The attached Court of Appeal Decision relates to the question of exclusive letting rights for Management Rights operators. It had appeared from earlier precedents that the Body Corporate did not have the right to grant a Manager exclusive letting rights to any apartment complex and thus bind the Apartment Owners to that arrangement. The attached Court of Appeal Decision dated the 6th August 2013 shows that the Court of Appeal upheld the High Court Decision that the appointment of an exclusive letting agent is not "ultra vires", meaning beyond the power of the Body Corporate. This should mean that contracts for the sale of Management Rights which include a Body Corporate provision that the Body Corporate appointed Manager has exclusive letting rights, should remain binding. The Apartment Owners would usually still have the option to remove their property from the letting pool with the appropriate notice. If however an exclusive letting appointment is enforceable, they are not able to arrange for anyone other than the Body Corporate appointed Manager to let their apartments.

This summary is not intended to offer legal advice or opinion. As always, it is imperative that independent professional legal advice be obtained in these matters.

IN THE COURT OF APPEAL OF NEW ZEALAND

CA345/2012
[2013] NZCA 351

BETWEEN	ABCDE INVESTMENTS LIMITED & ORS Appellants
AND	JOHN BERNARD VAN GOG AND KIM MARGARET VAN GOG First Respondents
AND	BODY CORPORATE S89906 Second Respondent

Hearing:	22 May 2013
Court:	Arnold, Harrison and Rodney Hansen JJ
Counsel:	T J Rainey and J P Wood for Appellants M D Branch and K I Bond for Respondents No appearance for Second Respondent
Judgment:	6 August 2013 at 2.30 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants must pay the first respondents costs on a standard band A basis together with usual and reasonable disbursements.

REASONS OF THE COURT

(Given by Harrison J)

Introduction

[1] The Terraces is a 23 unit residential complex at Mount Maunganui which has been subdivided into units under the Unit Titles legislation.[1] The relevant planning instruments prohibit owners from residing permanently in their units or retaining permanent tenants and limit the units to being used for short stay accommodation of not more than three months (that is, essentially as holiday accommodation). Owners have used their units in this way since the development was completed in 2000.

[2] While the units are self-contained residences, the complex is operated in a way similar to a motel. Building managers who own one of the units, unit 23 (the management unit), offer accommodation services on behalf of owners who wish to let their units for short terms. The relationship between the managers and the owners is governed by a series of contractual instruments including a memorandum of encumbrance. Seven of the unit owners (collectively ABCDE) challenge the validity of the encumbrance, and appeal against the judgment of Collins J in the High Court dismissing an application for a declaration that the encumbrance is unenforceable.[2]

Facts

[3] The relevant facts are not in dispute and can be summarised briefly as follows:

(a) On 8 November 2000 the directors of Ocean Beach Custodians Ltd (OBCL), the developer of the Terraces, signed a notice of change of the amended rules to be lodged for the proposed body corporate.

(b) On 27 November 2000 the directors of OBCL signed the memorandum of encumbrance in the capacities of both encumbrancor (as registered proprietor of units 1–22) and encumbrancee (as registered proprietor of unit 23). By virtue of this encumbrance, OBCL (as proprietor of unit 23) agreed to pay itself (as proprietor of

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1 Created by the Unit Titles Act 1972 but now governed by the Unit Titles Act 2010.

2 *ABCDE Investments Ltd v Van Gog* [2012] NZHC 1131, (2012) 13 NZCPR 539. The second respondent abides the decision of the Court.

units 1–22) a rent charge of $1 per year for 999 years and abide by the relevant covenants.

(c) On 6 December 2000 the unit plan of the Terraces was deposited. Body Corporate S89906 came into existence under the Unit Titles Act 1972. OBCL was the original owner of all the units. On the same day the memorandum of encumbrance was entered onto the titles to units 1–22. Unfortunately, however, the Body Corporate did not formally adopt the amended rules.

(d) On 20 December 2000 a management agreement was entered into between the Body Corporate and the proprietors of unit 23 as building managers. That agreement contained provisions granting the building managers the exclusive right to exercise the letting service on the property but acknowledging that unit proprietors could use letting services provided by others off the property.

(e) When taking possession of units new owners signed agreements with the managers authorising the latter to operate the letting of their units to the public for short term visitor accommodation. The letting agreement provided that the building managers were the owner's "exclusive agent and representative to act as Building Manager for the Owner" and that they had "an authority and exclusive right to negotiate tenancies with existing and prospective tenants on terms approved by the Owner". It also covered the managers' remuneration, allocation of expenses and provided for rights of termination. The managers provided management services for short term visitor accommodation on the basis of the letting agreements.

[4] Clauses 3 and 4 of the encumbrance are at the centre of this argument. Clause 3 reads relevantly:

> The proprietor of the relevant unit ... agrees that the Encumbrancee is entitled exclusively to exercise the Letting Service in respect of the Units and for that purpose the Body Corporate may enter into an appropriate agreement with the Encumbrancee on such terms and conditions as the Body

Corporate may deem fit (all as set out in body corporate rules registered on or about the date of registration of this encumbrance).

[5] Clause 4 relevantly provides:

> The proprietor of the relevant unit comprising the Land agrees with and for the benefit of the Encumbrancee that the Body Corporate shall not without the prior written consent of the Encumbrancee:
>
> (a) authorise any person to, nor permit any person nor any of its staff, nor itself exercise the Letting Service or any letting service of the same or similar nature as that carried on by the Encumbrancee; or
>
> (b) licence, lease or grant restrictive or exclusive use of any part of the common property other than to the Encumbrancee for the purpose of allowing any person to exercise the Letting Service or carry on any letting service (all as set out in body corporate rules registered on or about the date of registration of this encumbrance).

[6] Letting arrangements entered into by the building managers on behalf of unit owners apparently worked without incident for some years. The present managers, the first respondents John and Kim Van Gog, purchased the management unit in 2005 and subsequently bought two other units in the complex. At the same time they took an assignment of the management agreement entitling them to act as managers for the balance of a 20 year term.

High Court

[7] In recent years some owners including ABCDE have terminated their holiday letting agreements with the Van Gogs. ABCDE applied to the High Court for declaratory relief under the Declaratory Judgments Act 1908, without opposition, that: (a) the amended rules of the Body Corporate were invalid; (b) the management agreement was invalidly entered into by the Body Corporate and was not binding; and (c) if the Body Corporate rules were valid, certain provisions in the amended rules were ultra vires and the management agreement was invalid and void.

[8] Collins J granted the first two declarations. The Judge held that the amended Body Corporate rules were invalid because they were not formally adopted by the Body Corporate after it came into existence. Accordingly, the Body Corporate's rules were those set out in the second and third schedules of the Unit Titles Act 1972

(except to the extent altered by the subsequent legislation).[3] As to the management agreement, Collins J held that it had been entered into without authority and was ultra vires. This was because it had been entered into under the invalid amended rules.[4]

[9] ABCDE also sought a declaration that (a) the Van Gogs were not entitled to the exclusive right to let units to the public; or alternatively (b) the encumbrance was invalid and unenforceable. In upholding the Van Gogs' opposition, Collins J held that the encumbrance was enforceable. He treated the encumbrance as a mortgage by virtue of the existence of a rent charge clause which bound successors in title (that conclusion is not challenged on appeal).[5] He was satisfied that the commercial arrangements constituted by the amended rules and the letting agreements when read together with cl 3 of the encumbrance constitute a restriction on unit owners letting the units except through the building managers' services.[6]

[10] ABCDE appeals against the High Court judgment on two grounds. First, it said that the encumbrance does not confer on the building managers the exclusive right to exercise the letting service. Second, if that argument failed, it said that the encumbrance does not contain all essential terms necessary to give rise to an enforceable contract between the managers and owners. We shall address the two grounds in that order, noting that in argument before us Mr Rainey substantially modified the first ground and Mr Bond submitted that our answer to the first ground will necessarily answer the second ground.

Decision

(a) Enforceability

[11] In support of ABCDE's appeal, Mr Rainey originally submitted that on a proper construction the encumbrance does not confer on the encumbrancee, the

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3 At [25].
4 At [29] and [32].
5 At [36], applying s 101 of the Land Transfer Act 1952, the definition of mortgage in s 4 of the Property Law Act 2007 and the judgment of this Court in *Jackson Mews Management Ltd v Menere* [2009] NZCA 563, [2010] 2 NZLR 347 at [59].
6 At [44] and [63].

building managers, the exclusive right to exercise a letting service for owners in the complex. His written synopsis advanced detailed submissions in support.

[12] However, in argument before us Mr Rainey conceded that the encumbrance did confer on the building managers an exclusive right to exercise the letting service. Nevertheless, he submitted that this grant of exclusivity was not sufficient of itself; something more was required to create an enforceable right to undertake the letting service – namely, execution of a valid management agreement between the Body Corporate and the encumbrancee. This extra step was necessary to translate the right of exclusivity into an effective right – what Mr Rainey called giving the encumbrance its "vitality". The owners would allow the building managers to exclusively exercise the letting service solely through the mechanism of this subsequent contract. Implicit in that extra step was the limitation on the Body Corporate's powers arising from the terms of the Unit Titles Act and, in particular, that any requirement imposed on unit owners through a management agreement to use the services of a manager would be ultra vires.

[13] In the result, Mr Rainey submitted, the Body Corporate cannot require a unit owner to use a single letting agent. The owner must have a choice. This was confirmed by the management agreement. When that agreement was read in conjunction with the amended rules, the developer's intention was clear – the building managers had the right to offer an exclusive letting service on-site but the owners retained the right to use other letting services off-site. On Mr Rainey's argument, cl 3 cannot be construed as more than a positive obligation to allow the encumbrancee to enter into agreements with encumbrancors.

[14] While Mr Rainey advanced a careful and detailed argument, in our judgment the issue is straightforward and can be addressed on an orthodox construction of the relevant provisions in their contractual setting. In his reply before us, Mr Rainey accepted that the decisive issue is to determine the operative effect of the first part of cl 3.

[15] The meaning of the words used in cl 3 is plain and unequivocal. As Mr Rainey now acknowledges, the first part of that provision operates to confer on

the building managers an exclusive right to exercise a letting service. The right stands alone and is enforceable in its brief terms. The agreement recited in that part does not require any party to act. In particular, as Mr Bond submits, it does not oblige the owners to appoint the building managers or to do anything else.

[16] The agreement in the first part of cl 3 operates as a restriction on an owner's rights of use of a unit to the extent that an owner wishing to let a unit for short stay accommodation must use the building managers' services. This prohibition is not of absolute effect; it only takes effect where an owner decides to let a unit. As Mr Bond points out, at least one owner has never let its property and has no need to use the building managers' services.

[17] The encumbrance does not define the phrase "the Letting Service" where used in the first part of cl 3. The words are self-explanatory and do not require formal definition, particularly in the context of a development which can only be used for short-term stays. However, it is common ground, as Collins J found,[7] that the definition provided by the amended Body Corporate rules applies. While the rules were not validly adopted, they were nevertheless in existence and specifically referred to and effectively incorporated by cl 3. The fact of invalidity does not exclude the rules from consideration for this purpose. They specifically define a "Letting Service" as:

> the exclusive right of the Building Manager to let Units out for rent or reward to third parties on behalf of the Proprietor of the relevant units.

[18] Thus, we are satisfied that the first part of cl 3 is an unconditional agreement by owners granting the building managers the exclusive right to let their units, which the building managers are entitled to enforce in the usual way.

[19] In order to maintain ABCDE's challenge to the validity of cl 3, Mr Rainey focused his argument on the second part of the provision. As noted, it constitutes an agreement between the owners and the managers that the Body Corporate "... may enter into an appropriate agreement with the [building managers] on such terms and conditions as the Body Corporate may deem fit ...". In effect, Mr Rainey was saying

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7 At [41].

that the second part of cl 3 is the operative part of the provision; and that the encumbrance is conditional or does not take effect unless and until the managers and the Body Corporate "enter into an appropriate agreement", which in turn would govern the relationship between the owners and the managers, effectively subsuming the agreement found in the first part of cl 3. He characterises that part as merely declaratory.

[20] We do not accept Mr Rainey's submission. The agreement contained in the first part of cl 3 stands alone and can be enforced on its own without reference to what follows. The second part is no more than the owners' acknowledgement of the building managers' authority, which existed independently of the encumbrance, to enter into a management agreement with the Body Corporate and is arguably superfluous. Mr Bond correctly emphasises the use of the word "may" as recognising the managers' right to contract with the Body Corporate. But the second part cannot be construed as having mandatory effect against the building managers.

[21] In our judgment there is no basis for Mr Rainey's argument or the distinction he draws between the building managers' exclusive right to operate a letting service on-site and the owner's right to use other letting services off-site. This argument appears artificially designed to bring into play the declaration which Collins J made unopposed that the management agreement was invalid, based on Lang J's decision in *Russell Management Ltd v Body Corporate No 341073*[8] that it was ultra vires the Unit Titles Act 1972 for a body corporate to reserve in its rules the right to enter into a management agreement granting a third party the exclusive right to let out units in a complex. It was for that apparent reason that Mr Rainey subjected the amended rules, the management agreement and the standard form letting agreement to detailed analysis.

[22] However, we are satisfied that the validity of cl 3 is unaffected by whether the managers and the Body Corporate enter into a management agreement and, if so, its terms. The second part of the provision does no more than acknowledge the managers' freedom to contract with the Body Corporate on appropriate terms. It

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8 *Russell Management Ltd v Body Corporate No 341073* (2008) 10 NZCPR 136 (HC).

cannot be read as qualifying or subsuming the effect of the unconditional agreement found in the first part. This argument must fail.

(b) Essential terms

[23] Alternatively, Mr Rainey says, even if the encumbrance were interpreted as conferring on the encumbrancee the exclusive right to exercise the letting service, the encumbrance does not contain all the essential terms of the letting service to constitute an enforceable agreement between the parties; the further terms necessary for such an agreement cannot be ascertained from reading the encumbrance in conjunction with the amended rules; and there is no proper basis to selectively incorporate the terms necessary to make an enforceable agreement from the letting agreements subsequently entered into between unit owners and the building managers.

[24] In this respect Mr Rainey submits that Collins J erred because (a) he incorporated the terms of a document not in existence when the encumbrance was entered into; (b) he only selected some of the terms for incorporation in the composite agreement; and (c) he ignored the terms of the management agreement which preserved the owners' rights to engage others. Accordingly, to have any enforceable meaning, the scope of the letting service must be settled at the time the encumbrance came into existence. Clause 3 omits an essential term – the scope and conditions of the letting service (for example, fixing price).

[25] We do not accept Mr Rainey's argument. It proceeds on the premise, which we have rejected, that cl 3 imposes a positive obligation on the parties to enter into a formal letting agreement. Mr Bond accepts that Collins J erred in taking into account the standard form letting agreement as fully explaining the basis upon which the building managers conduct letting services on behalf of owners.[9] That is because the letting agreements were not signed until after the encumbrance was executed.

[26] However, the validity of individual letting agreements entered into directly between owners and the building managers cannot be and has not been called into

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[9] At [62]–[63].

question. The letting agreements remain binding on and enforceable against the parties. They stand independently of the encumbrance. As Mr Bond submitted, their existence merely reflects what was contemplated at the time the encumbrance was executed – that the owners and the managers would subsequently enter into separate agreements on mutually acceptable terms whenever the owners decided to let their units.

[27] Once it is accepted that cl 3 is of negative effect, there is no need to embark upon a separate inquiry into whether the encumbrance is enforceable by virtue of the absence of essential terms. The prohibitory effect of the encumbrance is enforceable on its own. It does not require incorporation of any additional terms. This argument must fail also.

[28] We add for the purpose of completeness that Mr Rainey did not rely on the termination provisions of the letting agreement to support his argument. Clause 7.3 entitles either party to cancel the agreement on written notice. That right might be said to envisage that owners could use an alternative provider. However, as we have already noted, the letting agreements stand independently of and were entered into subsequent to the encumbrance, and the termination provision is explicable in the context of an individual owner's decision made during the term of a letting agreement to use a unit for private rather than rental purposes.

Result

[29] The appeal is dismissed.

[30] ABCDE must pay the Van Gogs costs on a standard band A basis together with usual and reasonable disbursements.

Solicitors:
Rainey Law, Auckland for Appellants
Harkness Henry, Hamilton for First Respondents