first sight appear draconian) have been enacted.

2.8 Clearly, this is less significant for the buyer of a proposed lot, because, at the time of taking title, the body corporate has not been "trading' for very long.

3 Information Sheet and Warning Statement

3.1 It should hardly be necessary at this late stage to mention the need for a Warning Statement and Information Sheet to be attached to the Contract, but for completeness I will cover it briefly.

3.2 The approved form of Information Sheet is required by section 206(5) of the BCCM Act to be attached to the contract as a first or top sheet. The approved form of Warning Statement is required by section 366 of PAMDA to be attached as the first or top sheet of a "relevant contract". A relevant contract is one for the sale of residential property in Queensland, other than a contract formed on a sale by auction.[14]

3.3 The seller is taken to have complied with section 206(5) if:

- the lot the subject of the contract is residential property; and
- the Information Sheet is attached to the contract immediately beneath the Warning Statement.

3.4 Two important points need to be noted:

- The approved forms of Information Sheet and Warning Statement change from time to time. Therefore, care needs to be taken to ensure that the latest version is used. There was an unexpected change recently when administration of the BCCM Act was transferred from Department of Natural Resources and Mines to Department of Tourism, Racing and Fair Trading. A number of contracts have the wrong Information Sheet as a result. **Always check the relevant Department's web site before deciding on an Information Sheet or Warning Statement.**
- If a contract relates to a non-residential lot or a sale by auction, then the Warning Statement should be omitted and the Information Sheet should be the first or top sheet of the contract. If you do not do this, then section 206(5) of the BCCM Act will not have been complied with and the contract **may be at risk.**[15]

[14] See definition of "relevant contract" in section 364 of PAMDA.
[15] See discussion in paragraph 4.4 to see why I have used "may".

PART B – EXISTING LOT CONTRACTS

4 Disclosure statement

4.1 Before a buyer enters into a contract relating to an existing lot, section 206(1) of the BCCM Act requires the seller to give the buyer a "statement" (commonly referred to and in this Part of the paper referred to as a "**Disclosure Statement**") that complies with section 206(2) to (4). The Disclosure Statement deals with the following subject matter:

(a) details of the secretary of the body corporate and, if a body corporate manager is responsible for issuing information certificates, the body corporate manager;

(b) annual contributions payable by the lot owner;

(c) if the seller is the original owner and the contribution schedule lot entitlements are not equal, the reason for them not being equal, as stated in the community management statement;

(d) improvements on the common property for which the owner is responsible;

(e) listing of body corporate assets **required** to be recorded on the register;

(f) identifying the regulation module applying to the scheme;

(g) information about whether there is a committee of the body corporate, or whether the body corporate manager is engaged to perform the functions of the committee; and

(h) other prescribed information (of which there is none at this stage).

4.2 Items (c) and (g) were added by the Amendment Act. No doubt the REIQ Disclosure Statement in the Contract will be reviewed to incorporate these additional items, but in the meantime, you will need to be careful to ensure that they are added.

4.3 Like most of these provisions there is always a "catch". The obvious one here is the requirement to disclose the body corporate assets. The assets to be disclosed are not those that are recorded on the register, but those that are **required** to be recorded on the register. This means that your body corporate records inspection (or any disclosure information sold to you by a body corporate manager) may not give you the information you need and you may have to obtain express instructions from the seller.

4.4 This is where the first opportunity arises for the buyer to cancel the contract. Section 206(7) of the BCCM Act provides (emphasis added):

> *The buyer may cancel the contract if:*
> *(a) the seller has not complied with subsections (1) **and** (5); and*
> *(b) the contract has not already been settled.*

However, the buyer's right to rescind is by no means clear. Use of the word "and" suggests that the seller must fail to comply with both the Disclosure Statement requirements and the Information Sheet requirements before the buyer can rescind. One can argue that the legislature probably intended to use "or" instead of "and", but that may be a difficult argument to win. This involves the question of purposeful interpretation.

4.5 Under the principles of purposeful interpretation the Courts may have regard to the purpose of a particular legislative provision and not give the words being interpreted a meaning that would defeat that purpose. A Court may prefer a construction that achieves the legislative purpose rather than one that frustrates that purpose. *New South Wales –v- Macquarie Bank Limited*[16]; *Nokes –v- Doncaster Amalgamated Collieries Ltd*[17]. To some extent this is given statutory sanction in Queensland by section 14A of the *Acts Interpretation Act 1954*. Despite this, the Courts will still apply the ordinary and grammatical meaning of words unless to do so would give them a meaning that was clearly not intended. *Kingston –v- Keprose Pty Ltd*[18]; *Mills –v- Meeking*[19]; *Cooper Brookes (Wollongong) Pty Ltd –v- Commissioner of Taxation (Cth)*[20] and *Cattow –v- Accident Compensation Commission*[21].

4.6 So far as reading "or" for "and" is concerned, there have been occasions where a Court has been prepared to do this. See *Re the Licensing Ordinance*[22] for an examination of the authorities. However, generally speaking, it is clear from the authorities that the Court would need to be satisfied that the legislature had made a mistake and the result would be absurd or unintelligible if "and" was given its natural meaning. See *R. –v- Oakes*[23]; *Barker –v- Barker*[24] and *Re Trade Practices Tribunal; Ex parte Tooheys Ltd*[25].

4.7 I think it is most likely that the Court would give the word "and" in section 206(7) its ordinary and grammatical meaning. There is no need to give it another meaning to ensure the provision is not absurd or unintelligible. It is arguable that to give a buyer the right to cancel for one rather than both failures is too harsh and the legislature may well have intended that both sets of circumstances exist before a cancellation right arises. If section 206(7) is to be given its ordinary and grammatical meaning, then mere non-compliance with either sub-section 206(1) or sub-section 206(5), will not give the buyer the right to cancel the contract.

4.8 That brings me to the next issue; what constitutes non-compliance with section 206(1)? For example, what if you relied upon the body corporate's asset register to list the body corporate assets and it turned out that a couple of significant assets were missing from the register? Does this mean that you have failed to comply with sub-section (1)? You certainly would not have strictly complied with section 206(2)(e).

4.9 Section 206(4) of the BCCM Act says the Disclosure Statement must be "*substantially complete*". Section 206(8) says the seller does not fail to comply with sub-section (1) "*merely because the statement, although **substantially complete** as at the day the contract is entered into, contains **inaccuracies***" (emphasis added). These subsections raise the question whether,

[16] (1992) 30 NSWLR 307 (CA)
[17] [1940] AC 1014
[18] (1987) 11 NSWLR 404
[19] (1990) 169 CLR 214
[20] (1981) 147 CLR 297
[21] (1989) 167 CLR 543
[22] (1968) 13 FLR 143 at pp. 146-7
[23] [1959] 2 QB 350
[24] (1976) 13 ALR 123
[25] (1977) 16 ALR 609

notwithstanding insufficient disclosure (as with the body corporate assets example) or inaccurate disclosure, section 206(1) has been complied with.

4.10 While the words "substantially complete" have been considered in a number of contexts, no definite meaning is clear. However, a number of principles emerge from the cases. First, to talk about something being "substantially complete" implies that something is outstanding. *Bowery –v- Babbitt*[26]. The term "substantially" connotes "in the main" or "essentially" per Ambrose J. in *Re Bonny*[27]. Substantial completion would also involve completion to an extent necessary to achieve the purpose of the legislative provision *Aetna Cas. And Sur. Co. –v- Butte-Meade Sanitary Water District*[28].

4.11 A requirement for there to be "substantial" compliance with legislative formalities indicates an intention to allow a degree of discretion. When the term is used in a quantitative sense it does not necessarily mean "most", but may mean only "much" or "some" *Terry's Motors Ltd –v- Rinder*[29]. See also *Re Cashin*[30]. Dean J. in *Tillmanns Butcheries Pty Ltd –v- Australasian Meat Industry Employees Union*[31] observed that "*substantial is a word calculated to conceal a lack of precision*". In a relative sense substantial means considerable *Radio 2UE Sydney Pty Ltd – v- Stereo FM Pty Ltd*[32].

4.12 That brings me to the issue of "inaccuracy". To be accurate a thing must be "conforming exactly with the truth or with a given standard"[33]. There is nothing in Chapter 5, Part 1, of the BCCM Act (which is the Part we are concerned with) that would suggest that anything other than the ordinary meaning of "inaccurate" should apply. Therefore, if it fails to conform because something is missing or something is incorrect, then, it can be said to be inaccurate.

4.13 All of this suggests that minor omissions or minor errors will not necessarily result in section 206(1) not being complied with. This is particularly so where they are not material to the interests of the buyer in the context of the overall transaction. In turn, this makes it even more difficult for a buyer to rely upon section 206(7) to cancel the contract. At least the risk for a buyer is such they would need to be clearly prejudiced or very desperate to attempt a cancellation under these disclosure provisions. In any event, we will see later in this paper that there are likely to be far more attractive opportunities for the buyer to cancel the contract.

4.14 Before leaving these disclosure provisions it is important to note that section 208 of the BCCM Act says the buyer may rely upon the information in the Disclosure Statement as if the seller had warranted its accuracy. It follows that, in most cases, the buyer's only clear remedy under these provisions may be an action for damages for breach of warranty, if damages have in fact been suffered.

5 Seller's contractual disclosure

5.1 By "Seller's Contractural Disclosure" I mean the "Seller's Disclosure" page at the back of the Contract. This is where body corporate related information is disclosed by the seller to protect

[26] 99 Fla. 1151
[27] [1986] 2 Qld R 80 at 82
[28] 500 F.Supp 193
[29] [1948] SASR 167 at 180
[30] [1992] 2 Qld R 63
[31] (1979) 42 FLR 331 at p.348
[32] (1982) 44 ALR 557
[33] *The Australian Concise Oxford Dictionary*, 3rd Edition.

against warranties that the seller is required by the Contract to give or are implied by the BCCM Act.

5.2 Clause 7.4(2) of the Contract contains a number of body corporate related warranties by the seller. It is in the following terms:

(2) The Seller warrants that, except as disclosed in this contract, at the Contract Date:

(a) *there is no unregistered lease, easement or other right capable of registration and which is required to be registered to give indefeasibility affecting the common property or Body Corporate assets;*
(b) *there is no proposal to record a new community management statement for the Scheme and it has not received a notice of a meeting of the Body Corporate to be held after the Contract Date or notice of any proposed resolution or a decision of the Body Corporate to consent to the recording of a new community management statement for the Scheme;*
(c) *all Body Corporate consents to improvements made to common property and which benefit the Lot, or the registered owner of the Lot, are in force;*
(d) *the community management statement recorded for the Scheme contains details of all allocations that affect the Lot or the registered owner of the Lot; and*
(e) *the Additional Body Corporate Information is correct (if completed).*

5.3 The Additional Body Corporate Information is the information provided in the Reference Schedule of the Contract and it relates to lot entitlements. The provision of this information is voluntary, but if it is given the seller warrants as to its accuracy. As a matter of practice it should always be given.

5.4 Clause 7.4(5) gives the buyer the right, if materially prejudiced, to terminate the contract if:

- a warranty in clause 7.4(2) is not correct; or
- the Additional Body Corporate Information is not completed.

5.5 Pausing there for the moment! If you look at the content of the warranties and the need for the buyer to show "material prejudice" you may form the view that the risk for the seller is not that significant. Conversely, the protection for the buyer is not that good either. Generally, I agree with those views.

6 Stocktake

6.1 If we look at the position so far, it is fair to say that from the seller's perspective, if the Contract and Disclosure Statement are prepared **reasonably competently**, then the chances of a buyer cancelling the contract or succeeding in a claim for compensation as a consequence of the terms of the Contract itself are fairly unlikely. The risks are certainly within an acceptable level for the seller.

6.2 That is not intended to suggest any deficiency on the part of the Contract. The rationale for this approach in the Contract is based on the fact that it compliments the implied warranties in the BCCM Act in favour of the buyer rather than attempting to duplicate or supplement them. This means that we must now look at the implied warranties in the BCCM Act to see the total picture.

7 Warranties implied by the BCCM Act

7.1 When the BCCM Act was originally passed, section 180[34] implied a number of warranties in favour of buyers in all sale contracts. All previous versions of the Contract were prepared with these warranties in mind. Section 180 was substantially amended by the Amendment Act (and subsequently re-numbered as section 223) and the warranties in favour of buyers have been strengthened to the extent where it will now be difficult for a sale contract to be prepared so as to preclude cancellation by the buyer. Strong words, but I think they are justified! These implied warranties are therefore of critical importance when preparing all contracts for sale of existing lots in community titles schemes.

7.2 The implied warranties are in section 223 of the BCCM Act. They are implied in a contract for sale of a "lot". In turn, lot is effectively defined to mean a lot **or proposed lot** in a community titles scheme. However, it will be seen later that the warranties are probably of limited benefit to a buyer of a proposed lot. The most significant warranties are in section 223(2), which reads as follows:

> *(2) The seller warrants that, as at the date of the contract—*
>
> *(a) to the seller's knowledge, there are no latent or patent defects in the common property or body corporate assets, other than the following—*
>
> *(i) defects arising through fair wear and tear;*
> *(ii) defects disclosed in the contract; and*
>
> *(b) the body corporate records do not disclose any defects to which the warranty in paragraph (a) applies; and*
>
> *(c) to the seller's knowledge, there are no actual, contingent or expected liabilities of the body corporate that are not part of the body corporate's normal operating expenses, other than liabilities disclosed in the contract; and*
>
> *(d) the body corporate records do not disclose any liabilities of the body corporate to which the warranty in paragraph (c) applies.*

7.3 In addition, section 223(3) implies a warranty by the seller that, as at the completion of the contract, to the seller's knowledge, there are no circumstances (other than circumstances disclosed in the contract) in relation to the affairs of the body corporate likely to materially prejudice the buyer. This is intended to cover situations such as an administrator being in charge of the scheme or the scheme being in such disarray that the buyer cannot be satisfied as to whether the warranties have been breached.

7.4 The following should be noted about these warranties:

[34] Section 180 is the original section number.

- They have effect despite anything in the contract or in any other contract or arrangement.[35]

- The words "*latent or patent defects*" and "*actual, contingent or expected liabilities*" are very extensive. They really capture everything. They also relate to the body corporate assets (including things like the lawnmower, floating marina and gym equipment).

- While warranties (a) and (c) in section 222(2) are restricted "*to the seller's knowledge*", warranties (b) and (d) are in absolute terms. Therefore, if the body corporate records disclose latent or patent defects, or actual, contingent or expected liabilities of the relevant type, there is a breach of the warranty irrespective of the seller's knowledge.

- Manufacturing defects or defects arising from mistreatment or vandalism may not fall within the "*fair wear and tear*" exclusion.

- For the purposes of the warranties in section 222(2), the seller is taken to have knowledge of the matter if they have actual knowledge or ought reasonably to have had knowledge.[36]

- The only real comfort for the seller arises from the ability to exclude the warranties in respect of defects and liabilities disclosed in the contract. Disclosure is made on the Seller's Disclosure page at the back of the Contract.

7.5 Disclosure therefore appears to be the answer. The problem is knowing what needs to be disclosed. Clearly, the body corporate records need to be inspected before a seller can attempt disclosure. The inspection needs to be done thoroughly, so let's assume you use a competent body corporate records inspection company. When you get the report, how do you decide what needs to be disclosed and what does not? A difficult (and risky) decision indeed! My suggestion is that you insert in each of the first 3 panels of the Seller's Disclosure sheet the words "**All those disclosed or referred to in the annexed body corporate records inspection report**." You then annex the entire report, thus leaving it to the buyer to determine what is relevant and what is not.

7.6 Whatever approach one adopts, it must be understood the potential for a seller to breach these warranties is relatively high, even when the contract has been carefully prepared. Therefore, solicitors acting for sellers (assuming they prepare the contract) should consider advising their clients about the risks involved, particularly where there is a concurrent purchase. That brings us to the nature of the risk.

7.7 Section 224(1) of the BCCM Act allows the buyer to cancel the contract "*if there would be a breach of a warranty established under this part were the contract to be completed at the time it is in fact cancelled*". Cancellation is by written notice to the seller and, in the case of an existing lot, the notice must be given within 14 days after the later of the following happen:

- the buyer's copy of the contract is received by the buyer or a person acting for the buyer (i.e. when the parties are bound under PAMDA); and

[35] Section 222(1) of the BCCM Act.
[36] Section 223(4) of the Act.

- another period agreed between the buyer and seller ends.[37]

Irrespective of any agreement the buyer has 14 days in which to conduct a due diligence on the body corporate.

7.8 The buyer's right to cancel under Chapter 5 Part 3 of the BCCM Act is in addition to, and does not limit, any other remedy available to the buyer for breach of the warranties. Therefore, even if a buyer does not discover the breach within the 14 day due diligence period the seller still faces the prospect of a claim for damages. Alternatively, the buyer may choose to claim damages instead of cancelling the contract.

7.9 There is one other matter that needs to be mentioned. Any breach of the warranties in section 223, no matter how insignificant the amount of money involved and no matter what level of reserve funds are held by the body corporate, can trigger a right of cancellation for the buyer. This is most unfair on the seller and is in contrast of the seller's position before the Amendment Act commenced. The old section 180(3), which was repealed by the Amendment Act, limited the application of the previous warranties (which were not as extensive of the current warranties) where the cost of remedying the defects and discharging the liabilities did not exceed the **total** of the body corporate's available funds and 1% of the purchase price. In my opinion, this was a fair arrangement that should not have been removed.

8 Body corporate due diligence

8.1 The reality is that some form of body corporate due diligence exercise is now necessary for both buyers and sellers of existing lots. No doubt this will slow down the contract preparation stage of the conveyancing process, but this will be unavoidable if the seller is to be protected against contract cancellation.

8.2 The options for a seller's solicitor who is preparing a Contract (or for that matter any real estate agent who is preparing a Contract) are:

- ***First option:*** Assuming the seller has a good knowledge of the affairs of the body corporate, to interrogate the seller (preferably using a comprehensive check-list) about the subject matter of the warranties.

- ***Second option:*** Obtain the information from the body corporate manager or secretary.

- ***Third option:*** Do an inspection of the body corporate records or obtain a body corporate records inspection report from a competent inspection agency that adequately covers the subject matter of the warranties.

- ***Fourth option:*** Following clear advice to the seller about the risks involved, obtain instructions from the seller not to undertake any body corporate due diligence prior to preparing the contract. This would best be done in association with the first option.

I will make a few comments about each of these options.

[37] Section 224(2) of the BCCM Act.

8.3 The first option will not be feasible in most cases because few sellers will have enough knowledge about the affairs of the body corporate to provide sufficient information. Where this option is adopted, a good paper trail should be created and the exercise should be combined with the fourth option.

8.4 So far as the second option is concerned, some body corporate managers charge a fee for providing the information needed to complete Disclosure Statements. To my knowledge, none are prepared to provide the information about defects or liabilities (nor should they). Personally, I have difficulty with the body corporate manager providing information beyond that required by the statute (such as the Disclosure Statement information). First, I think there is a conflict between the manager's duty to the body corporate and the lot owners on the one hand and the person to whom the information is being provided (for a fee that the manager keeps) on the other hand. How can the manager (who is a fiduciary) discharge both duties? Second, I understand most manager's have not made appropriate disclosure to and obtained informed consent from bodies corporate to do what they are doing. Third, if the manager makes a mistake, I am sure the person who suffers a loss as a result will also look to the body corporate for compensation. This would be an issue for that person who would also be a new member of the body corporate. Apart from all that, the fees commonly charged by managers are almost the same as the cost of a body corporate inspection report, yet the information provided is totally inadequate to protect against breach of warranties.

8.5 The third option is the safest. If the inspection is being carried out by a non-professional, care needs to be taken to ensure that all records are made available and that they are properly analysed. In my view, a comprehensive written report from the person inspecting is the best outcome because it can be annexed to the Contract, as previously suggested.

8.6 If the fourth option (with or without the first option) is chosen, then the critical thing will be ensuring that the seller's consent is an informed consent. My suggestion is that the seller be given advice in conference by a qualified solicitor (not a Para-legal) covering the need for the disclosure and the consequences of inadequate or incorrect disclosure. The seller must have a clear understanding of the risks involved. I would then confirm the advice in writing.

8.7 I appreciate that all this impacts on the current practice where Contracts are prepared by real estate agents. I think the reality is that agents will need to either:

- become much more proficient (and organised) in the preparation of Contracts and ensure that they are covered by their professional indemnity insurance; or

- vacate contract preparation in favour of solicitors.

8.8 Turning now to the position of the buyer's solicitor, they are under a duty to determine whether (among other things):

- the provisions of the BCCM Act regarding disclosure and the attachment of an Information Sheet have been complied with; and

- any of the seller's express or implied warranties have been breached.

They must report the results to the buyer and advise them of their rights, as well as any risks involved. It is then the buyer's right to decide what (if anything) they want to do in response. Sometimes they will want to cancel the contract, not because of the breach of warranty, but

rather because they have decided not to buy for other reasons (e.g. because disharmony within the building was subsequently discovered).

8.9 To discharge this duty the buyer's solicitor must undertake a due diligence process in relation to the body corporate. This will necessarily involve the inspection of the records of the body corporate. Arguably, it may also involve a building inspection report, although I note that this is not the current practice in relation to the purchase of existing community title lots.

9 Conclusions so far

My conclusions in relation to contracts for the sale of existing lots are:

(1) The body corporate is effectively an unlimited liability company and a buyer automatically becomes a member of this company when they take title. As a member they are liable to contribute to the unfunded liabilities of the body corporate, with the potential of having to contribute disproportionately to their interest.

(2) The legislature has recognised this by implying extensive warranties in favour of buyers and giving them the opportunity to conduct a due diligence on the body corporate. Breach of these warranties allows the buyer to cancel the contract.

(3) The seller is given the right to protect themselves against buyer cancellation by disclosing any information that might otherwise result in a breach of the warranty. This complicates the Contract preparation phase of the conveyancing process.

(4) The buyer will be concerned to conduct their own due diligence on the body corporate to ensure that the seller is not in breach of the warranties (including express warranties).

(5) There is a real issue as to whether real estate agents should continue to be involved in the preparation of Contracts for the sale of existing lots in community titles schemes.

PART C – PROPOSED LOT CONTRACTS

10. Disclosure statement

10.1 Before a buyer enters into a contract for the sale of a proposed lot, section 213(1) of the BCCM Act requires the seller to give the buyer a "statement" (commonly referred to and in this Part of the paper referred to as a "**First Disclosure Statement**") that complies with section 213(2) to (4). The Disclosure Statement deals with the following subject matter:

(a) the amount of annual contributions reasonably expected to be payable by the buyer;

(b) certain particulars about engagements of a body corporate manager or service contractor for the scheme (i.e. terms and certain cost estimates);

(c) the terms of any authorization of a letting agent;

(d) details of body corporate assets proposed to be acquired by the body corporate;

(e) copes of relevant proposed community management statements;

(f) identification of the relevant regulation module; and

(g) other prescribe matters.

10.2 Three changes were introduced by the Amendment Act that impact on disclosure. The first related to item (b) and that was consequential to the introduction of Codes of Conduct for body corporate managers and caretaking service contractors which become implied as a term of their agreements.[38] While item (b) still requires the terms of any engagement of a body corporate manager or service contractor to be disclosed, it does not require inclusion of the relevant Code of Conduct.

10.3 The second change saw the insertion of the requirement to identify the regulation module proposed to apply to the scheme (item (f) above). This information should appear in the proposed community management statement, which is also required to be disclosed, but clearly the legislature wants a more obvious disclosure of this particular matter.

10.4 The third change is somewhat hidden. It relates to item (e) in that item (e) requires the relevant proposed community management statement to be disclosed. The Amendment Act introduced a requirement for a community management statement that relates to certain schemes where the contribution schedule lot entitlements are unequal to explain the "just and equitable" basis that justified departure from the presumption that they should be equal.[39]

10.5 The only other change to the proposed lot disclosure provisions relate to the circumstances in which the contract can be cancelled by the buyer. Before a buyer can cancel the contract they must now establish **all** of the following matters:

(a) the contract has not been settled; and

(b) at least one of the following applies:

(i) the recorded community management statement is different to the one disclosed; or

(ii) a community management statement for a higher scheme is different to the one disclosed; or

[38] See section 115 and Schedules 2 and 3 of the BCCM Act.

[39] Section 66(1)(d) was added by the Amendment Act (section 24(1)) and it requires, inter alia, a community management statement to state why unequal contribution schedule lot entitlements are not equal. However, it should be noted that this requirement does not apply where a scheme becomes a layered scheme from existing basis schemes under Chapter 2 Part 11 or where development approval for the scheme is given before 4 March 2003.

(iii) the disclosed community management statement does not contain the explanation about unequal contribution schedule lot entitlements where that is required (as to which, see paragraph 10.4 above); or

(iv) information disclosed in the First Disclosure Statement, as rectified by any further statement, is inaccurate; and

(c) because of a difference or inaccuracy under paragraph (b), the buyer would be materially prejudiced if compelled to complete the contract; and

(d) the cancellation is effected by written notice given to the seller by the buyer not later than the latest of the following:

(i) 3 days before the buyer is otherwise required to complete the contract;

(ii) 14 days after the buyer is given notice that the scheme is established or changed; and

(iii) another day agreed between the buyer and the seller.

10.6 In relation to the matters that must be established by the buyer to cancel a contract for non-disclosure, the Amendment Act effectively introduced items (b)(iii) and (d) above.[40]

11. Contractual warranties

There is nothing in the Amendment Act that impacts on any warranties that a seller or buyer may wish to include in the sale contract (e.g. that the building will be constructed in a good and workmanlike manner).

12. Implied warranties

12.1 The effect of the new implied warranties on proposed lots is not clear. For the purpose of those warranties a "lot" includes a proposed lot.[41] The warranties are implied in a contract for the sale of a "lot".[42] The substantive warranties are given "as at the date of the contract".[43] Those warranties relate to the common property, body corporate assets and the body corporate.[44] The uncertainty arises from the fact that none of those things exist "as at the date of the contract". Despite this, section 224 of the BCCM Act, which relates to cancellation of the contract for breach of the warranties, clearly envisages a cancellation notice being given in respect of a contract for a proposed lot.

12.2 In my opinion, it is arguable that these substantive warranties cannot operate in respect of a proposed lot and a contract cannot be cancelled if those warranties are breached. Such an

[40] See section 68 of the Amendment Act.
[41] Section 220 of the BCCM Act.
[42] Section 223(1) of the BCCM Act.
[43] Section 223(2) of the BCCM Act. The warranty in section 223(3) is the most insignificant of all the warranties, although it is given as at the completion of the contract. The result is that it is not susceptible to the same fate of the substantive warranties.
[44] Section 223(2) of the BCCM Act.

argument is supported by the decision in *Gelski v. Dainford Limited*[45] which considered similar express warranties in a sale contract. Section 224 can easily be explained as being intended for the warranty in section 223(3), relating to circumstances that materially prejudice, which expressly applies "as at completion of the contract".

12.3 It follows that:

(a) the implied warranties in section 223(2) of the BCCM Act about latent or patent defects and actual, contingent and expected liabilities probably have no application to contracts for the sale of proposed lots; and

(b) the implied warranty in section 223(3) about circumstances related to the affairs of the body corporate likely to materially prejudice the buyer does apply to contracts for the sale of proposed lots.

13. Cost recovery clauses

13.1 The only other change introduced by the Amendment Act that directly affects contracts for the sale of proposed lots relates to the insertion of a new section 225 dealing with the recovery of certain costs by the original owner.

13.2 That section prohibits an original owner form recovering from the buyer of a lot or the body corporate any part of their costs incurred in the "*original owner control period*" in entering into a contract providing for the engagement of a body corporate manager or service contractor or authorising a letting agent, unless they relate to a period during which the buyer was the owner of the lot.

13.3 The "*original owner control period*" is defined to mean the period in which –

(a) the body corporate is constituted solely by the original owner; or

(b) the original owner owns, or has an interest in, the majority of lots in the scheme or, in any other way, controls the voting of the body corporate.

13.4 There are a number of concerns about this section:

- The costs seem to be restricted to those involved "in entering into a contract" rather than those involved after entry into the contract or under the contract (e.g. a proportion of a management fee payable to a building manager).

- The exemption relating to the period that a buyer is an owner of a lot[46] requires that the buyer must have been liable under the BCCM Act as a lot owner for the costs sought to be recovered. If the costs were paid by the original owner on behalf of the body corporate (as is the case in relation to insurance premiums), and the original owner seeks to recover them from the buyer as an adjustment, then the lot owner would not have been liable for them under the BCCM Act as a lot owner. They would therefore not be recoverable by the original owner.

[45] (1985) NSW Title Cases ¶30-061.
[46] Section 225(3) of the BCCM Act.

- Where the costs cannot be recovered from the buyer, they cannot be recovered from the body corporate. Therefore, the original owner cannot be reimbursed.

13.5 It follows that care needs to be taken to ensure that costs associated with body corporate managers contracts, service contracts and letting agency authorizations should be channelled through the body corporate and picked up in the normal levy process rather than being made the subject of adjustment between the original owner and buyer at settlement of the sale (as is commonly the case with insurance premiums).

14. Part 3 conclusions

My conclusions in relation to the Part 3 coverage are:

(1) Care needs to be taken to ensure that the changes to the disclosure requirements are taken into account when preparing a First Disclosure Statement.

(2) The implied warranties have very little practical impact on contracts for the sale of proposed lots.

(3) There are no other changes introduced by the Amendment Act that have significant practical impact on the preparation of contracts for sale of proposed lots. However, that is not to say that there have been no changes that impact on the way in which particular projects should be structured from a title, subdivision or management perspective. That is a subject separate and distinct from the preparation of proposed lot contracts.

Gary Bugden
30 September 2003