Management Rights 'top up' Tool Kit[1]

Management Rights, in a body corporate context, comprise a package of legal and contractual rights and obligations relating to the building management and on-site letting pool business. Long term Caretaking and Letting agreements (which can be either separate or combined) are the key management rights documents.

Building managers often ask bodies corporate to increase the term of these agreements by 5 years. This is commonly called a "top-up" request. Dealing with such a request is an important and sometimes difficult task for a body corporate. The Management Rights 'top-up' Tool Kit is intended to provide useful guidance for committees who receive top-up requests from their managers.

[1] This Tool Kit is suitable for use under all Regulation Modules, except for the *Body Corporate and Community Management (Specified Two-lot Schemes Module) Regulation 2011*.

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1. Management rights

Management rights are typically a 'package' which comprises:

(a) a manager's unit;

(b) rights to occupy common property (including an office and reception area);

(c) a management and letting agreement (which can be separate agreements or combined in a single agreement); and

(d) a by-law conferring exclusivity in relation to on-site letting.

The management and letting agreement have a term of 10 or 25 years, depending upon the Regulation Module which applies to the community titles scheme. It provides for the caretaking of the building and the conduct of a letting business within the building by the manager.

2. Top-ups

As the term of the management and letting agreement diminishes, the management rights package becomes less valuable and more difficult to sell, mainly because of the limited availability of finance for shorter term agreements. In those circumstances, managers tend to ask the body corporate to 'top-up' the term of the agreements by 5 years. Managers can ask for such a top-up once every year, but not more frequently.

This Tool Kit is intended to assist bodies corporate to understand the background to the topping-up of management rights agreements and to provide guidance as to how they should deal with top-up requests from managers.

3. Top-ups and the "value" proposition

Managers rarely admit that the top-up to the term of their management rights increases the value of those management rights. Nor do they pay regard to the fact that, at the time they purchased, the purchase price took into account (or should have taken into account) the term then remaining and the fact that a diminishing value asset was being acquired.

Indeed, not so many years ago some managers maintained that top-ups had no effect on the value of their management rights and this was supported by a letter from a prominent management rights marketing agency. Today, the fact that top-ups increase value is clearly illustrated by the practice of some managers offering cash incentives to owners to encourage them to vote in favour of top-up motions. There is a good example in a recent QCAT case where the manager offered letting pool owners free furniture packages for their units if the top-up motion was passed.[2]

[2] *BRK Resorts Pty Ltd v Octavian Popescu and Body corporate for Moroccan-View Towers CTS 16282* [2017] QCATA 106.

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4. Manager justification

Managers sometimes put forward reasons as to why a body corporate should agree to their top-up request. Common reasons include:

(a) the benefits of having a long-term stable letting business and caretaking service by someone with a personal interest in and good knowledge of the building;

(b) it is standard industry practice to top-up the term of management rights;

(c) the bank financing the manager requires the term of the management rights to be topped-up;

(d) the manager requires the top-up to achieve more favourable terms on their bank financing;

(e) the management rights are no longer marketable without an increase in the term; and

(f) the manager has faithfully and diligently served the body corporate and deserves to be given a top-up.

Each of these reasons will be briefly considered.

Long term stability

The average tenure for managers is a relatively short period (probably around 4 to 5 years), whereas in the 1980's and 1990's average tenure was substantially longer (probably around 10+ years). Also, management rights are frequently sold shortly after a top-up occurs. Therefore, the long-term stability and long-term commitment benefits are arguably not sustainable in this age of frequent "trading" in management rights.

Standard industry practice

It is correct to say that managers frequently ask for top-ups. It is also correct to say that historically bodies corporate routinely granted them, often without considering the implications of doing so. However, these days bodies corporate are looking more critically at top-up requests and they are frequently being rejected. Therefore, in our opinion, it is misleading to describe the practice as "standard" or "usual" or "routine", without further qualification.

Bank requirement

Banks certainly encourage top-ups because it improves an important aspect of their security. However, banks do not formally "require" the 'top-up' in the sense of making it a condition of continuation of the loan. Therefore, it is misleading to suggest that banks **require** the top-up to occur. It is more accurate to say that banks 'encourage' top-ups.

Better finance terms

This may be a reasonable statement. As finance facilities come up for review a bank may offer a more attractive interest rate if the term of the management right is extended. This improves the bank's security and reduces its risk – two factors which may go to the rate of interest being charged. Sometimes banks require higher capital repayments as the length of the term

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diminishes. Whether these are valid reasons for a body corporate to grant a top-up is another issue.

Marketability issues

Again, this may be a reasonable statement. However, from our experience an important factor in marketability is the price being asked for the management rights. The shorter the remaining term, the less valuable the management rights. They are a depreciating asset. However, many managers fail to take this into account and are focused more on the price they want to achieve than on the actual value of what they are selling. Again, whether this is a valid reason for a body corporate to grant a top-up is another issue.

Reward for service

This may or may not be a valid submission, depending upon the circumstances of the particular scheme. However, its validity as a reason for the body corporate granting a generous commercial concession is the key issue for lot owners to consider, particularly having regard to any implications for the body corporate.

5. Gallery Vie clauses

In December 2014 the Queensland Civil and Administrative Tribunal handed down a decision which upheld the right of a body corporate to terminate management rights in circumstances where a manager company went into liquidation after a financier had stepped in and appointed a receiver to the company.[3] This is commonly called the *Gallery Vie case*. Following that decision, it became normal practice for default clauses in management rights agreements to be drafted so as to "plug" what was a clear loophole in the legislation.

It also became common practice for managers, in conjunction with a 'top-up' request, to ask bodies corporate to amend the default clauses in their existing agreements to 'plug' that loophole. The managers are motivated to do this because of the possible difficulty management rights purchasers may have in financing their purchase without the amendment. This is usually referred to as a request to include a "*Gallery Vie clause*". While the request is common it should not be considered a "standard" concession or "standard industry practice".

While the manager's need for this amendment is legitimate, there is still the question whether it is in the interests of the body corporate to agree to include them. By including the clause, the body corporate is depriving itself of a possible future opportunity to deal with a non-performing manager who will most likely be different from the current manager. In addition, there are serious implications for a body corporate if a liquidator is appointed to their corporate manager and they do not have the ability to terminate the agreement. Liquidation is a normal terminable event in any commercial agreement and it is arguable that management rights agreements should not be an exception. Owners should be given the opportunity to consider this outcome and its full implications.

[3] *Vie Management Pty Ltd (Receivers and Managers Appointed) (In Liquidation) v Body Corporate for Gallery Vie CTS 37760* [2015] QCAT 164.

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6. Issues for a body corporate to consider

A body corporate committee and lot owners generally will need to consider a range of issues relevant to the desirability or otherwise of granting the top-up. The issues may vary from scheme to scheme, but the following are some of the issues which commonly arise:

(a) the age of the agreement (older agreements often fail to meet the current requirements of the scheme or they conflict with existing legislation);

(b) whether the "chain of title" to the management rights is cumbersome;

(c) whether the duties are still appropriate for the needs of the building now and into the future;

(d) whether there are any onerous provisions in the agreement;

(e) the future commitments of the manager; and

(f) whether the body corporate would be acting unreasonably if it refused the manager's proposed motion.

Each of these issues will be briefly considered.

Age of the agreements

Agreements age as their terms diminish. However, some agreements which have been topped-up multiple times were drafted up to 20 years ago but still have another 15 or 20 years to run. Generally speaking, the older the agreement, the greater the likelihood that it:

(a) does not fit the current requirements of the building;

(b) contains provisions which are now outdated (often because of changes to the legislation); and

(c) contain an outdated annual fee (too high or too low).

The 'chain of title'

Every time management rights are sold, a Deed of Assignment is entered by the outgoing manager, the incoming manager and the body corporate (as well as guarantors in the case of an incoming corporate manager). In addition, every time a top-up occurs a Deed is entered by the body corporate. In these days of active "trading" in management rights and regular topping-up of terms of agreements it is not uncommon for the chain of title to comprise 5 or more Deeds to evidence ownership of the current manager. Some we have dealt with have had up to 10 Deeds. The greater the number of Deeds the greater the risk of technical deficiencies in the chain of title and/or interpretative issues in relation to the agreement itself. To continue to perpetuate the chain of title may be undesirable from the body corporate's perspective.

At the same time as an assignment or top-up of the management rights, the chain of title should be examined to determine whether it suffers from any technical deficiencies. Such deficiencies are best dealt with at that time, rather than allowing them to continue undetected.

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Appropriateness of the duties

As buildings and their surroundings age and as body corporate legislation is updated, the caretaking duties can become inappropriate for the current needs of the building. The older the agreement, the greater the risk of this occurring. In these circumstances, it may therefore be unwise to extend the life of the agreement.

Onerous terms

A review of the agreement may reveal that one or more of its provisions may be onerous. A common example is a clause providing for an annual review of the Manager's remuneration based on CPI or 3% (sometimes even as high as 5%), whichever is the greater. Such a provision is uncommercial and will usually result in the annual fee becoming too high for the value of the duties being provided. If the agreement contains onerous provisions it may therefore be inappropriate to extend the agreement and prolong the life of the onerous provisions.

Manager's commitment

It may be appropriate for the body corporate to seek advice from the manager as to their future commitment to the building. Are they planning to stay or do they intend to sell soon? Sometimes it may even be appropriate to consider imposing a condition to the top-up requiring the manager to stay for a set period before the 'top-up' takes effect (subject to what we say later).

Acting reasonably

Section 94(2) of the *Body Corporate and Community Management Act 1997* ("**Act**") requires the body corporate to act reasonably in exercising its functions. This requires the body corporate to act reasonably when deciding whether to pass a top-up motion. The test to be applied in determining whether the body corporate acted reasonably is whether the body corporate took into account all relevant factors and achieved a reasonable balance of the competing interests affected by the proposal.[4] The Act does not put the body corporate under any obligation to assist the manager in achieving its own commercial interests, let alone to achieving them to the detriment of the body corporate itself.

7. A difficult decision for owners

Clearly from what has been said above, the decision whether to grant a 'top-up' can be a difficult one. A body corporate committee should ensure that a proper analysis is undertaken to identify and assess any issues, including legal issues, of relevance and then place the results of that analysis before the general meeting which must decide whether to grant the 'top-up'. The lot owners can then weigh up all the relevant factors and achieve a reasonable balance of the competing interests of the body corporate and the manager before deciding how to exercise

[4] *Waters v. Public Transport Corporation* (1991) 173 CLR 349 and *Ainsworth and Ors v. Albrecht and Anor* [2016] HCA 40.

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their vote. It is only in this way that the body corporate can discharge its duty under section 94(2) of the Act to "*act reasonably*" in deciding the motion.

8. Prohibition on body corporate obtaining a benefit

In a normal commercial situation, if one party to a contract requests an extension of time or material change to the contract, this creates an opportunity for the other party to seek to improve their position under the contract in some way. For example, "yes, *we will increase the term by 5 years if you agree to add the lawn mowing to your list of duties*". In the case of management rights agreements this is generally very difficult, with the result that any concession granted to a manager will often be 'one-sided', as unfair as that may be.

The reason can be found in section 113(1) of the Act, which provides:

> "*The body corporate for a community titles scheme must not seek or accept the payment of an amount, or the conferral of a benefit, for –*
> *(a) .....*
> *(c) extending the term of –*
> *(i) an engagement of a person as a service contractor for the scheme; or*
> *(ii) an authorisation of a person as a letting agent for the scheme*."

To reinforce this provision, section 113(3) of the Act provides for the manager to recover from the body corporate the amount paid, or the value of the benefit gained. This restriction on 'negotiating' with the manager is, in itself, one of the matters which may be taken into account by committees and lot owners in deciding how to respond to 'top-up' requests.

If a body corporate wishes to change the terms of the management and letting agreement as part of a top-up process it will need expert legal guidance as to what can be achieved within the limits of the above restrictions.

9. Guidance for committees

Committee members should:

(a) approach top-up requests cautiously;

(b) make formal enquiries of the manager as to their future intentions;

(c) obtain competent advice on relevant legal and commercial issues; and

(d) make that advice, along with all other relevant information available to lot owners as part of the process of considering the merits of the top-up motion.

Consideration should be given to obtaining the following advice –

- Legal advice (looking at the legal issues identified above in the context of the actual agreements)
- Financial advice (assessing the long-term financial implications of the extension and the 'value for money' proposition when compared to using market based services from independent contractors)

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- Performance review (assessing the standard of caretaking and letting services being provided)
- Duties review (to determine whether the current duties are still appropriate and the implications of entrenching them longer term)

If the body corporate decides to make enquires about the manager's future intentions, those enquires need to be carefully framed. The pro-forma letter of enquiry in **Form A** can be used.

There are good reasons for the above approach. A Committee's duties can generally be described as analogous to the common law duties of the board of a company. This follows a similar analogy drawn in relation to the respective duties of individual committee and board members.[5]

At common law, directors must fully disclose to shareholders information in their possession which is material for the shareholders to decide whether to attend a meeting, and if so, to understand and form a judgment on an item of business.[6] This includes material commercial information which is known to or accessible to directors.[7] This is aligned to the principle that directors must act fairly towards shareholders in relation to notices of meetings.[8] The common law duty extends to directors obtaining and providing information reasonably required by shareholders to enable them to make an informed decision.

Members of a body corporate committee should assume that the above rules apply equally to them when dealing with top-up or Gallery Vie requests from managers.

10. Check-list

Form B is a Check List that can be used by committees to ensure that they correctly approach a top-up request from their Scheme's manager.

11. Instructing a lawyer

If a lawyer or other professional is to be retained to advise the body corporate, that action should be properly authorised at a meeting of the committee or by vote outside committee. The motion in **Form C** is recommended for that purpose.

Copies of the following materials will usually be briefed to the lawyer or other professional:

(a) community management statement;

(b) management and letting agreement(s);

(c) all assignment and variation Deeds;

(d) request from manager for top-up, including materials in support (e.g. resolution, draft Deed, etc.);

[5] *Re Steel and Others and the Conveyancing (Strata Titles) Act, 1961* (1968) 88 W.N.Pt.1 pg 467.
[6] *Westchester Financial Services Pty Ltd v Acclaim Exploration NL* (1999) 32 ACSR 499; [1999] WASC 87.
[7] *ENT Pty Ltd v Sunraysia Television Ltd* (2007) 61 ACSR 626; [2007] NSWSC 270.
[8] *Devereaux Holdings Pty Ltd v Pelsart Resources NL (No 2)* (1985) 9 ACLR 956; 4 ACLC 12; *Chequepoint Securities Ltd v Claremont Petroleum NL* (1968) 11 ACLR 94 at 96.

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(e) information regarding current duties and their appropriateness; and

(f) information about the 'value for money' of the current arrangements (e.g. is the annual fee out of sync with the duties it covers?).

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Form A

Pro-forma letter of enquiry

[Date]

[Addressee]

Dear [Salutation],

Request for top-up of management rights

We refer to your request for general meeting approval to the topping-up of the term of your management rights by 5 years.

The committee is in the process of compiling all relevant information with the intention of providing it to unit owners to assist them in making their decision on the proposed top-up. The committee would like to include with that information your answers to the following questions:

1. Do you intend to, or is it likely that you will, sell the management rights anytime within the next 2 years?
2. Do you intend to offer any incentive to unit owners to encourage them to vote in favour of the top-up motion? If so –
   (a) will you make that offer to all owners or just to a portion of the owners (such as the owners who are in the letting pool); and
   (b) what are the proposed terms of that offer?
3. What is your main reason for wanting the top-up?
4. If your main reason is financially related are you prepared to make relevant figures available to the committee or its consultant to assess the merits of that main reason?
5. Are you prepared to commit to pay the body corporate's legal, administrative and general meeting costs associated with its consideration of the top-up motion irrespective of the outcome?

Your early response to those questions would be appreciated.

Yours faithfully,

…….
[***Name***]

Secretary
Body corporate for [Name] CTS [Number]

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Form B

Checklist

Item	Task	Comments
1	Receive and acknowledge top-up request	
2	Letter in response to manager (Form A)	
3	Resolution or VOC to appoint lawyer	
4	Compile documents and appoint lawyer (Form C)	
5	Consider need for financial analysis and advice	
6	Consider need for facilities management assessment	
7	Compile all information and hold committee meeting	
8	Committee chooses support, opposition or neutrality	
9	Committee circular to Owners with supporting material	
10	General meeting held and decision made by secret ballot without the use of proxies	

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Form C

Committee resolution appointing lawyer

RESOLVED THAT, in relation to the request by the manager for a top-up of the term of its management rights, the body corporate:

(a) accept the Bugden Legal fee proposal for it to advise on:

(i) legal and commercial issues relevant to such a top-up;

(ii) the content of the motion and Variation Deed proposed by the manager; and

(iii) the respective responsibilities of the committee and unit owners in considering that request; and

(b) authorise the Chairperson to provide ongoing instructions from the body corporate to Bugden Legal in relation to the matter.

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