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TRAPS IN COLLECTIVE SALES – POTENTIAL PROBLEM WITH OPTION AGREEMENTS

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Option Agreements

Option agreements are frequently used as a mechanism to facilitate collective sales of lots in a strata scheme. Such option agreements (commonly called "Options") provide a number of helpful mechanisms and tools to provide a degree of flexibility.

A recent decision of the Supreme Court of NSW has demonstrated that there can be traps for owners of strata lots who are using Options as part of a collective sale process.

The case provides helpful reminders about how options should be used in a collective sale process, and the matters to be aware of if lot owners are going to be properly protected in that process.

The Recent Supreme Court Decision – March 2021

In this decision (*BP7 Pty Ltd v Gavincorp Pty Ltd* [2021] NSW SC 265) the Supreme Court of NSW determined that a purchaser/developer of lots in a strata scheme was entitled to get out of contracts for the purchase of certain strata lots. The contracts had been brought into being by the vendor (lot owner) exercising a "put" option. Not only was the developer/purchaser able to get out of each contract, but they became entitled to the return of almost all of the option fees which had been paid to the vendors/lot owners.

Background to Options

An option agreement is normally structured so that a potential buyer pays an amount to the owner of land, giving that potential buyer the right to purchase the property at a fixed price within a particular time frame. So, for example, a buyer might pay the owner of the strata lot 5% of the value of that lot for the right to purchase that lot at a fixed price in 12 months' time. The upfront fee is called the "Option Fee" and is normally not refundable to the purchaser/developer, whether or not they actually proceed with the purchase.

The purpose of giving the purchaser a period of time in which to exercise those rights, is so that the purchaser can investigate and prepare for the various processes which might need to occur to enable the redevelopment of the land to take place. So, in the case of a strata scheme, a purchaser/developer may pay an amount to each lot owner to enable the purchaser/developer to buy those properties at a fixed price at some future time, and in the meantime the purchaser/developer can progress obtaining development consent with the Council.

This type of Option is called a “call” option, because the purchaser “calls” on the vendor to sell them the property by taking certain formal steps.

There is another version of an Option which is called a “put” option, and the “put” option is often found co-existing with a “call” option. A “put” option enables a vendor to require a purchaser to enter into a contract to purchase the property at a fixed price at some future time.

Very often, both “call” and “put” Options are entered into simultaneously, in the same document, in theory granting rights to the purchaser to acquire the property or for the vendor to require the purchaser to acquire the property at some future time.

Additional Complication - The Nature of Residential “Cooling Off” in NSW

For over twenty years, there has been a regime in place in NSW which grants to purchasers of residential property the right to “cool-off” (change their mind) even after they have exchanged contracts. This enables purchasers to change their mind in circumstances where they have not had the benefit of obtaining legal advice prior to entering into a contract for the purchase a residential property or for other reasons.

This right can be waived by that purchaser obtaining a certificate from a solicitor or licenced conveyancer, agreeing that the “cooling off” rights have been waived. If a purchaser does exercise their cooling off rights, then they are entitled to a refund of the deposit, less an amount of 0.25% of the purchase price.

In the case of an option to purchase residential land, there are provisions contained within the conveyancing legislation which give similar cooling-off rights to a standard contract. Such rights in an Option can also be waived with a similar certificate, and they normally would be waived.

The Facts of this Case

In this decision of the Supreme Court, a number of lot owners in a strata scheme had entered into Options with a developer. The Options gave the purchaser/developer the right to purchase the property for a period of approximately 18 months from the date that the Options were entered into.

The document concerned then granted a “put” option, giving the vendors/lot owners the right to require the purchaser to enter into a contract for a short period after the expiration of the call option. That is, if the purchaser/developer did not choose to exercise the call option, then the vendors/lot owners could exercise the put option and require the purchaser/developer to enter into a contract.

In this case, the purchaser/developer did not exercise their rights under the call option, and the vendor tried to exercise the put option.

What Went Wrong?

As a result of the vendors/lot owners exercising the put options, contracts were entered into between each vendor/lot owner and the purchaser/developer. Due to the conditions in the option and each

contract, the option fees originally paid by the purchaser/developer to each vendor (and normally non-refundable) became the deposit payable under the contract which had been brought into existence. However, the Court found that the purchaser/developer was entitled to rescind (get out of) each contract because of the lack of a certificate waiving that right. In each case here, the purchaser/developer exercised their "cooling off" rights, and therefore they were entitled to a refund of their deposit less .25% of the purchase price.

The Consequences

The Court found that the purchaser/developer was entitled to exercise their cooling off rights. The Court also found that the purchaser/developer was entitled to a refund of the deposit less .25% of the purchase price. Because the documents said that the option fee paid to the vendor/lot owners was deemed to be the deposit under the contract brought into existence as a result of the exercise of the put option, almost all of those options fees which had been paid to the vendor/lot owners some 18 months earlier had to be refunded.

Each vendor/lot owner will now have to make a significant refund to the purchaser/developer.

Implications for Lot Owners in Strata Schemes Contemplating Collective Sales

If you are a lot owner in a strata scheme which is contemplating entering into option agreement for the sale of your lots, then it is critical that you obtain specialist legal advice in relation to the form of those options, particularly where those options involve a "put" option element. Whilst it is one thing not to be able to require a purchaser/developer to proceed, it is extremely galling for a vendor/lot owner to have to repay the option fees which they have received 12, 18 or 24 months earlier.

If you are a lot owner and have already entered into option agreements with a purchaser/developer, then it is important that you understand the nature of the particular agreement into which you have entered – it

may be necessary for you to obtain some advice about the consequences of exercising any part of that option, particularly a “put” option.

In particular, vendors/lot owners need to be certain that they will not be liable to refund all or part of the valuable option fees which they have received from a purchaser/developer and they will also need to be sure that if they decide to exercise their “put” option rights, that there will be an enforceable contract with the purchaser/developer.

There is no doubt that Options can be a very powerful tool in facilitating collective sales in strata schemes, but lot owners should ensure that they are properly advised before entering into such documentation.

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About JS Mueller & Co Lawyers

JS Mueller & Co Lawyers has been servicing the strata industry across metropolitan and regional NSW for 40 years. We are a specialist firm of strata lawyers with in depth and unmatched experience in, and comprehensive knowledge of strata law and levy collection.

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