



Understanding Company Title

FOURTH EDITION

JFMLAW
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A JFMLAW Guide: Understanding Company Title

FOURTH EDITION

The Basics

What is Company Title?

Company title is a scheme of land ownership through which a company owns the title to land. Shareholders who have purchased shares in the company are entitled to exclusive occupation of a flat in a building on that land. In this regard, shareholders in a company title buildings do not technically 'own' the land. Rather, they are shareholders in the company that owns the land.

The purpose of this guide is to help everyone connected with company title properties to understand in detail how company title works, be they current shareholders, prospective purchasers, board members or company managers.

KEY TIP

Shareholders in company title buildings do not technically 'own' their flat.

How are Companies Regulated?

Owners corporations of Strata Title buildings are regulated by a range of legislation that is specific to strata title. Companies, on the other hand, are governed by their constitutions, and are regulated by the *Corporations Act 2001* (Cth). They may also have rights and obligations under other legislation, including the *Work Health and Safety Act 2011* (NSW), the *Environmental Planning and Assessment Act 1979* (NSW) and its associated regulations, and Part 3 of the *Local Court Act 2007* (NSW).

However, there is no comprehensive or specific legislation regulating company title buildings as there is with Strata schemes, and the *Strata Schemes Management Act 2015* (NSW) does not apply to company title.

KEY TIP

Understanding the legal aspects of company title is much more complicated than the more straightforward Strata schemes. Read up or get advice if you are in doubt about an issue.

The Constitution

The constitution is a binding legal document that regulates the internal management of a company. Older constitutions may be known as memoranda and articles of association.

Company constitutions can be complex legal documents. This is particularly the case for older Memoranda and articles of association, which tend to be written in quite archaic English. Typically, they include the following:

- a. A description of the shares that have been issued in the company and the flats with which those shares are associated.
- b. A specification of the rights of shareholders. The most important of these is the right to the exclusive use and occupation of a flat in the building.
- c. Provisions empowering the company to raise levies. The company may also be able to charge interest on any unpaid levies.

- d. A list of the powers of the company, including the power to carry out certain works and to enter flats for certain purposes.
- e. Provisions regulating the purchase and sale of shares in the company.
- f. The duties of the company in relation to maintaining company property (i.e. the building)
- g. Provisions regulating the letting or subletting of company title flats.
- h. Provisions regulating the conduct of company meetings and elections for office holders.
- i. A specification of the duties of shareholders and directors.
- j. A provision empowering the directors to make, amend and revoke house rules.

Many companies with older memoranda and articles of association are finding that it is difficult to apply their terms to disputes that arise in the running of contemporary buildings. In particular, such older documents tend to have a very vague definition of the division between property that is the responsibility of the company and property that is the responsibility of shareholders. Such documents frequently suggest that companies have the power to undertake acts which would now be illegal under corporation and anti-discrimination legislation.

KEY TIP

Companies with memoranda and articles of association prepared prior to 2001 should consider modernising them.

The House Rules

The term 'house rules' refers to the formal policy that regulates the management of the building and the conduct of its residents on a day-to-day basis. They may also be called 'regulations' or 'bylaws'. The house rules may be amended by the board from time to time, or formally adopted by a vote of the shareholders by way of an ordinary resolution .

Generally, it is preferable if the constitution provides the board with a power to issue house rules in order to allow it to respond quickly to developments in relevant commercial and regulatory contexts. For example, many companies were caught off guard by the advent of AirBnB, and were required to promptly issue house rules prohibiting or regulating the marketing of flats on online short term letting platforms.

House rules often contain provisions concerning:

- a. The use and maintenance of residential flats. For example, the house rules may specify the maximum number of occupants that may reside in a flat at any one time, whether pets can be kept in flats, and the process associated with obtaining approval from the company for major renovations within flats. It may also make provisions for reducing noise.
- b. The use and maintenance of common property owned by the company. For example, the house rules may specify the process for carrying out renovations and maintenance work on common property to maintain consistency in appearance.
- c. The process associated with the sale and letting of flats. For example, the house rules may specify how and when

- d. interviews are conducted for the approval of new shareholders and lessees by the board, and whether short term letting through online platforms such as AirBnB is allowed.
- e. Administrative matters. For example, the house rules may regulate how mail and deliveries are received, make provision for moving in and out of the building, and allocate the use of common property storage facilities.
- f. Safety matters. For example, the house rules may make provision for security arrangements for the building, regulate the positioning and testing of fire alarms and fire extinguishers, and regulate the distribution of keys,
- g. The control of security in the building by limiting the number of keys available to residents.

KEY TIP

Make sure that the board has the power to issue and amend house rules in order to allow it to respond quickly to commercial and regulatory developments.

Common Property

Ordinarily, the constitution will provide that the company has responsibility for certain parts of the property and the shareholder associated with each unit has responsibility for other parts of the property. The property which the company has responsibility for is often called 'common property'.

That said, it is often the case that older memoranda and articles of association do not specify the boundaries between the common property and the property which is the responsibility of a

shareholder. This can give rise to disputes when shareholders or the company wish to undertake renovations.

One way in which companies can get around these difficulties is to adopt a set of renovation and maintenance rules which outline:

- a. what renovations of what parts of the property the shareholder is entitled to undertake, and in what circumstances they are entitled to undertake them;
- b. what renovations of what parts of the property the company is entitled to undertake, and in what circumstances they are entitled to undertake them;
- c. what parts of the property the shareholders are required to keep clean and in good repair; and
- d. what parts of the property the company is required to keep clean and in good repair.

Adopting such a set of rules is a practical way in which companies can avoid many of the disputes that arise without having to change the constitution.

Purchasing and Selling Shares in a Company Title Building

Purchasing Shares

Before purchasing shares in a company, prospective buyers should ensure that they do the following things:

- a. Read and understand the constitution and the house rules.

Particularly, purchasers should have a clear picture of:

- i. exclusive use and occupation of a flat.
 - ii. their duties as a shareholder.
 - iii. their potential financial liabilities to the company by way of levies and interest accrued on levies.
 - iv. The extent of their ability to lease their flat and sell their shares.
- b. Explore appropriate financing options. In this regard, it is worth noting that it can be more difficult to obtain finance by way of a mortgage over shares than it is to obtain finance by way of a mortgage over land. Typically, mortgagees require a personal guarantee by the shareholder and recognition of the security interest in the shares by the company. The mortgagee will usually retain the share certificate.
 - c. Conduct a pre-purchase inspection of the flat associated with the relevant shares. This will help to ensure that the purchaser has a clear picture of the likely repair and

maintenance costs that will be incurred in the short to medium term.

- d. Obtain a company inspection report. This will help the purchaser to inform himself or herself about the state of the management of the company and its financial position, and any recent issues relating to the building.

The process for purchasing shares in a company can be rather different from the process associated with the purchase of land. For example, constitutions generally require that prospective shareholders obtain the consent of the board prior to the registration of their shares. This generally requires purchasers to submit written references to the board, attend an interview with board members, and to affirm that they have read and agree to be bound by the house rules and the constitution. The process of submitting references, attending interviews and agreeing to the constitution and house rules typically takes place between exchange and settlement. Accordingly, settlement is almost always conditional on getting board approval.

KEY TIP

It is a good idea to get an experienced solicitor to review the contract for sale, the constitution and the house rules.

Getting a Loan to Buy a Company Title home unit

Company title conveyancing is a specialised field. Our conveyancing team offers a checklist for pre-purchasers that helps them navigate the issues that tend to arise.

For enquiries about the checklist and other information, contact

Joanne Liang on 9331 0266 or email joanne@jfmpropertylawyers.com.au

Vendor's Pack

It is important that all incoming purchasers are given sufficient information about the company to allow them to determine whether they want to buy shares before they enter into a contract to do so. Purchasers should not be surprised about levies that are due to be paid or major capital works that are on the horizon.

Companies can manage this issue by developing a vendor's pack. A vendor's pack is a set of documents that are distributed by vendors to purchasers on a confidential basis to help purchasers develop an understanding of the governance of the company and their likely liabilities as shareholders. The vendors pack should include a copy of:

- a. the constitution;
- b. the house rules;
- c. any minutes approving renovations which may be taking place after the sale;
- d. any minutes approving levies that may be payable after the sale;
- e. any minutes concerning future capital works;
- f. any significant liabilities that the company has taken on, such as loans secured against the property or by circulating security interest.

Companies which interview incoming shareholders may wish to require all persons who are being interviewed to have first received and reviewed a vendor's pack.

KEY TIP

It is a good idea to have potential purchasers sign a confidentiality acknowledgment before receiving a vendor's pack to ensure that they do not disclose the information received in the pack to a third party or use it otherwise than for the purposes of deciding whether to purchase the shares.

Selling Shares

The Australian Securities and Investments Commission has issued a Regulatory Guide which allows shareholders who wish to sell their shares in a company title company to escape some of the onerous requirements associated with the marketing and sale of shares in other types of companies.

Shareholders who wish to enjoy the benefit of a reduced compliance burden will need a contract which satisfies the requirements set out in the Regulatory Guide.

Governance and Management

The Board

The board is a group of directors responsible for the governance of the company.

The constitution will empower the board to exercise certain powers, and it will hold regular meetings in order to pass resolutions for the governance of the organisation.

Depending on its size, the board may be divided into smaller subcommittees for the purposes of managing specific issues. For example, there may be a specific renovations subcommittee.

These subcommittees will generally be composed of a subset of board members, and will provide reports to the board. The board will make the final decision on any issues raised in those reports.

KEY TIP

In practice, sub-committees should only be used in larger buildings.

Board meetings

Board meetings must be conducted on a regular basis. They will be moderated by the chairperson, who will seek to facilitate a constructive, respectful, and efficient meeting that runs in accordance with the agenda.

Typically, the items on the next page will be on the agenda.

Board Meeting Agenda Items

- a. the approval of the minutes of the previous meeting.
- b. the disclosure of any conflicts of interest and their management.
- c. a discussion of any ongoing or proposed maintenance or building works.
- d. discussion of Work Health and Safety and Fire Safety matters.
- e. a report by the Treasurer as to the accounts and financial position of the company.
- f. a discussion of any complaints made or issues raised by shareholders.
- g. a discussion of any contracts that are up for renewal.
- h. a discussion about any reports prepared by subcommittees or external experts.

KEY TIP

It is often a good idea to develop a board code of conduct to ensure that meetings are civil, inclusive and productive

The Board and General Meetings

A company may hold two types of general meeting. They are the Annual General Meeting (AGM) and Extraordinary General Meetings (EGMs).

The Annual General Meeting (AGM)

The AGM is a meeting of all of the shareholders in the company that will be held within six months of the end of each financial year. Specific procedural and quorum requirements for the meeting will be contained in the constitution.

Generally, the AGM will be comprised of various reports from office holders such as the chairperson and the treasurer, followed by an election of directors and office holders for the next year.

The board may seek to pass a number of ordinary resolutions at the AGM. For example, an ordinary resolution may be passed to appoint a Company Manager. Such resolutions require the support of 50% of the company's shareholders.

Notice of General Meetings of Members

It is important that members receive a written notice of a general meeting at least 21 days before it takes place. That notice should outline the resolutions that the shareholders will be required to consider at the meeting. It should provide a concise explanation of the resolutions, the reasons why they are being proposed and the risks or detriments associated with their passage. This statement should help the members to determine whether or not to vote in favour of it.

KEY TIP

If the directors propose a resolution, they may wish to include a recommendation that the members vote in favour of it.

Proxies

Some constitutions permit members to vote at general meetings by proxy. If this is so, it is important that a proxy form is sent out to each of the members with the notice of the meeting. That form should specify the date by which proxy forms need to be returned to the chairperson in order for their votes to be counted.

Ordinarily, a member may appoint a directed or general proxy. If a member appoints a directed proxy, he or she must vote in

the way that the member directs him or her to vote. If a member appoints a general proxy, he or she is able to decide which way he or she will vote.

Resolutions of Directors

Any director may propose a resolution of the directors. Ordinarily, directors can pass such resolutions on most matters which might concern the management or operation of a company. Generally speaking, such resolutions can be passed by either:

- a. a majority of the directors who are present at a quorate meeting voting in favour of the resolution; or
- b. all of the directors indicate that they are in favour of a resolution by signing a document which sets out the resolution.

It is important to ensure that all resolutions are recorded either in the minutes of a meeting or in a separate record of resolution. That record should be signed by the chairperson and confirmed at the next meeting of directors.

Resolutions of Members

Ordinarily, a general meeting of members can pass resolutions on matters which concern the governance of the company. Such resolutions may be proposed by the directors or a group of members. Certain matters require ordinary resolutions. Others require special resolutions.

For example, an ordinary resolution may be passed to elect new directors, adopt reports or appoint auditors. Such ordinary resolutions must be passed by a majority of the members who are present at the meeting.

Similarly, a general meeting of members can pass a special

resolution to repeal, replace or amend the constitution of the company or to alter the rights of a class of shareholders. Such ordinary resolutions must be passed by over 75% of the members who are present at the meeting.

There are a number of ways in which members can vote. Typically, members should vote by a show of hands unless one of them demands a secret ballot.

Good Meeting Procedures

The chairperson is required to ensure that a general meeting is conducted efficiently and effectively. A failure to do so can cause a meeting to get out of hand, and can give rise to disputes as to whether resolutions were validly passed.

In order to ensure that a meeting is carried out effectively, chairperson should take all reasonable steps to ensure that:

- a. he or she has taken an attendance roll, and noted any absences or apologies, prior to the commencement of the business of the meeting;
- b. only one person speaks at any given time;
- c. a person who wishes to speak on a particular topic or a particular resolution speaks only on that topic or that resolution and does not stray into other matters;
- d. shareholders do not bully, or act offensively or aggressively towards, other shareholders;
- e. the meeting runs to time, including by limiting the period of time for which a person can speak on a particular topic or resolution;
- f. the precise wording of all resolutions are formally proposed

and seconded before a vote is held;

- g. he or she has received, and determined the validity of, all appointments of proxies prior to the meeting; and
- h. he or she is prepared to hold a ballot in the event that a person calls for one.

It is a good idea for the chairperson to include a brief description of the rules that will be applied at the meeting in the bundle of documents that the shareholders receive as notice of the meeting. It is also a good idea for the chairperson to explain them briefly prior to the start of the business of the meeting.

KEY TIP

Basic meeting procedures may be included in the house rules

Extraordinary General Meetings (EGMs)

An EGM is a meeting of all of the shareholders in the company that will be called if the board wishes to put a specific proposal to the shareholders. For example, an EGM may be called to amend the constitution. Such a move will require the company to pass a special resolution supported by 75% of the company's shareholders. EGMs may also be called to sell company assets or decide whether to convert the building to strata title.

KEY TIP

Before an EGM, boards should prepare an explanatory statement to inform shareholders how any proposed resolutions will benefit the company

The Office Holders

Company title boards have a number of office holders. They include the chairperson, the treasurer, the secretary, and in some cases, company managers.

The Chairperson

The chairperson presides over board and company meetings, and seeks to ensure that they are conducted efficiently and effectively. He or she is often tasked with managing board recruitment and succession, and may have additional functions that are conferred under the constitution.

The Treasurer

The treasurer is the person who oversees the finances of the company and manages its accounts. He or she will provide regular reports to the board on the financial position of the company, and make sure that the company complies with all of its financial and auditing responsibilities.

The Secretary

The secretary is required to ensure that all board and company meetings are properly called, that relevant information is collated and distributed prior to meetings, and that accurate minutes of meetings are kept and approved.

KEY TIP

It is worthwhile establishing clear position descriptions to assist in board renewal and to avoid the duplication of responsibilities.

The role of Company Managers and Building Managers

Some companies will appoint an external manager to collect levies and to manage the operations of the building on a day-to-day basis.

In larger buildings a building manager may also be necessary to attend to cleaning and basic maintenance duties.

KEY TIP

The board or a sub-committee should review the performance of the company manager and building manager and the terms of their contracts on an annual basis.

What Obligations do Directors have?

Directors have a number of important duties, which must be observed. These may be derived from the constitution, the *Corporations Act 2001* (Cth), the common law and equitable principles relating to directors of companies. They include:

- a. The duty to act with due care and diligence. For example, a director must be reasonably acquainted with the structure of the company and its financial position, and must make a reasonable effort to read and seriously engage with all documents or reports that come before the board.
- b. The duty to maintain the confidentiality of board discussions. While this does not prevent the publication of the minutes of meetings in an approved form, a director would breach this duty if he or she discloses information to unauthorised individuals.

- c. The duty to disclose and avoid conflicts of interest. For example, if a director owned a construction firm and the company was considering doing major renovations which could be carried out by that firm, the director would be required to inform the board that he or she is the owner of a construction company and excuse himself or herself from any board discussions on the issue.
- d. The duty not to misuse information. For example, the director in the previous example could not use information about the proposed renovations that he or she obtained at a board meeting to generate a business opportunity for his or her company.
- e. A duty to act for a proper purpose. For example, the director in the previous example could not vote in favour of a resolution to undertake certain renovations for the purposes of providing his or her construction firm with additional revenue.
- f. A duty to act in good faith and in the best interests of the company as a whole. For example, a director may be found to have breached this duty if he or she proposed a resolution that was in the interests of a group of shareholders on a particular floor of which he or she was a member, but to the detriment of the interests of the company as a whole.

Board Culture

Board culture is one of the favourite topics of modern corporate regulators. It refers to the practices, principles, and processes that a board adopts when conducting its business. A positive board culture can help to ensure that the building as a whole is run efficiently and effectively. A negative board culture can lead to friction and inefficiency.

Each director must commit to some basic values in order to ensure that a positive board culture is upheld. A few such values stand out:

a. Civility.

The culture of a board will be toxic if directors do not conduct themselves in a civil manner. This means that each director should be polite, courteous, and respectful in all their dealings with other directors. For example, directors should not be demeaning or insulting, should not attempt to monopolise discussion, and should not advocate their opinions in a zealous or aggressive way. Bullying is not acceptable. By maintaining civility, each director helps to create a productive space in which different views can be expressed and mutual decisions can be made. It is particularly important in the context of residential buildings, in which directors often have to live alongside each other.

b. Inclusivity.

The board should not be divided into factions or interest groups. As a director, you should engage with all other directors in an appropriate manner. You should not deal with board issues with a small sub-group of directors outside board meetings.

c. Attendance and punctuality.

A positive board culture requires every director to attend all board meetings punctually and having read the relevant board materials. Without doing so, board business can become disjointed and frustrating.

d. Accountability and Integrity.

As a director, you must recognise that you are all ultimately

responsible to the company's shareholders. In this respect, you must endeavour not to conduct yourself at a board meeting in a manner that is not consistent with what you think the interests of its shareholders are.

KEY TIP

A sub-committee of the board could be set up to draft a board code of conduct, which will help all board members come to grips with the key components of a positive board culture.

Work Health and Safety Obligations

Until November 2016, company title companies were required to comply with the full range of obligations imposed on persons conducting a business under the *Work Health and Safety Act 2011* (NSW) and *Work Health and Safety Regulation 2011* (NSW). Since November 2016, many company title companies have been exempted from most obligations.

Company title companies may still be required to comply with work health and safety obligations if part of their buildings are used for commercial purposes, or if they are directing contractors to carry out works involving dangerous plant or chemicals.

It is important to remember that company title companies may be liable for risks to visitors that do not arise under the work health and safety legislation. For example, they may be liable in tort as occupiers of common property at general law. This means that, while companies need not comply with the letter of the work health and safety legislation, they should seek to take reasonable steps to comply with its spirit to ensure that the common property is safe for all entrants.

Fire Safety Obligations

Part 9 of the *Environmental Planning and Assessment Regulation 2010 (NSW)* requires companies to provide Fire & Rescue New South Wales with an Annual Fire Safety Statement. The Annual Fire Safety Statement is a certificate prepared by a qualified fire consultant stating that each of the essential fire safety measures contained in the building's approved Fire Safety Schedule work properly.

Fire safety cannot be treated merely as a routine matter of regulatory compliance. As Deputy Coroner Dillon explained in his final report on the Inquest into the *Death of Connie Zhang*, all persons with responsibility for the management of residential buildings should seek to establish a “real safety culture” that is built on a constant “mindfulness” of potential fire safety risks.

Directors should be mindful of their legal responsibilities for safe building and remember that to tradesman, fire inspectors and others, the building is a workplace, with all that that implies.

KEY TIP

Boards should engage an experienced fire consultant to make regular reports to the board on fire safety matters, and review his or her performance and contract on an annual basis.

Altering Common Property

Common property cannot be altered without the consent of the board. Generally, constitutions also impose a duty on the board to carry out necessary repair and maintenance work on the common

property and to charge a levy to establish a fund out of which such works can be financed.

Constitutions may also provide the board with power to carry out more substantial works on the common property and to charge a special levy to finance the works. If the constitution does not provide such a power, a special resolution will need to be passed to give the company such a power prior to any major works being carried out.

The company may need to obtain a development approval in respect of the proposed works, and to comply with various regulatory requirements under the *Environmental Planning and Assessment Act 1979* (NSW). It is also worth noting that many company title buildings are affected by heritage regulations which may require certain components of the external appearance of the buildings to be maintained. This can affect the scope of any proposed alterations to the common property.

KEY TIP

It is a good idea to obtain advice from a development consultant with respect to any proposed structural alteration to a unit or common property in order to guide the board through the development application and approval process.

When alterations to the building require the consent of the local council, the development application usually needs to have the Company seal attached. The attachment of the seal must have directors' approval.

There may be times when the directors are concerned about

attaching the seal to a development application. If this is so, they should get legal advice as to the company's rights.

Maintaining Company Records

It is important that companies retain important documents in physical and electronic form for a period of at least seven years. The following records should be kept:

- A copy of all financial statements, including balance sheets and profit and loss statements.
- A copy of all minutes of directors meetings and general meetings of shareholders.
- A copy of documents associated with all transactions entered into by the company, including building contracts and insurance contracts.
- A copy of all interactions with regulatory authorities, such as ASIC, Safe Work Australia, and the ATO.

An up to date register of members should be maintained at all times.

The company should also maintain a register of any charges or security interests registered over assets owned by the company. Such security interests may arise if the company borrows money from a bank.

If you need help

ASIC Information Sheet 76 has a comprehensive list of all of the records a company should keep. Section 9 of the *Corporations Act 2001* (Cth) also contains a definition of 'financial records' which tells companies which records they need to keep.

KEY TIP

Consider uploading your physical documents to a cloud computing server. It is important to have a digital backup that can be used if physical documents are damaged.

Rights, Duties and Disputes

Shareholders' Rights

Tenants under leases have a number of rights that are recognised at common law, such as the right to quiet enjoyment of the leasehold property, while shareholders will only have such rights as are expressly or impliedly conferred on them under the constitution or a separate licence agreement or other contract with the company

Often, the only 'rights' that a shareholder possesses is the right to exclusive use and occupation of a flat and a limited right to grant a lease over that flat in approved circumstances.

Some modern constitutions may replicate some of the rights granted to lot owners under the *Strata Schemes Management Act 1996*, the *Strata Schemes Management Act 2015*, and the associated model by-laws, such as the right to peaceful enjoyment of the property. Such rights are rarely granted by older constitutions.

KEY TIP

Review the constitution and house rules to determine what rights each shareholder has.

Shareholders' Duties

The constitution may require shareholders to discharge a variety of duties. Typically, these duties include:

- a. not using their flat, or permitting their flat to be used, in a way that creates a 'hazard or nuisance' by interfering with the rights of other occupants.

- b. not using the common property in a way that unreasonably interferes with the use of the common property by other occupants.
- c. not making structural changes or alterations to their flat without the consent of the company.
- d. maintaining their flat in a good state of cleanliness and repair, and undertaking necessary repairs on wear and tear.
- e. allowing the directors access to their flats for the purposes specified in the constitution.
- f. complying with the house rules.

KEY TIP

Review the constitution and house rules to determine what duties each shareholder has.

Companies Repairing Flats

If a shareholder does not comply with his or her obligation to keep his or her flat in good and proper repair, most constitutions provide the company with a power to issue a breach notice with which the shareholder must comply in a specified period of time. Though it is often effective, this process can be slow and cumbersome to implement. It is often more efficient for constitutions to supplement the breach notice regime with provision that empowers the company to:

- a. enter a shareholder's flat where the company suspects on reasonable grounds that the shareholder has failed to comply with his or her duty to keep that flat in good and proper repair;

- b. carry out any works that may be necessary to put the flat in good and proper repair; and
- c. charge the shareholder for its costs in carrying out those works.

Such a power can be exercised in circumstances in which repairs are particularly urgent or are required to prevent damage to common property or another flat.

Leasing

Constitutions and house rules generally have strict requirements governing the ability of shareholders to lease their flats to tenants. These requirements aim to restrict the disruption that is caused by frequent short-term leases. Common requirements include:

- a. a prohibition of leasing until the relevant shareholder has been occupied the flat for 12 months.
- b. a prohibition of short term leasing and licensing, so that shareholders cannot advertise their flat on online platforms such as AirBnB.

There is typically an exception for short term stays by family and friends of the shareholder.

- c. a prohibition on long term leasing. This usually takes the form of a maximum permissible length for a lease, such that the right to occupancy of the flat must be returned to the shareholder after a specified period of time.
- d. a requirement that prospective tenants be approved by the board. This usually requires prospective tenants to submit written references to the board, attend an interview with board members, and to affirm that they have read and agree to be bound by the house rules and the constitution.

Some constitutions prohibit leasing altogether. If this is the case, directors should be mindful to ensure that the prohibition is either enforced consistently, or removed from the constitution by way of a special resolution. Complex disputes can arise where prohibitions on leasing are selectively enforced.

KEY TIP

Put specific and procedural provisions about leasing in the house rules rather than the constitution. This will allow the board more rapidly to respond to changes in the short term leasing market.

Short Term Stays

In recent years, many company title buildings have found themselves confronted with an influx of short term tenants and licensees. This influx has been facilitated by the emergence of online leasing platforms such as Airbnb. This is a particular problem in the Potts Point area, in which Airbnb is often used to lease properties for 'bucks' nights' and other social occasions.

Company title boards need to get on the front foot quickly. There are a number of strategies that they can adopt. These include:

- a. Modifying the house rules to prevent short-term letting or licensing without the consent of the board.
- b. Limiting the number of keys that are issued to shareholders and tenants.
- c. Amending the constitution to provide the shareholders indemnify the company for any loss or damage that results from the conduct of tenants, sub-tenants and licensees.

- d. Monitoring comings and goings from the building.
- e. Communicating expectations to shareholders and tenants

Penalty Clauses

Many constitutions impose monetary ‘penalties’ on shareholders in the event that they breach the constitution or house rules. Such clauses will not be enforceable if the amount that the shareholder is required to pay is not a genuine pre-estimate of the loss that would be suffered by the company as a result of the breach of the relevant provision in the constitution or by-law.

Companies should be particularly cautious about any such clauses. For example, some house rules require shareholders to pay a lump sum for each day on which they are in breach of short term leasing provisions in house rules. Given that the loss actually incurred by the company as a result of such a breach will be difficult to estimate in advance, it may be more appropriate to require such shareholders to indemnify the company for the costs of repairing any damage or cleaning any mess caused by short-term lessees.

KEY TIP

The board should review ‘penalty’ clauses and consider more appropriate ways of protecting the company from loss resulting from breaches of house rules or the constitution.

Dispute Resolution

Section 34A of the *Local Court Act 2007* (NSW) provides the Local Court with jurisdiction to make a variety of orders in relation to certain forms of company title disputes. An application for an order under s 34A can be made by the company, a shareholder, a resident, or a former resident.

The jurisdiction of the Local Court is broad, and encompasses the following types of disputes:

- a. Disputes about the health and safety of occupiers and visitors: for example, the company may seek an order requiring an occupier to grant its representative access to a residential flat in order to carry out a fire safety inspection. Conversely, a shareholder may seek an order requiring the company to install child safety devices on unsafe windows in common property hallways.
- b. Disputes about the common property: for example, the company may seek an order against a shareholder to prevent the shareholder from carrying out unauthorised landscaping works on a common property garden area.
- c. Disputes about the use of residential flats: for example, the company may seek an order preventing a shareholder from keeping a pet in a residential flat in breach of the house rules.
- d. Disputes about the behaviour of people occupying residential flats: for example, a shareholder may seek an order against a tenant, requiring the tenant to cease playing a loud musical instrument during the night.
- e. Administrative disputes: for example, the company may seek

an order against a shareholder requiring the shareholder to pay an overdue levy and any interest that has accrued on that levy.

It is worth noting that many constitutions provide that the company can recover reasonable legal costs from a shareholder who they are required to take to court. If such a provision is included in the constitution, a shareholder who is successfully taken to court over a failure to pay a levy will have to pay both the levy and any reasonable legal costs that the company incurred in taking the court action.

Modern constitutions will typically make provision for the resolution of some disputes by way of mediation or arbitration as a prerequisite to any court applications. This can be a particularly cost effective way of resolving many disputes. Moreover, if proceedings are commenced in the Local Court, the magistrate may enquire into the steps that the parties have taken to resolve the dispute outside court. This may be relevant for determining costs orders.

KEY TIP

Boards should consider including a dispute resolution clause in the house rules that refers minor disputes to mediation at the Community Justice Centre

Levies

All constitutions provide the company with a power to charge levies or contributions on its shareholders. Such levies are payable by the respective shareholders in proportion to their percentage shareholding in the company.

The company will ordinarily charge a levy or contribution to establish an 'administrative fund' to finance the day-to-day management of the building or a 'sinking fund' to carry out building works. It may also have the power to charge a 'special levy' to cover liabilities that cannot or should not be satisfied by the administrative fund or the sinking fund, such as major capital works or significant emergency repairs.

KEY TIP

Boards should be attentive to the scope of their constitutional power to charge levies. Some levies may require an ordinary resolution.

Collecting Levies

Boards must take a proactive stance to ensure that levies are paid on time and in full. The company cannot operate unless it has sufficient funds to finance its operations and any proposed works.

There are a number of things which the company can do to maximise its chances of efficiently collecting levies: These are listed on the following page.

Levies

- a. Ensure that the constitution provides for the restriction shareholders' voting rights in circumstances in which their levies have remained unpaid for an extended period of time.
- b. Ensure that the board has a constitutional power to charge interest on unpaid levies.
- c. Ensure that the company has a constitutional power to recover any unpaid levies through debt recovery proceedings in the Local Court.
- d. Ensure that the constitution makes provision for the eventual forfeiture of shares in the event of a failure to pay levies.
- e. Ensure that the constitution provides the company with a charge or lien over the proceeds of the sale of any share as security for any unpaid levies.

Companies may be able to further protect their interest in recovering levies by allowing shareholders to occupy their units under separate licence agreements that may be terminated by the company in the event that levies are unpaid for a certain period of time. These agreements can help companies to protect their position in the event of a priority dispute with a bank. If such an agreement is terminated because of the failure to pay levies, the company can recover funds by granting a new licence to occupy to a third party in return for the payment of rent.

KEY TIP

Boards should review the constitution to make sure the company has sufficient protection and powers to deal with a shareholder default on the payment of levies.

The board should have a policy for the collection of arrears in levies. This policy should be sent to all shareholders annually.

Recovering Interest

Most constitutions provide the board with power to charge interest on unpaid levies. This is important for getting levies paid promptly and can compensate the company for not being able to use the funds while the money was overdue.

Directors should be careful to ensure that the amount of interest charged is not so excessive as to constitute an unenforceable penalty. This can be done by ensuring that the amount of interest charged does not extend more than 2-3% above an applicable small business lending rate. The Commonwealth Bank of Australia's rate is a good guide.

KEY TIP

Make sure that interest is charged at a rate that is not too far beyond an applicable market rate.

Recovering Legal Costs

Many constitutions also provide that the company may recover legal costs from any shareholder it has successfully taken to court to recover unpaid levies or rectify a breach of the constitution or house rules. This allows the company to lessen the risk associated with commencing litigation. It will not, however, protect the company in the event that it is unsuccessful in the claim.

It is important to make sure that any such clause provides that costs are to be recovered on an indemnity basis. Such 'indemnity' costs will cover a greater proportion of the actual legal fees incurred by the company than 'ordinary' or 'party-party' costs.

KEY TIP

Boards should make sure that legal costs are recoverable on an indemnity basis.

Conversion to Strata Title

The process associated with the conversion of a company title building to a strata title building is complex, and can be costly. It does, however, allow shareholders and directors to rely on the provisions of the strata title legislation for the purposes of resolving disputes and managing the building.

The key prerequisite to conversion is the unanimous support of all shareholders. Without such unanimous support, it is unlikely that the process will be able to be carried out.

The conversion process generally runs as follows:

1. First, the company must be satisfied that it has a power under the constitution that permits it to convert the building into strata title. If the company does not have such a power, it will be required to alter the constitution by way of a special resolution passed by 75% of all shareholders at an EGM.
2. Second, the board or the company must resolve to convert the building into strata title in accordance with the constitution.
3. Third, a licensed surveyor must be engaged to prepare a strata plan. The plan should be ratified by each of the Shareholders, and submitted to the relevant local council for approval. The local council may withhold its approval until such time as certain building works are carried out.
4. Fourth, the company must obtain approval from all mortgagees who hold security interests in company title shares. Consent is generally given as a matter of course.
5. Fifth, the approved strata plan must be lodged with Land & Property Information for registration.

6. Sixth, title to the lots in the new strata plan must be transferred to each shareholder. Title in the lots are ordinarily transferred for nominal consideration.
7. Seventh, the transfers must each be assessed for stamp duty. Nominal stamp duty will be charged if the transfer is accompanied by a statutory declaration outlining the nature of the conversion arrangement and affirming that the transferee was the owner of shares in a company title company immediately before the registration of the strata plan.
8. Eighth, each transferee must register his or her stamped transfer form at Land & Property Information. Upon doing so, they will obtain a duplicate certificate of title and become the registered proprietor of the relevant lot in the strata plan.
9. Ninth, the new Owners' Corporation must hold its first AGM. There are a number of statutory requirements detailing what must be discussed at that meeting and what information must be provided to the residents.
10. Tenth, the company should be wound up voluntarily.

KEY TIP

Shareholders with mortgages should confer with their mortgagees to discuss the implications of the conversion for their loans.

Company Title Developments

Property developers are increasingly looking towards company title as a means of structuring new residential projects. The Australian Securities and Investments Commission has issued a Regulatory Guide which may allow some developers who wish to deliver a company title project to reduce some of the burdensome compliance costs typically associated with sales of shares in companies.

Those developers who cannot take advantage of the Regulatory Guide are still able to unlock value by using the company title form. Many developers have recognised that company title has sufficiently flexibility to allow them to create bespoke developments that deliver real value to investors. This flexibility is often not available in traditional strata and community title projects.

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