10 Years and Terminated: Court Upholds Cap to Pre-2003 Building Management Agreement

There has been a widespread practice of extending caretaking or building management agreements to get around the 10 year cap in the Strata Schemes Management Act 2015 (**SSMA 2015**). In the recent appeal decision of *Australia City Properties Management Pty Ltd v The Owners – Strata Plan No 65111* [2021] NSWCA162, Chief Justice Bathurst affirmed on appeal that deeds of variation used to extend the term of the agreement for a period of greater than 10 years by adding option periods were, in fact, capped at a term of 10 years.

A review of the appeal decision is detailed at the end.

Supreme Court Decision

At first instance in the case of *Australia City Properties Management Pty Ltd v The Owners – Strata Plan No 65111 [2020] NSWSC 1505*, his Honour also held that The Owners – Strata Plan No 65111 (**Owners Corporation**) validly terminated the caretaker agreement for gross misconduct and gross negligence by the caretaker being Australia City Properties Management Pty Ltd (**ACPM**) as ACPM improperly used electricity paid for the Owners Corporation over a period of 18 years and failed to promptly notify the Owners Corporation of a fault with the building's emergency warning system, which could have had dire consequences in the event of a fire.

The decision by His Honour gives some guidance to owners corporations regarding the expiry of lengthy caretaker agreements and what conduct of a caretaker or building manager would amount to gross misconduct or gross negligence. The decision also details the importance of correctly drafted duties being set out in any caretaker agreement as these were strictly interpreted by the Court. We have experience in assisting owners corporations in all these areas.

A more comprehensive review of the case is detailed below.

Brief Facts – Supreme Court Decision

The case concerned a caretaker agreement entered into by The Owners – Strata Plan No 65111 (**Owners Corporation**) on 30 March 2001 with the caretaker being Australia City Properties Management Pty Ltd (**ACPM**).

The Owners Corporation terminated the caretaker agreement based on a term within the agreement that it could terminated if ACPM *"is guilty of gross misconduct or gross negligence in performing its responsibilities"*. ACPM, in response, argued that the Owners Corporation was not entitled to

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terminate the Agreement and, as a result, ACPM should be entitled to damages of about $2 million for the Owners Corporation's repudiation of the agreement, as the agreement had a term of 40 years.

Relevantly, ACPM calculated these damages based on the Owners Corporation taking possession of the caretaker lot, Lot 179, in Strata Plan No. 65111 (**Scheme**) and claiming that, had the Owners Corporation, not allegedly repudiated the agreement, ACPM would be the caretaker of the Scheme until March 2041. This excessively long term of the agreement was created by way of various deeds of variation that added option periods to the initial caretaker agreement.

The Owners Corporation cross-claimed against ACPM for numerous breaches of the caretaker agreement based on alleged overcharges by ACPM and it claimed restitutionary relief. There was also a claim by the Owners Corporation for ACPM improperly using electricity supplied to Lot 179, which supply was being paid for by the Owners Corporation.

Term of Caretaker Agreement

The first major issue considered by His Honour was what the appropriate term of the caretaker agreement should be, when taking into account the initial agreement of 30 March 2001, the various deeds of variation adding option periods onto the initial agreement and the legislative changes brought about by the Strata Schemes Management Amendment Act 2002 (**Amendment Act**) and the Strata Schemes Management Act 2015 (**SSMA 2015**).

The Amendment Act made a number of key changes to the Strata Schemes Management Act 1996 (**SSMA 2016**), being that it incorporated a specific definition of "caretaker" (s 40A), set the maximum term of any caretaker agreement to 10 years (s 40B) and gave additional powers to the Tribunal to make orders with respect to caretaker agreements (s 183A), including with respect to the length of the agreement's term.

Any agreement entered into prior to the Amendment Act that would be considered a caretaker agreement pursuant to the Amendment Act was retrospectively brought within the amendments, however, the maximum 10 year term and additional power granted to the Tribunal was limited in that it did not apply to *"such an agreement"* (Sch 4, cl 12(2)(b)-(c)).

His Honour concluded that, in the first instance, the second deed of variation of the caretaker agreement between the Owners Corporation and ACPM displaced the original agreement as the agreement under which the building manager was appointed and so expired 10 years from the second deed of variation stating that *"it would be an absurd result if the legislative provisions operated so that parties to "such an agreement" within cl 12(2) could vary the agreement by adding decades to its term, and yet retain the benefit of cll 12(2)(b) and 12(2)(c)"* (at [52]).

His Honour then turned the final deed of variation entered into by the parties in April 2015. This deed fell within the savings and transitional provisions in Schedule 3 of the SSMA 2015, pursuant to which, any caretaker agreement (referred to as "building manager agreements in the SSMA 2015) in force prior to the SSMA 2015 coming into force would only be given an additional term of 10 years (Sch 3, cl 15(2)). His Honour concluded that this deed of variation was also a separate agreement with a

capped 10 year term resulting in the term of the appointment of the caretaker expiring, no later than, 29 April 2025 (at [68]) – being about a 24 year period.

To assess the expiry date of any caretaker (or building manager) agreement that has had its term varied, it is important to consider both the Amendment Act and the savings and transitional provisions in Schedule 3 of the SSMA 2015.

Gross Misconduct and Gross Negligence

The Owners Corporation put forward a number of situations that it alleged amounted to gross misconduct and gross negligence and His Honour did not accept the majority of the allegations raised, especially with alleged overcharging of the Owners Corporation.

Alleged Overcharging

His Honour concluded that the following charges by ACPM to the Owners Corporation was not overcharging:

(a) for an assistant building manager to assist the on-site employee of ACPM with his duties (at [85]);

(b) for additional security personnel in the Scheme to manage the overcrowding issue in the Scheme (at [103]); and

(c) for additional cleaning services to areas of common property in the Scheme (at [114]).

To reach these conclusions, His Honour strictly interpreted the list of duties set out in the caretaker agreement between the Owners Corporation and ACPM. By way of example, at [100], His Honour states (underline added):

> *"...Whilst the Agreement provides that the Caretaker has "Security Duties" (specified in cl 3 of Schedule 2), and contemplates that the Caretaker might engage a security guard to attend the reception areas (see cl 1(ai)), the Caretaker is not bound to have a security guard carry out any of those duties, much less employ a security guard for 112 hours per week…"*

This only highlights the importance of ensuring that the duties of a caretaker or building manager are clearly set in any agreement

Appointment to Committee

His Honour concluded that ACPM breached the caretaker agreement by having its director appointed to the executive committee of the Scheme but concluded that, although this amounted to misconduct, it did not amount to gross misconduct as (at [128]):

(i) the *"expression 'gross misconduct'…should be construed in accordance with the ordinary meanings of the words used*";

(ii) *"breach or breaches of the Agreement can be readily regarded as improper or wrongful conduct; if sufficiently serious and flagrant, the conduct may also be described as gross"*;

(iii) *"the overall circumstances must be considered at the time the right to terminate is sought to be exercised"*; and

(iv) as the Owners Corporation was aware that the director of ACPM was appointed to the committee as early as March 2010, that the director continued to be involved and that this situation was *"tolerated"* by the Owners Corporation for over 9 years before it sought to terminate the agreement.

Improper Use of Electricity

Notwithstanding the other points raised by the Owners Corporation, His Honour concluded that use of electricity supplied to Lot 179 by the ACPM, which was paid for by the Owners Corporation, did amount to gross misconduct as:

(i) agreement between the parties did not *"entitle the Caretaker to a free supply of electricity to Lot 179* (at [164]) and, on a strict interpretation of the agreement, ACPM was to provide all *"products, materials and equipment required for the performance of its"* duties (at [165]);

(ii) therefore, ACPM was in breach of the agreement and was in breach *"over many years by accepting the benefit of the electricity and remaining silent about the matter"* (at [169]); and

(iii) there was *"deliberate deception"* by ACPM, as it at one stage represented that the electricity was being paid by ACPM and not the Owners Corporation, even after it was aware that the Owners Corporation was paying for the electricity to Lot 179 (at [170]).

Fire Safety Failures

Further, His Honour concluded that ACPM not preparing an evacuation plan was not gross misconduct or gross negligence as it was evaluated by the expert to be a medium priority item, which required a review within 6 months and not urgent attention (at [194]-[195]).

However, His Honour concluded that ACPM's misconduct with respect to the Emergency Warning and Intercommunication System (**EWIS**) was gross as:

(i) ACPM is required to promptly report all matters that are a hazard or danger, of which it has notice, to the Owners Corporation (at [188]);

(ii) *"having regard to the potentially serious consequences of a faulty EWIS, the matter should have been brought to the attention of the Executive Committee promptly after the May 2017 testing, and in writing as part of a formal report"* (at [213]);

(iii) *"the breach of the Agreement is sufficiently serious to amount to gross misconduct or gross negligence"* (at [214]); and

(iv) *"[i]t would be difficult for an Owners Corporation to have any confidence in a Caretaker that failed to report matters of this kind"* (at [216]).

Decision on Appeal

On appeal, there were numerous grounds of appeal, for which the Court of Appeal held primarily in favour of ACPM being (paraphrased from [356]):

- The primary judge was correct in concluding that the conduct of ACPM in its unauthorised consumption of electricity amounted to gross misconduct – however this conduct amounted to a repudiation of its obligations under the Agreement and the Owners Corporation had contractual procedures for that breach available to it.

- The failure to report to the Strata Committee on the EWIS system did not amount to gross misconduct or gross negligence as "it was an error of judgment" by relying on an oral report to the Committee and seeking to monitor the EWIS system relying on the expertise of a contractor (at [164]) (noting Justice McCallum agreed with the primary judge's findings given the "*potentially catastrophic consequences of a failure to act on such information*" (at [361]).

- The Owners Corporation was entitled to terminate the Caretaker Agreement pursuant to the Agreement but was not otherwise entitled to terminate the Agreement outside of the machinery provisions of clause 9 and 10) and ACPM was not entitled to terminate the Agreement for wrongful repudiation by the Owners Corporation) – noting that the Notice of Termination was issued improperly and without ratification.

- ACPM was entitled to damages for the value of its interest under the Agreement due to the Owners Corporation's failure to follow the procedure set out in clause 10 of the Agreement, thereby causing ACPM to lose the value of its interest (that is, ACPM's right to sell the Caretaker Lots and assign management rights). However as the Owners Corporation did not correctly terminate the agreement, its conduct of entering into possession of Lot 179 and asserting that ACPM had no further rights under the agreement amounted to repudiation.

- The Court held that the Deeds of extension constituted "caretaker agreements" under the legislation and were limited to a term of 10 years – therefore the term of the Agreement was extended up to and expired on 29 April 2025.

- The issue of ACPM being required to sell Lot 179 to the Owners Corporation was to be referred to the primary judge (noting there was no implied term if termination by the Owners Corporation outside of the machinery provisions of the Agreement required ACPM to sell Lot 179 to the Owners Corporation). However Chief Justice Bathurst noted that the Owners Corporation did not have right to take possession of Lot 179 to the exclusion of ACPM by virtue of appointment of

attorney pursuant to clause 10.5, in any event (that is, ACPM was entitled to possession of Lot 179 until completion of the procedure under clause 10).

- ACPM was entitled to and awarded the following damages:

  - Compensation of $24,600 as a result of ACPM being unable to occupy Lot 179.

  - Damages of $7,840 and interest of $456.13 for lost profits between 17 August and 25 August 2019 (the period between the service of the notice of termination by the Owners Corporation and purported acceptance of repudiation by ACPM).

  - The sum of $975,000 for improper termination of the Agreement (noting a 20 per cent discount based on "*the possibility of the OC making a successful application under s 72 of the 2015 Act to vary the term of the Agreement, to declare void any of the conditions or to terminate the Agreement*" (at [350]).

Chief Justice Bathurst also reaffirmed the Second Reading Speech regarding lengthy caretaker agreements (at [349]):

In the present case the extension was agreed to by the OC in a general meeting. As the Minister said in the Second Reading Speech, if after 10 years the parties wish to extend for a further 10 years they could do so. There is no reason that decision cannot be made before the expiry of the 10 year period.

This conclusion, again, serves to highlight the importance of ensuring all duties of a caretaker and building manager are properly drafted in any agreement and that the bar for misconduct and negligence to be considered "gross" is rather high.

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