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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

DR N. BYRON, Presiding Commissioner

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON THURSDAY, 7 FEBRUARY 2008, AT 9.04 AM

Continued from 6/2/08

DR BYRON: Thank you very much, ladies and gentlemen, welcome to the fourth and final day of the public hearings from Sydney on the Productivity Commission's draft report into the market for retail tenancy leases in Australia. We're resuming with Professor Frank Zumbo. Thank you very much for coming this morning. If you could just introduce yourself for the transcript and take us through the main points you wanted to make and we will discuss that. Thank you.

PROF ZUMBO (UNSW): Thank you, Commissioner. Associate Professor Frank Zumbo, in the Australian School of Business at the University of New South Wales. Thank you for the opportunity to appear today. The market for retail leases in Australia plays a very important role in the economy. Since much the retail in Australia occurs through rented space, the rent paid by a retailer is a key cost of doing business. If the market for retail leases is not working efficiently, then that has an impact on a retailer's cost of doing business. An inefficient market for retail leases distorts competition in the retail sector and distorts the pricing for retail space. An inefficient market for retail leases adds inflationary pressure on consumer prices and in turn the economy and they're issues that I'd like to explore today.

Unfortunately, the draft report fails to get to the heart of the inefficiencies present in the market for retail leases in Australia. With all due respect, many parts of the report are superficial in their analysis of key inefficiencies in the market for retail leases. In the absence of this rigorous economic analysis of key market failures and inefficiencies within a market for retail leases a considerable shadow is cast over the draft report. The promotion of competition for the benefit of consumers should be a guiding principle for all economic regulators and regulation. Regrettably, some of the key problems in the market for retail leases were not assessed by reference to how consumers would benefit from reforms to ensure the most efficient and competitive market for retail leases in Australia.

What are key problems leading to an efficient market for retail leases? I've identified four key ones. There's probably one or two others that will emerge from my evidence this morning. Firstly, a lack of transparency in relation to rents and I explore that in some detail. Secondly, another key problem is a lack of contestability in relation to shopping centres. Thirdly, ineffective laws to deal with anticompetitive price discrimination by landlords and the fourth key problem identified is ineffective laws to stop abuses of unethical conduct by landlords.

I should say from the outset that the thrust of my evidence is to ensure an efficient market for retail leases. It's not about attacking any sector of the industry. Both landlords and tenants have a right to do their business within the laws of the state and the Commonwealth and should be allowed to do that. However, where there are inefficiencies and market failure there is a public interest that needs to be served rather than the private interests of landlords or tenants. What we want is an efficient market. An efficient market delivers the best results for consumers and

ultimately we want the best result for consumers.

In relation a lack of transparency in relation to rents, I do say from the outset that in my experience it would appear that the market for retail leases in Australia is probably one of the least transparent markets in terms of rents that one can find. The problem there essentially is one that, unlike other goods or services where I generally will know the price of the goods or services, today on the Internet you can go on there and you can find prices of almost anything. However, if I'm a tenant, a wannabe tenant or a tenant at renewal, I will often struggle to get comparable rents. Getting that information is easier said than done. In the absence of that information there is a real danger that tenants are making decisions in a manner that doesn't enable them to make an efficient decision on their behalf.

In any market the lack of transparency in the price of goods and services represents a significant market failure. In this case market failure arises because prices are not determined by an open and transparent process. Market fails where prices are determined by secret deals, information asymmetries or abuses of market power that inflate or distort prices. Markets operate most efficiently where all participants are fully informed. Conversely, markets are the least efficient where secrecy surrounds pricing within that market or the market is characterised by information asymmetries.

Given the efficient operation of the price mechanism is essential for efficient operation in the markets, any tampering, secrecy that surrounds the pricing within that market should ring very loud alarm bells; such alarm bells should be ringing very loudly in the market for retail leases. Of course, when we talk about tampering we're talking about cartel behaviour. The very little exploration that was undertaken in the report as to the level of pricing information exchange that occurs between landlords. Does that occur? To what extent does it occur? That has been an issue in other industries of late, particularly petrol where expressions like "cosy oligopolies" or "clubs are used. There may not be anything illegal about cosy oligopolies or clubs, but at least we need to ask the question. We need to explore the level of price information exchange that goes on between landlords.

Secrecy. Secrecy in relation to secret deals. Are any tenants getting preferential treatment? Are there any secret rebates? Maybe people get offended with the word "secret". But are there any payments or incentive being offered to tenants, whether they be anchor tenants or other tenants, that we need to know about. Those deals impact on the price in the market. Those deals, if not known, could distort the pricing decisions in the market.

Lack of transparency relates to the point I made earlier about inability of tenants generally speaking to be able to get information as to the market rent or to get comparables, to have some idea of what comparable rents are for that particular type

of business. If you don't have that information I suppose you could walk away if you're tenant up-front or wannabe tenant. But if you're in an existing arrangement and existing lease, then you simply can't walk away that easily and your ability to negotiate with the tenant on renewal is very much determined on your ability to access information as to what market rents are.

In relation to promoting transparency, the registration of leases office are the most efficient mechanism for the promotion of transparency. Registration of leases in today's information technology environment should be very easy and quite cheap. Economists call it a marginal cost of zero perhaps or very little, once the information is on the database people should be able to access it. Why aren't they able to access it freely? When I say "freely" not only am I saying about easily, but also at no or little cost to a person seeking that information. Yes, there are commercial providers of this information but their databases are limited by the fact that there is inconsistent registration of leases around the country. That does limit the benefit and value of those databases.

So transparency means registration ultimately of all leases and the availability of that information to all participants. Shopping centre owners have presumably access to that information. They may share that information. We would like to know how actively they share that information. But the tenants don't have ready access to that information. They may not have access to that rent information or that lease data.

Given that shopping centres have considerable information at their disposal and of course we need to know the extent of that to understand exactly how much information the landlords do have. As I said, they may share that amongst themselves. But the small retailer can only access a fraction of the information possessed by a shopping centre owner in particular. The question I pose is how can a small retailer negotiate efficiently in that environment, where they have only a fraction of the information that a landlord possesses? That level of information asymmetry is a major cause of market failure in Australia.

Anticompetitive price discrimination is an issue that I'd like to raise. While anticompetitive price discrimination is a form of anticompetitive conduct intended to be covered by section 46 of the Trade Practices Act and it remains a problem area, given the current ineffectiveness of section 46. Indeed, the repeal of section 49, dealing with price discrimination of the Trade Practices Act, was premised on the fact or belief that section 46 would be adequate or could be adequate to deal with anticompetitive price discrimination.

Unfortunately, 46 has failed to live up to expectations in that regard. Changes made by the previous government in their dying days last year did not fix section 46. Section 46 remains a problem and until section 46 is fixed, examples of

anticompetitive conduct and anticompetitive price discrimination, it will go ahead without any fear of the Trade Practices Act.

While it is clear that price discrimination occurs in the market for retail leases within shopping centres, there is no rigorous economic analysis in the draft report of the impact of that price discrimination on the level of competition between large and small business retailers in shopping centres. Yes, it looks like there is price discrimination. Yes, anchor tenants are given a better price, we're told. In many cases we're not aware of how good the price that the anchor tenant gets. We may know the rental from lease registration but there may be other deals that are part of the transaction, other rebates, secret or otherwise. Secret, in that sense, means that they are not disclosed to the market. So in that case, we know there's price discrimination.

Now, what we don't know, what we're not sure of, is exactly how that price discrimination impacts on competition between large and small retailers, how it impacts on competition for the benefit or detriment of consumers. For example, if the rent paid by large retailers is a fraction of the rent paid by a small retailer, then that small retailer is unable to provide any competitive or very little competitive constraint on the large retailer for the benefit of consumers. I noted that rent is a cost of doing business. If it is a larger cost of your cost of doing business as a small retailer than the cost of business of a large retailer, you are immediately at a cost disadvantage. If you're at a cost disadvantage, you are unable or constrained significantly in your ability to provide competitive tension against those large retailers. So if the large retailer is selling clothing and they have a huge advantage in terms of rents and you're a small retailer selling clothing, you immediately are at a competitive disadvantage. In that case, my concern is about consumers. Consumers may be paying higher prices in those smaller retail outlets because of the higher rents that that small retailer is paying.

Now, of course we may be told that retailers will compete with one another, even told perhaps that they compete aggressively with one another, but with small retailers at a substantial competitive disadvantage because of the much higher rents they pay, large retailers may not need to compete as aggressively with one another on price as they would have if there was competitive constraints provided by its small retailers. With shareholder pressure on all large retailers, with shareholder pressure on shopping centres and landlords to show record profits and to grow profit margins, lower rents may be pocketed by the large retailers rather than passed on to consumers. We don't know. We need rigorous economic analysis on that issue. Unfortunately that is missing in this draft report.

Clearly, therefore, there is a very real danger that price discrimination in the market for retail leases in shopping centres may be deterring or preventing competitive conduct within that market and if it deters or prevents competitive

conduct in that market, that may be detrimental to consumers. In short, price discrimination may be anticompetitive, in that a small retailer simply is unable to compete effectively and consumers are denied the benefits of vigorous competition between large and small, left to rely on any competition there may be between large retailers who I have pointed out may not have an incentive to price as aggressively as they would have if they were facing competition. So if high rents set a high price doing business for the small retailer, obviously the larger tenants, the anchor tenants, would be aware that there's a considerable amount of space in which they may be able to compete or not compete as they choose amongst themselves or by following one another, parallel pricing at a higher level rather than a lower level if there was competitive tension by small retailers.

Given there is price discrimination, we know there's price discrimination, we're not sure of how big that price discrimination is. We don't know how that price discrimination impacts on competition. We don't know how that impacts on prices, whether there is inflationary pressure being brought about by this price discrimination. There does need to be rigorous economic analysis of that issue.

Now, there needs to be also an understanding of how lower rents paid by large tenants or anchored tenants are cross-subsidised by higher rents paid by small retailers. Obviously the lower the rents paid by large or anchor retailers in shopping centres, the higher the rents that the shopping centres need to charge small retailers in order for the shopping centres to be viable. Shopping centres are businesses. They have to show a return. If they are giving one tenant, being an anchor tenant, for example, very deep discounts on rent, that shortfall has to be made up somewhere else, and the somewhere else is small retailers. So I do emphasise this is not about attacking any particular sector of the industry, it's about understanding how competition works in that sector.

Of course there's the possibility that shopping centres themselves are on the receiving end of abuses of market power by those anchor tenants. All too often shopping centres receive criticism or may receive criticism but sometimes they themselves may be victims of abuses of market power by those large or anchor tenants, so we need to understand, are there abuses of market power, not only within the setting of rents but in relation to how lower rents are secured and so forth.

Now, this requires assessment of whether large retailers and/or shopping centres are exerting market power in a way that distorts rents in shopping centres in an anticompetitive, so it's a question that needs to be asked. One may have a view or a thesis as to the result but that's where rigorous economic analysis can help us and this is where the Commission could be very helpful in thinking further about these issues.

Of course if the Commission found or there was evidence found of

anticompetitive price discrimination or even abuses of market power by landlords or by anchor tenants, unfortunately the Trade Practices Act is lacking. Section 46, as I said, is effectively useless at this point in time, so attention needs to be given to reforming section 46 and perhaps there may need to be a separate prohibition in the same way there is no a separate prohibition in the name of the Birdsville amendment, dealing with predatory pricing. Perhaps we need some specific laws dealing with anticompetitive price discrimination so that those issues can be put under the spotlight. There are international precedents for anti price discrimination laws, so they may need to be looked at and I ask that the Commission do look at those issues of market power, how price discrimination affects competition, how it affects competition in relation to consumers which is our ultimate goal in this exercise.

Moving quickly on to lack of contestability in relation to shopping centres, I'll be very brief on this. Efficient markets require low barriers to entry and contestability within those markets, very simple economic principles. If you have high barriers to entry, what happens is that people can exploit their market power to derive monopoly rents to the detriment of consumers. In the shopping centre market, it would appear that there are very high barriers to entry. You simply can't open up a shopping centre. There are zoning laws. Those zoning laws prevent or deter new entrants to the market. So the theory of contestability says that if markets are contestable, that will keep everyone honest because if markets are contestable, if one particular player in the market is extracting monopoly rents, that will attract others into the market to secure some of those monopoly rents or profits from themselves. But if you have - and this occurs in other industries - bottleneck facilities like refineries or you have a monopoly in relation to a shopping centre where people cannot build a shopping centre next to you or very close to you because of zoning laws, that's a very high barrier to entry, and that very high barrier to entry means that that market is not contestable.

So if there were instances - there may or may not be - but if there were instances where a shopping centre was exploiting their market power, their monopoly power because they are effectively a monopoly in that geographic area, then the theory of contestability tells us that those people will be protected or immune from competition. If the market is not contestable, they may be able to exploit that monopoly position. If they do so, there's no new entrant into the market. If there's no new entrant, then what keeps a landlord from extracting monopoly rents? Where is the countervailing power? Perhaps there is countervailing power from anchor tenants but the countervailing power exerted by the anchor tenants may then mean that the low rents extracted by the anchor tenants will have to be made up by the landlord from the smaller tenants, so these are questions that need to be addressed. There needs to be, as I keep saying, rigorous economic analysis of the use of zoning laws to deter competition in relation to shopping centres. These dynamics that impact on competition I respectfully submit have not been fully explored in the draft report. Moving on to - - -

DR BYRON: Sorry, Frank, just before you move on to point 3, do you have a proposed remedy for that class of contestability issues that you just discussed, because you had a proposed remedy for the first one.

PROF ZUMBO (UNSW): Obviously we need to look at zoning laws. We need to look at whether zoning laws can be reviewed to take into account these possible distortions in competition. Essentially the high barrier to entry is created by zoning laws, so that would be what would need to be targeted, but before doing that, we need to understand whether zoning laws are used. Now, in past experience, there have been numerous examples where one landlord uses zoning laws very aggressively to try to stop a competitor. We saw it in cinemas many, many years ago, where the established cinema operators wanted to stop Readings coming into the market. That also raises section 46 issues, so some of these issues could also be dealt with by an effective section 46, and section 46 is not effective. So if zoning laws are being used anticompetitively, then that does raise an issue under the Trade Practices Act - and unfortunately section 46 is not operating effectively - then that is a real gap in the law. Once again, it's not so much about drawing conclusions in my evidence but rather asking questions that respectfully should have been asked or explored more efficiently or in more detail in the draft report.

Now, of course it would come as no surprise to some that I would talk about stronger laws to stop unethical conduct by landlords. It's a debate that has been a long debate, going back to the early 90s with the enactment of section 51AA of the Trade Practices Act and subsequently section 51AC of the Trade Practices Act. Section 51AC is approaching its tenth anniversary. It came into effect in 1998. At that time, there were expectations, great expectations, that section 51AC would promote ethical conduct in relation to retail leases, in relation to franchising, in relation to other arrangements where small businesses may need to deal with a larger business.

Unfortunately during that time and over that time, you find that section 51AC has effectively fallen into disuse. The reason for that is quite simple and that is because section 51AC relied on the concept or the word or used the word "unconscionable". The courts, over the period of 10 years, have reverted back to essentially a common law equitable view of the word "unconscionable". The equitable doctrine of the unconscionable conduct - and I won't bore you with the details except to say that it was a very high threshold - basically the courts took the view that unless it was a very extreme situation, where you were drunk or mentally disabled or impaired and you were taken advantage of that, the other person knew that, you were stuck with your contract, unless of course there were other vitiating factors such as mistake and what have you. But in relation to unconscionable conduct, the common law, the equitable doctrine was a very narrow doctrine. The reason why we had section 51AC enacted was because of the narrowness of that

equitable principle; there was an attempt to try to broaden the concept of "unconscionable" through section 51AC.

Unfortunately over time, the courts have reverted significantly to those old equitable doctrines where it really needs to be very extreme conduct in order to succeed under section 51AC. Having done an analysis of section 51AC cases taken by the ACCC in recent years and within a franchising context, basically in the last four or five years, the Australian Competition and Consumer Commission has not taken any 51AC cases in relation to franchising and, I think I'm safe to say in relation to retail leases also, to court. So the ACCC has not taken any 51AC cases in those areas in the last few years. So in the same way that the ACCC has not taken any section 46 cases since the High Court decision in Boral in 2003, we find that in the last four or five years, the ACCC has not taken section 51AC cases in this area to court. Yes, they investigate cases. Some of those cases continue to be investigated over a long period of time by the ACCC but basically the message coming out of the ACCC is section 51AC is very difficult to prosecute, if not impossible.

So given that section 51AC is a very difficult section to establish because of the problem with establishing "unconscionable" and the very high threshold established by the courts in relation to "unconscionable", section 51AC is not operating as a mechanism for promoting ethical conduct by landlords. That's not to say that landlords are behaving unethically. There are many landlords that would behave ethically; most of the time, if not all of the time would try very hard to behave ethically. The question of course is what happens when landlords do behave unethically, and of course when would they behave unethically. What do we mean by "unethical"? I use the word "unethical" because if I use the word "unconscionable", immediately people will go to the legal meaning of that and it has a very onerous meaning, so we need to have an alternative word or an alternative way to deal with potentially unethical conduct.

In relation to section 51AC, the problem, as I've said, is the onerous definition of "unconscionable" accepted or adopted by the courts. In relation to section 51AC, I have to say there is no statutory definition of unconscionable conduct. Because there is no statutory definition of unconscionable conduct, we're left to the courts to determine what is meant by unconscionable conduct. A couple of things with that: one is it's taken a long time to get to the point where we know that the expression "unconscionable" is a very high threshold issue for the courts, but sometimes it is hit and miss when key definitions or key concepts are left to be defined by the courts. It's important, where parliament does enact new legislation where section 51AC was at the time, that they be clear as to exactly what that concept means. So the absence of a statutory definition of unconscionable conduct has created many problems in terms of it taking a long time to understand what that concept means and then finding out that that concept was a very onerous concept.

The other issue with 51AC is that there is a misconception about the list of factors used in section 51AC. Some people and many people I speak to believe that those factors in effect define unconscionable conduct. That's incorrect. The factors listed in section 51AC don't define unconscionable conduct or don't necessarily define, they are simply factors or matters that the court can take into account, and the court is not limited by the factors that the court can take into account. But in practice and in case law, those factors are the factors that the courts will look at; they do look at other factors also from time to time but at the end of the day, those factors are not considered to be a definition of what is unconscionable. That does create false expectations about the operation of section 51AC because when a small retailer who believes, rightly or wrongly, that a landlord may have been acting unethically or unconscionably, they go to look at those factors and they point to a few of them and they say, "Well, I think the landlord has fallen foul of some of these," but they don't look at the way the courts look at unconscionable conduct, but they look at those factors and those small retailers think, "Well, it's an open and shut case of unconscionable conduct."

That misconception is sometimes played up to because, for example, once again, in the dying days of the previous government, there was great fanfare about a new factor in relation to unilateral variation being added to the list of factors and that created an expectation that unilateral variation of contracts may be unconscionable, but that misconception has been added to because that factor is just another factor the courts can take into account or dismiss and they previously did look at those factors, so adding a factor and saying that it's a great step forward is really misleading small retailers and creating false expectations which then leads to disappointment, then that leads to small retailers feeling that the law as abandoned them.

So essentially in relation to unconscionable conduct or, more importantly, dealing with unethical conduct, it's about setting clear parameters, so both the landlord and the small retailer knows the bounds of acceptable conduct in that instance. It's not about saying that the landlord is bad and the small retailer is good, it could be the other way around. If there was clarity as to what was ethical or unethical, then both parties, both landlord and tenant, would be more appreciative of what is acceptable conduct. We hear these expressions, "Hard bargaining is permissible," yes, it is, but we don't know where the line is drawn in relation to ethical and unethical, or at least to give some guidance as to what is ethical or unethical. So in that regard, the solution that could be explored to help deal with these issues would be to insert a statutory definition of the term "unconscionable".

Clearly, section 51AC and the expression "unconscionable" in that context was intended to have a broader meaning. The courts have given it a very high or very onerous meaning, it has a very high threshold, so the parliament perhaps should make it absolutely clear what the parliament intended that concept to be and in particular emphasise that it is a broader concept to the equitable doctrine and

demonstrate that by using key words and expressions which have been used elsewhere and which have acceptance, such as the word "unfair" and they could be used to define "unconscionable". Concepts such as good faith could also be used to define what is meant by "unconscionable".

That is an attempt to try to resuscitate section 51AC because basically 51AC is on life support because it's fallen into disuse. Either we try to resuscitate it as a mechanism for setting out what is ethical or unethical or we try a new approach, and it may be time for a new approach, given that the word "unconscionable" has a lot of baggage with it that the courts seem to draw on. Unless there was a statutory definition of the word "unconscionable", perhaps it's time to enact a statutory duty of good faith.

The duty of good faith is not something that is new. The Court of Appeal here in New South Wales have long accepted that there is an implied duty of good faith in commercial arrangements. It's been accepted I understand in Victoria and in Western Australia. So the courts are very comfortable with this concept of good faith. Given that acceptance, given that there is that body of law there, why not simply accept that concept as a concept for defining what is ethical and what is unethical? So having a specific statutory duty of good faith would deal with many of the issues that have arisen under section 51AC. It would go a long way, if not almost all the way, to setting up parameters of what is ethical and unethical conduct. So a statutory duty of good faith should be explored in that context.

I should say that there is a considerable body of case law dealing with what is meant by an implied duty of good faith. The courts are telling us what it is and what it's not also, which is very useful, because we don't usually get that in an unconscionable conduct instance. For example, there are a number of cases - I've picked one where there was a summary of what is meant by good faith or acting in bad faith which is obviously the opposite of good faith. You're acting in bad faith if you act arbitrarily, if you act capriciously, unreasonably or recklessly; if you act in a manner that is oppressive or unfair in its result by, for example, the seeking to prevent the performance of a contract or withhold its benefits; failing to act reasonably in general, failing to have regard to the other party's interests, but the courts say that good faith does not require that you act in the other party's best interests, you do act in your own best interests but you don't act arbitrarily, capriciously or unreasonably in the context. So that case law is there available for the Commission to review and I would suggest strongly that the Commission look at what the courts are saying about an implied duty of good faith and make an assessment as to whether there could be a statutory duty of good faith to set out the parameters of what is ethical and unethical. Once again, it's not about drawing conclusions about whether there is unethical conduct but rather providing a mechanism whereby those allegations can be tested. At the moment, it's very hard to test those allegations in relation to "unconscionable" because, as I say, the courts are

taking a very onerous view of the word "unconscionable".

The other area that perhaps should be explored in the absence of the failure of section 51AC is to look at a new regime for dealing specifically with unfair contract terms. Unfair contract terms have been dealt with in consumer transactions in Victoria, they have been dealt with in the United Kingdom and in Europe. In the United Kingdom, they have been in operation for well over 10 years. In this context, unfair contract terms are specifically defined as terms that go beyond what is reasonably necessary to protect the legitimate interests of the party seeking to impose that term. So "unfair" in this context is not a layperson's view of "unfair", it is not a general view of the word "unfair" but rather a specific view of "unfair" that says that if a party seeks to go beyond what is reasonably necessary to protect that party's legitimately business interests, then that person has crossed the line, and that line may be that the stronger party - and I use that as shorthand - is seeking to impose terms that go beyond what is reasonably necessary. He may be seeking to shift contractual risks on to a smaller business unnecessarily, unnecessarily in the sense that it's simply an abuse of contractual power and an ability for the stronger party to shift those risks because the weaker party may have no choice but to take it or leave it. But that criteria of what is reasonably necessary to protect the legitimate interests is a workable criteria. The courts have accepted, the legislation has accepted it is legitimate to protect your interests. If you've entered into a contract of bargaining you're entitled to protect that bargain. Both parties are entitled to protect that bargain. The reality is the stronger party has the greater ability to protect that bargain, and because they've got that greater ability some may act unethically and try to exploit that contractual power.

In that context there needs to be a benchmark, a criteria, and that criteria is the definition of an unfair contract term that's been used in that context, which makes it clear that you can do whatever is necessary to protect your legitimate interest, but if you go beyond that within the context of the contract then that could be scrutinised. It works effectively in a consumer context. The Law Commission in the United Kingdom has suggested it should extend to small businesses. There is an acceptance that in relation to small businesses an unfair contract term regime may have a lesser or narrow application. That's accepted, but in many cases a small business is comparable to a consumer, but not all. So in many cases a consumer is much more vulnerable, but that's not to say that a small business is not also vulnerable, but to a lesser degree.

There was discussion in Australia about the possibility of an unfair contract term regime applying to small businesses also and that debate is ongoing. Some people say, well, you know, business uncertainty in relation to all these proposals. In relation to unfair contract term, that uncertainty can effectively be removed by having a mechanism in the unfair contract term legislation that allows contracts or terms to be pre-approved. So you can have an industry contract, for example, with

terms that have been approved by a regulatory agency following consultation and review, and once that contract has been looked over and approved for its fairness it can't be attacked under the unfair contract term regime.

So in a leasing context, if you have an unfair contract term regime and you have this ability to pre-approve leases, for example, that lease can be pre-approved with those terms through a very public process. Once that is approved, that contract stands and is not able to be attacked under the unfair contract term regime. It's a safe harbour for that contract. So it's about promoting mechanisms whereby the parties have certainty and we avoid this endless debate about, "Some landlords are behaving unconscionably. What is unconscionable? They're behaving unethically. How do we define that?" Yes, we can use concepts like good faith, but maybe we should cut to the chase and have a situation where contracts or leases can be pre-approved for their fairness.

I'll make a couple of other quick points. Other suggestions for trying to resuscitate section 51AC would be to turn those factors in section 51AC into definitions or mini definitions of what is unconscionable. So with appropriate rewording of those factors they could be turned into defining criteria, definitions if you like, of what is unconscionable. Of course that has challenged, I accept that, but once again it's an attempt to provide a context, a framework, an ability to short-circuit these disputes before they just get their own head of steam. They're some opening remarks. I could say more but I'm very happy to allow the Commissioner an opportunity to quiz me.

DR BYRON: Thank you very much. That has been extremely valuable and there are a few things that I'd like to seek further elaboration on. I think in your introductory remarks about wanting an efficient market to get the best results for consumers, I thought that was exactly what we had in our draft report. So I think we are in heated and vigorous agreement on that point.

PROF ZUMBO (UNSW): That's the starting point, Commissioner.

DR BYRON: That's the starting point in terms of what we want to get and why we want to get there. The first of your four key areas, let's have a look at the lack of information and transparency. I agree with you that most of the issues that have been brought to our attention in the course of our inquiry basically relate to either serious information asymmetries or the lack of transparency, responsibility and accountability of what's going on. So the idea of shining some bright spotlights in the corners in the dark where, you know, cockroaches sometimes gather, that's precisely what we're looking at. You've spoken about the registration of leases that should be cheap and easy to do and cheap and easy for people to use. I guess we've asked exactly the same question: how can a small retailer negotiate efficiently without access to comprehensive information?

It seems that we then depart in our approach in that we're trying to focus more on how could society better inform small retailers about what's going on. I guess this runs through all four of your key problems and what to do about them, is that you seem to not surprisingly pick up on legislative means of preventing the misuse of power by those who have more information - you know, knowledge is power. The other way to deal with that asymmetry might be to better inform and empower those who currently less informed. So whether we go the information route to build up the ability of small retailers, small business people, to stand up for themselves or whether you say, well, this inequality in negotiating expertise is best dealt by putting legislative limits on what the more powerful party can do. Is that an unfair criticism to say that you're focusing on how do you limit the more powerful rather than say, how do you bolster the knowledge and resources of the less informed and less powerful?

PROF ZUMBO (UNSW): Not at all. I believe the starting point has to be that information is available. So you empower people to be able to help themselves. In that context, seeking mandatory registration of all leases in this context would be a very important starting point, if not ending point. So empowering people, allowing those people that have that access to that information, may deal with the majority of problems. If you know going into a lease that you are at a massive competitive disadvantage, you may not go into that lease. Sure, small tenants appreciate that anchor tenants do get a better deal, but they may not appreciate the magnitude of the better deal that the anchor tenant gets.

Once again, we don't have ready access to what those discrepancies are, how big they are. You hear evidence from time to time. I see examples of very large discrepancies in rents paid by anchors and small retailers. As a small retailer you just can't compete. In that case do small retailers know that? If they know that, if they know the magnitude of the discrepancy between the rents and they still continue to go in, then that's a matter for them. You can't stop people entering that transaction. That's a very important first step, but the other side where I look at it is to suggest that even if you have full transparency, you still may have other market failures, and that is abuses of contractual power, abuses of market power, and those issues do need to be deal with by an appropriate legal framework. It's not about tilting the field in favour of one side or the other. It's about firstly, having transparency and trying to overcome the information asymmetry so that all tenants and particularly small tenants can make an informed choice. Having made that informed choice, then they enter the transaction, they enter the lease. Subsequently, if there are abuses of contractual power - because once they're in the lease they're captive - and the landlord then has considerable power. Sure, landlords have an interest in a small retailer succeeding, but there are conflicting pressures sometimes on the landlord as opposed to the small tenant, for example. The landlord needs to show a return on their investment. If the anchor has to squeeze down the rent to uneconomic levels for the landlord, the landlord needs to make it up somewhere.

The only place they can make it up is a small retailer, so the small retailer in that case is a victim of other people's abuses of market power perhaps. So those issues need to be looked at from a legal perspective, but I treat them separately.

DR BYRON: But they can also be looked at as an education issue. I mean, I've got literally armfuls of brochures that have been put out by all the retail tenancy units in the state and the ACCC and things that say, "Do not sign this lease until you've got expert legal and commercial advice. Your house may be at stake." That sort of information has been available to warn prospective small business people and to inform them and the conclusion that we've come to in the draft report is that even though there have been many attempts to educate and inform, it seems that there are a lot of people who either don't pick up the brochure, they don't read it or if they read it they don't understand it or even if they read it and understand it, they don't take any notice of it. Then they get themselves into trouble and then we're into, "How do you repair the damage of these people who are in a very vulnerable and fragile situation?" There are obviously limits to how far we can get with this education approach.

PROF ZUMBO (UNSW): Absolutely. I'm a firm believer in education, but education has clearly its limits and has its limits where you might educate people, but if that information, the key information is not available, you can educate people to make inquiries about rents. But if they can't get that information, if they can't get that information readily, the education has served only half the problem there. The other half is that the information is not available. So education is important. Obviously people need to be aware that going into a business is risky and I believe that many people, if not everyone understands that business is risky. It's not a guarantee of business success. But if you start from the premise that you don't know what comparable rents are, you don't know the magnitude and discrepancy and gap between your rent and the anchor tenants, if you don't have that critical pricing information, then you're at a considerable disadvantage even before you start and even before you start reading the educational materials that say business is risky.

DR BYRON: We're certainly not opposed, in fact we're actively encouraging to better inform the marketplace. I don't think the Commission has ever taken a position against better informing everybody in the marketplace.

PROF ZUMBO (UNSW): It's a matter of how you do it, Commissioner, if I can interrupt you there. Unless there is disclosure of that rent and the rent pricing information is not readily available, you're going to have market failure and you're going to continue to have market failure. So what we really do need to explore as a society is how do we make this market more transparent in relation to rent information. It is not transparent at the moment. So we really do need something like mandatory registration of leases. We also perhaps need some disclosure of comparable rents within the shopping centre. There may be different ways to achieve the same results. So if I'm going to be a small retailer in a shopping centre I

need to know comparable rents and I need to know who those comparable rents are based on.

So there have been instances where comparable rents have included other tenants which wouldn't ordinarily fall into that comparable rent category, so the level disclosure there of comparable rents is an issue that needs to be looked at. But fundamentally there has to be the ability of a tenant to get onto the Internet and know what the market rent is at any point in time and they're not able to do that at the moment.

DR BYRON: We have been taken to task for saying in the draft report that there are a number of tenant advocates, especially tenant advisers that have basically started to emerge. I guess particularly in the last five years, but in all the jurisdictions we have been in it is possible for a tenant to find a tenant advocate or a consultant or a lease adviser who can tell them what sort of rents their competitors are paying, what their neighbours would be paying and so on. But as the head of one retailer organisation said to us, "The basic problem is that most of our members are too stingy to paid $500 for advice that could save them $50,000."

PROF ZUMBO (UNSW): But with all due respect, why should they pay $500 when that is on a public database which I should be able to access for a fraction of the $500. I mean, if the lease is registered on a public database I should be able to get on the Internet - which I might pay $2 or $5 or whatever - I should be able to get on there and be able to access it in all states. So why can't tenants be able to get on to the Web themselves on that public database without having to pay $500 to get comparable rents and do it themselves. In this day and age were encouraging people to use the Internet in all sorts of ways. Why not in this way, in this industry?

DR BYRON: Good. Your second point about efficient markets requiring low barriers to entry and therefore the need to have a close review of the effects of zoning, I thought listening to you that what you were saying again was very consistent with what we'd actually suggested in the draft report, the argument for reviewing the zoning implementation to see to what extent it would be anticompetitive. Did I miss something there?

PROF ZUMBO (UNSW):: I would say you need to go one step further and also look at whether the Trade Practices Act is adequate in dealing with those issues. Yes, you do, say, look at zoning laws, but there needs to be - and maybe I've missed this in terms of analysis of how it may affect that, that hasn't happened in the report. Maybe an understanding of where it has happened, reviewing of local council objections that may be put in by competitors and the circumstances of those. You hear from time to time community action groups that are opposing developments. You also hear of shopping centre owners that may be opposing developments and other business interests of opposing developments. We need to know why those

developments have been opposed and we need to dig down to find that information.

DR BYRON: Okay.

PROF ZUMBO (UNSW): I mean, how often does it happen? How often does a particular shopping centre owner or a particular business object to competitors in a particular local council area? Good question. We need to ask that question. If it never happens we don't have a problem. If it happens consistently such that - - -

DR BYRON: Almost universally.

PROF ZUMBO (UNSW): If that business is aggressively using zoning laws to stop competition entering the market, that is an issue of concern to consumers because consumers are then being denied a choice in that market.

DR BYRON: Moving on to the third point about stronger laws against unethical behaviour and your comments about section 51AC. Again, I thought we're probably in heated agreement. But the thought occurred to me while you were speaking, is it possible that section 51AC is actually doing some work even though few cases or virtually no cases go to court if in fact many cases or many situations, complaints et cetera, grievances are being settled out of court and perhaps with more generous settlements than what otherwise have occurred simply because section 51AC does exist and it's in the background, it's the big stick in the closet. You don't see it wielded very often, but simply the fact that it's there, could that be doing something? I mean, we can't answer this question, I'd just like your opinion.

PROF ZUMBO (UNSW): It's interesting you make those comments. I have to say in my experience, all the discussions I've had, no-one - including myself - believes that section 51AC is working. It has had an impact on the most extreme forms of conduct because they're the obvious forms of unconscionable conduct that a court would say would be unconscionable. So in those very extreme cases, yes, it works. But is unethical behaviour defined only by extreme conduct? There is an area below those most extreme forms of conduct that are not being dealt with by section 51AC. It's not about litigation. It's not about encouraging litigation. I would not want to see a flood of section 51AC cases or any cases. I would rather that they be resolved quickly and speedily and efficiently. But in terms of 51AC because the court has set the threshold so high an unethical larger business will simply say, "Well, I haven't met that criteria. Get lost."

DR BYRON: It's not a credible threat that would actually discipline behaviour.

PROF ZUMBO (UNSW): Yes. More importantly it's not so much the threat, but also there's not a criteria that a small tenant can go to and say, "Well, you behaved unethically and this is why." If you do go there now and argue the landlord has

behaved unethically, the landlord looks at you, laughs at you, walks away and says, "Well, 51AC doesn't help you and I'm not unconscionable under section 51AC."

DR BYRON: Your point about setting clear parameters for behaviour for both parties, I guess that was one of the things that we had in mind when we floated the possibility of a mutually agreed code of behaviour in retailing which would, if you like, be a circuit breaker to restore some trust and confidence in the market. There might be a number of ways of restoring confidence, either the statutory definition of unconscionability or the statutory duty of good faith which we will certainly follow up on, thank you. I guess the idea of an agreed code which was widely publicised might do that and there are probably a few other options we could think off that would set the parameters so that people understand where the lines are drawn.

PROF ZUMBO (UNSW): Sure, and there are various ways to deal with it. In terms of a code it has to be mandatory, I make that point very emphatically. The reality is voluntary codes only work in relation to ethical players. It's the bad apples that don't apply the code and that's where you have the problems. It's like in the franchising sector, there was a voluntary code and you found that good franchisors adhered to the code and the bad franchisors, the unscrupulous ones did not, and that was the section of the industry that was causing all the problems. So you need a mandatory code if you use that as way of setting parameters.

DR BYRON: Doesn't that actually signal something - if someone refused to sign on to the code of good behaviour and I'm thinking of making a deal with them, doesn't that ring little alarm bells and say, "Maybe I should go and deal with someone who has signed on"?

PROF ZUMBO (UNSW): Interestingly in the franchising code you had very good franchisors that weren't a member of the voluntary code because they felt that their standards exceeded the code. So in that case the non-signatory can simply say, "I've got higher standards. I've got better standards." How does the tenant in that case make an informed decision or a smaller business make that decision. So unless it's mandatory, unless you cover everyone, you're going to have free riders, more market failure and the bad apples give a bad reputation to the industry as a whole. We found in the franchising sector that before the franchising code you had some bad apples that were giving the industry a bad name, many of those, if not most of those, if not all of them have been weeded out to a point where the reputation on the franchising industry is a lot higher than it was pre that mandatory code.

So a mandatory code also has reputational benefits for the industry as a whole. If it's mandatory we stand by our code, everyone adheres to it, everyone plays by the same rules, that has a positive reputational benefit on the industry as a whole.

DR BYRON: Thanks. Just to clarify on the statutory duty of good faith, this

basically would apply to all commercial relationships, it's not just a retail tenancy - - -

PROF ZUMBO (UNSW): Yes, it would apply to all relationships, but it could immediately apply within a retail tenancy context given the states have retail tenancy legislation and they can include a statutory duty of good faith within their retail tenancy legislation almost overnight.

DR BYRON: Or would they include it in some overarching legislation that applied more generally across all times - - -

PROF ZUMBO (UNSW): Yes, ideally I prefer the legislation to apply universally, nationally and all transactions, not a piecemeal - because you might have in the state of New South Wales having a statutory duty and not in Victoria. But in the same way I have to say with the unfair contract term legislation only applying in Victoria, that's lifted national standards in terms of draft in certain consumer contracts. So even if one state, say, the state of New South Wales had a statutory duty of good faith that may raise standards of conduct nationally if you're a national shopping centre operator, for example.

DR BYRON: I think that takes me through most of the questions I wanted to follow up with you. I guess in view of the time we probably should keep moving on. Were there any closing comments that you'd like to make?

PROF ZUMBO (UNSW): Only to emphasise this is about finding ways and mechanisms to promote a more efficient outcome for all players, landlords tenants and most importantly consumers. It's not about picking sides, it's not about picking winners, it's about having a legal framework that everyone understands, it's about having transparency. At the end of the day of mandatory registration of leases would have nominal cost, enormous benefits. What's there to hide? If there's nothing to hide why not have mandatory registration of leases. Why not have that information on the public register? If the landlords are sharing that information amongst themselves, why can't tenants be able to share that information about themselves to promote a more efficient market for the benefit of consumers is a key point I'd like to leave the Commission with.

DR BYRON: I think that's an excellent key point and one that I don't think we have any trouble in accepting.

PROF ZUMBO (UNSW): Thank you.

DR BYRON: Thank you very much for coming and for your time today.

PROF ZUMBO (UNSW): Thank you.

DR BYRON: Can we move on to the representatives from the pharmacy guild of Australia, please. Thank you very much for coming, gentlemen. Whenever you're comfortable and settled and got your papers sorted out, if you could each introduce yourself for the transcript. Good to see you again, Angelo.

MR SOMMARIVA (PGA): Thanks, Commissioner. I think you've already met me in the past. I thank you again for the opportunity to put forward our views. I am Angelo Sommariva. I'm the strategic planning officer in the strategic policy division at the Pharmacy Guild of Australia.

MR McBEATH (PGA): Commissioner, Peter McBeath. I'm a community pharmacist. I've been a proprietor pharmacist since 1972 and I have various business interests in shopping centre pharmacies and other pharmacies.

DR BYRON: Thank you very much and welcome.

MR McBEATH (PGA): Thank you.

MR SOMMARIVA (PGA): Again, Commissioner, I just want to thank you and the Commission for the opportunity to put forward our views. This is the second time that we've participated in the hearings. Sir, rather than revisit the same issues that we covered in the first hearing, we felt it more appropriate to cover issues that we know are specifically happening in New South Wales, in pharmacy in New South Wales. As we have established, with me today I have Peter McBeath who, as he described, has been a pharmacist for many, many years. He knows the industry inside out. He has had pharmacies in all sorts of different sites, including strip sites, small shopping centres, subregional shopping centres, so we're delighted to be able to bring his wealth of experience to our contribution to the Commission's report.

We spoke last time about whether the market was working or not specifically in a shopping centre scenario. We briefly argued that one supplier giving space to numerous tenants effectively equals a monopoly. We understand the draft reports arguments that if you're not happy with the conditions you're offered by a shopping centre, then it's best to obviously not sign or find an alternative. But one thing that we would argue in the specific context, especially of pharmacy, where we seek to be accessible to the community in general and wherever the community may be, we often find that there are few alternatives.

MR McBEATH (PGA): My experience, that's going back of course, shopping centres really didn't exist when I went into pharmacy. So the area in which pharmacy operates has obviously changed dramatically with the grace of shopping centres. My experience with shopping centres and listening to Professor Zumbo who preceded us - he raised a lot of the issues about exclusivity rights granted to one landlord in a given area. So being my chosen profession of pharmacy I have little

option but to seek to operate businesses in that environment.

Maybe if I outline an experience in my existing shopping centre pharmacy which I have now had for nearly 20 years, it probably opens up a whole lot of issues as well that are in your draft report.

DR BYRON: Excellent.

MR McBEATH (PGA): I commenced in this negotiated the site in this particular shopping centre - I commenced operations in 1989. I had a four plus four lease, new centre, you know, struggled early but did okay in the end. Subsequent to that I sought an extension of lease. I was offered a five-year lease which there was no way negotiations could extend that period of time. The rental offered to me was a substantive increase on the rent that I was paying, some 50 per cent. It was based on - the negotiating officer for the landlord informed me that they had my figures which, of course, they required in the lease and that even though the lease stated that those figures were not to be used for any other purpose other than information for the operation of the centre, the first statement was, "Well, you're taking X and you can afford to pay 8 per cent of X and that's the number." So I guess that goes into some of unconscionable clauses in leases, if you like, in that you're told one thing and then it's immediately used for the very purpose that you obviously as a tenant didn't want it used.

I was unable to negotiate past that point. Having been there eight years I felt I should accept it as I just really wasn't able to negotiate - I did negotiate some reduction in the rental rate because I was able to show some figures that their figure was unreasonable. At the end of that period, which was then 13 years, I was refused an extension of lease on the basis that the centre was to be refurbished, something which I didn't particularly object to, the refurbishment that is, I objected to not being given tenancy. So I sat there on a monthly tenancy for what turned out over two years.

At the end of that period when the centre was in disarray and my business had probably dropped 20 to 30 per cent in that period, the rent hadn't, they refused to negotiate any rent reduction. I was then offered a new lease on new premises within the building, an increase in space which I welcomed. The new rate was about double what I was paying. I was offered it on a take it or leave it basis and offered a five-year term. Given that the new site that I was offered considered of a concrete floor and three concrete walls, no ceiling, no shopfront, no nothing - when I say a concrete floor, it was an uneven concrete, they laid it several times, it was on different levels which, I am sure you can appreciate, makes it fairly difficult to fit out and in the end it brought about considerable costs in trying to remedy that particular problem.

I did retain the services of a professional rent negotiator and I wish he had only cost me $500, I would be much happier, but it was more like $5000 plus, and we're now talking some five years ago. We started at a rate of some $1400 per square metre - and I use these numbers to demonstrate the difficulties - over a five-year lease would have been totally unviable for me and I considered with my experience and the fact that I had had quite a number of businesses over the years, most of which had been successful, that I did have some understanding of the market; I had been there at that stage 15 years, so I knew the local market.

With the help of the negotiator we got the figure down in a final offer, $1050 and a five-year lease. With a fit-out cost of somewhere between four and five hundred thousand dollars, about half a million dollars worth of stock, that again was unviable, particularly the five years, and the rent was certainly not acceptable; the five years was totally unacceptable. Fortunately, my negotiator happened to know the principals of the landlord and he rang one of them to say, "You're about to lose your pharmacy. He's going to walk out," which I was about to do. I was prepared to walk out. The following day, to the chagrin of the negotiator, I had a new offer at $800 and eight years at which I felt that I had to accept because it was obviously going to be the best offer I got. We subsequently relocated. For the first year the business still traded at a loss and I must say now it's trading quite well to the extent that percentage rentals have come into play.

I have read a considerable part of your draft report. I am not quite sure whether your understanding of percentage rental - and forgive me if I'm wrong, I'm not suggesting anything - but percentage rentals, of course, come into play after which the base rent, the percentage of sales, whatever that percentage figure is, exceeds the base rental figure. So it's not just a straight percentage and in my case we have now reached that point. The reason I raise it is - and I listened to Professor Zumbo again about consumers - because we have now reached that point and where that figure is, in my case, 7 and a half per cent of certain sales in the business, we have elected not to sell low margin products because at 7 and a half per cent it's very hard to sell something at 2 or 3 per cent margin and make a profit which is pretty obvious.

DR BYRON: Yes, of course.

MR McBEATH (PGA): So the consumer in this case and the products and - I raise them because in studies done on the centre one of the reasons people visited that particular pharmacy over many years was that we had a very specialised business in baby care, so the products we sold were baby products, particularly baby nappies and baby formula. We did monitor the prices after that and the price of those products in the majors did rise after we ceased to stock the products. So the consumer does lose out under those percentage rental-type clauses. I think that story probably opens up a whole lot of areas that haven't been raised in your report.

MR SOMMARIVA (PGA): In terms of percentage rents, one of the reasons that we're so against them is that many of them are done on the basis that there is a percentage rent above a base rent and one of the reasons that we don't like to see this is because basically the shopping centres that demand these rents take extra money during periods of growth, the good times of a business, without actually sharing the risk of a downturn. Did you want to expand any more on that?

MR McBEATH (PGA): I think I've raised that earlier that even in the current situation, the current lease that I have with this particular pharmacy, we trade at a loss for the first year but still had to pay that base level of rent. Now our sales have gone up, now we're paying more of our profit but no compensation for when we're under the figure.

DR BYRON: So basically there's an asymmetry in that, that they share some of the benefits in the good times but the landlord takes none of the pain in the bad time.

MR McBEATH (PGA): Absolutely.

MR SOMMARIVA (PGA): That's correct. Obviously we've touched on the issue of information asymmetry as well. Professor Zumbo went into great detail already. A couple of points that we wish to add to this is that we're concerned at the lack of recourse available to tenants who have been given inaccurate information which can at times happen. Particularly, for instance, in terms of traffic movements and that sort of thing.

MR McBEATH (PGA): Following that up, all leases that I have seen or signed have a clause that states that you rely on your own research and own information and have no recourse to information provided to you by representatives of the landlord or words to that effect.

DR BYRON: Can I just follow that up. It is probably a more general question, but we've talked a lot during the last few days of the hearings here that the major differences between being on a strip and being in a shopping centre - and to try and summarise all the briefly, in a shopping centre the turnover is higher, the rents are higher, and in a sense the reason you are paying higher rents is because the centre claims an expertise in management to generate more foot traffic which will generate more turnover and therefore more profit. Mr Anthony Herro, who is a solicitor who specialises in retail tenancies, was sitting where you're sitting a couple of days ago and he said that the standard sort of lease that evolved over centuries to deal with a tenancy in a strip doesn't seem to fit very well, it doesn't transfer to this new concept of a managed shopping centre where you're actually not renting a box, but you're also paying a premium to get a sort of a management service that in effect the landlord is contracting to you know, "We're going to put people past your door and if you're

good enough you'll be able product to them and make a profit."

We were wondering whether it might be useful to try and make that a bit more explicit so that if the landlord does something that puts more people past your door, you know, he gets an additional rent, but if does something that puts fewer people past your door, whether it's through changing the carpark or whatever, then there should be a quid pro quo to that. They're claiming they've got the expertise in managing centres to maximise traffic and turnover and all the rest of it and if they do it well they presumably should be paid for it. But if they do it badly there should be some feedback and I was just wondering if you have any reaction to any of that.

MR SOMMARIVA (PGA): If I could just briefly, one of the things that we're arguing is that there is absolutely no recourse for a small business or a tenant who is given the wrong information. Of course you make a business decision based on the information you are given at the beginning, whether to sign a lease or not, based on traffic numbers and that sort of thing that you are told will be going past your door. As you say, these shopping centres specialise in getting people into the shopping centre. If these figures turn out to be wrong then the small business owner who has made the decision based on the figures given is basically in a lot of trouble because there is absolutely nothing that he or she can then do to actually correct that situation.

DR BYRON: But if the centre management was going to be paid in two parts - one the sort of base rent for the box and the other one for how well they do the management part and generating the traffic - then it might focus their minds a bit more and presumably you would then want to know that the turnover was accurate. In fact somebody suggested to us that you might want to not only be able to audit the centre management's outgoings, but you might want to audit the traffic counts. So in terms of Professor Zumbo, this is another part of getting information and transparency into the market. There are all sorts of things being said about traffic flows and going up or down, let's have some figures that we all have and that we all know are accurate, none of this, you know, "We've got our information but we won't tell you. Go and get your own."

MR McBEATH (PGA): Can I comment on this. I think this gets to what Professor Zumbo was talking about of lease registrations. If you've got information on what people are paying across the market - and I guess I go back here - if I want to rent a shop down the strip here in Kings Cross, I can go to any number of real estate agents who will tell me that shop is rent at an amount of money. It doesn't what I want to do with it particularly, as a rule that's how much it is. When you go into a shopping centre they say, "Well, you're a pharmacist and that's what we want. That's the site and that's how much we want from you as a pharmacist for that particular site." You've got no benchmarking at all available to you. You don't know what other tenants are paying and whether that might or might not be reasonable, and you don't know what is being paid in other shopping centres for similar types of sites

unless you ring a few mates and say, "What are you paying?" and you've got to have pretty good mates because nobody likes telling you too much about their commercial arrangements. It's very hard to find from other tenants in the centre what they're playing. You know, everyone plays their cards pretty close to their chest because at the end of the lease you've got nothing so you tend to want to keep all that information to yourself.

So there's a real problem there of a lack of ability to benchmark. For instance, I could be told that there's 100,000 people a week walking into the centre, but I don't know how that translates into business in a particular circumstance. If I had the figure for different shopping centres and said this shopping centre has so many people through the front door and that then means that a pharmacy could expect to do so much per square metre of sales of square metre of space, that has some meaning and then you've got some relativity. None of that information is available to us at all. So when you go into a centre - in my case I generally get some demographic surveys done at my expense to find out what the local area is likely to be. I will use information provided to me by the landlord which generally is available these days, used not to be but generally is. You get some demographic information about where they expect their clientele to come from, marry that up with the type of people you expect to come into your pharmacy and decide whether or not you've got a business proposition. That's what I do. I assume most people do something similar, but we don't have that benchmark.

We've got no way of knowing whether our conclusions are reasonable. To have that sort of information would be extremely beneficial. It may be that the shopping centres do publish some traffic figures. I'm not a hundred per cent certain of that. I do see them in some publications that I get. I do see some traffic figures or a centre saying that they have moved, or they have had particular movements in traffic figures, but what that means I'm not sure in that most of the traffic movement of course are counters through doors and it depends whether this is somebody going in and out all day through a door, or whether all doors are measured, or you're not quite sure.

DR BYRON: That may be a very poor proxy for what you're interested in. I mean, if the shopping centre has multiple levels and multiple corridors, what you really need to know is how many people are moving along the corridor outside your front door, because if they're all down the other end of the building in the food court that's not going to do you any good.

MR McBEATH (PGA): No, that's the assessment you have to make when you go into a larger facility with multiple levels, whether or not the site that you're being offered is - what sort of business you're going to do on that site. That's a commercial decision, no different to putting a business on the strip out here somewhere.

DR BYRON: Yes.

MR SOMMARIVA (PGA): A further thing relating to information is that we have concerns over figures that are collected by some, particularly shopping centres, where of course figures are collected for statistical reasons and to work out centre turnovers and that sort of thing, but what we're finding from our members is that figures are often used against our own members obviously at at least renewal time. The reason that we object to this is because it basically or effectively means that people are being penalised for running successful businesses. We feel that this has been largely ignored in the report in any case. Did you want to add to that?

MR McBEATH (PGA): Only that I find percentage rents inequitable. I think you should be able to go in there knowing what your rent is going to be and run your business accordingly. I've already used the example that I've had to change my product mix rather than lose money on certain types of trade, which is just plain crazy.

DR BYRON: But we have had other people come to hearings and say that they would like to have all rent on turnover basis because that way if the landlord is doing their job and generating the traffic and sales are up he doesn't mind paying the rent, and if the traffic is down for whatever reason, as long as the rent that he pays is proportional to the turnover that he makes he's happy. So some people have actually argued the exact opposite to this.

MR McBEATH (PGA): Yes, I understand that. I think in pharmacy we have slightly different issues in that the bulk of our business - and I think it's in the submission that the guild has made - is in the area of supply of prescriptions, the payment formula for which is controlled by the Commonwealth and isn't consistent across the types of drugs supplied on prescription such that some products could have a margin as low as 2 or 3 per cent. In a pharmacy paying percentage rental it's a bit of a problem allowing that unlike most types of business, a pharmacy is reactionary to the consumer request in that if somebody presents a prescription for a drug then it's expected and incumbent on the pharmacist to provide it regardless of the margin on the product.

So it's not that I can say, "Well, I'm going to have a margin of 30 per cent on all my products across the board and that way I can therefore pay a percentage because all things are equal, I can control it." We can't and so therefore that's something that you've got to look at as to where your money is. It may well be in different situations - and certainly it is in my own case, that my pharmacy practices have very different gross margins depending on the prescription product mix. So a percentage rental across the board makes an assumption that all things are equal, and they're not. I think pharmacy is very different in that area and I can't think of anybody else who operates in a retail environment who has the bulk of their prices controlled. There may be others. I haven't thought about it particularly, but I can't

think of anybody else who has.

DR BYRON: I think the newsagents would say they're in a similar situation.

MR SOMMARIVA (PGA): A further issue that has already come up this morning is that of start-up costs. One of the things that I mentioned just before relates to the lack of alternatives in certain areas to going into a shopping centre, for example, particularly in growth areas. The standards of fit-outs that are demanded these days is something that has added to the start-up cost and that of legal fees of the landlord which have to be paid by the tenant are just two things that we would point out as good examples as to why start-up costs are an issue of concern to us. Aside from that, we have found from some of our members, including Peter, that there are certain levies that are charged from time to time which are costs that one would reasonably expect should be covered by the landlord, be that a leaking roof or in Peter's case he has a different example.

MR McBEATH (PGA): Yes, my specific example goes back to the same centre I just spoke about. There were some construction faults in the carpark which resulted in the degradation of the carpark surface. The resurfacing of the carpark was then deemed repairs and maintenance and payable under the outgoings, and to recover the money all the tenants were levied quite a considerable amount of money to pay for the resurfacing of the carpark which came about because of structural faults in the building, which I think is wrong but under the legal definitions or the legal interpretation that we were liable. All the tenants were liable. I think that was wrong.

This also goes to the huge start-up costs that we now face in pharmacy and I assume that other people do, but I mentioned mine before in that particular site. Five-year leases were brought in at one stage I think to protect tenants and grant certain rights, and as reported I think in your report and mentioned elsewhere, they have somewhat become the norm rather than the exception. So whilst it was intended that by having a minimum of five years that was some protection, in fact the five years has tended to become the maximum. I think that is inadequate in a high-cost situation such as a centre for a pharmacy with the standards required. The other real negative that that brings about is basically a pharmacy forced to operate in that environment has no goodwill attached to it because there is inadequate time to recoup any of that benefit that you have generated by being there. I would be reluctant to buy into that situation. I never have. Some people do with the belief, not always met, that they will get a further lease, or a favourable further lease.

DR BYRON: That's how people get themselves into a very vulnerable situation.

MR McBEATH (PGA): That's right but again, you've talked about planning laws and how they grant monopoly rights. I happen to be a pharmacist. The only place I

can practise as a pharmacy is where I can put a pharmacy and you get locked into that situation at times. You can either definitely work for a wage I guess, but if you choose to be a proprietor and do all those things that really we've got the skill to do, that's the situation you generally find yourself in. Often and Angelo mentioned new suburban developments of which I'll name one, I have no interest in it at all, but Rouse Hill in Sydney is a huge growth area. There is a major shopping centre there. I honestly don't know who owns it. There are no other places or no other sites within a reasonable distance for retail shopping. So whilst shopping centre owners maintain that they generate the business, it's a bit like the drover's dog we heard about years ago, you would be pretty hard pressed not to be successful where there's suddenly 15,000 homes built and they're the only shops. You would be pretty hard pressed not to make a success of it, so there's two sides to that story.

DR BYRON: Can I just follow up on that question about the fit-out standards and so on. We've had a lot of complaints about I guess you'd say the micro-management that not only what the fit-out must be and the standard but someone can come in and say, "That brown is out of fashion now. We want grey," and you've got to pay for it or, "No, carpets are out this year. We want tiles," and two years later they say, "No, tiles are out. We want carpets."

MR McBEATH (PGA): Been there.

DR BYRON: Yes, but on the other hand the counter-argument that's put to us that somebody goes into the shopping centre knowing that the shopping centre management have the ability under the lease to make these sorts of demands for whatever reasons, good or bad, and so one cynic sitting where you are sitting said to us that in a way you're like a subcontractor, that the shopping centre management is offering you the opportunity to run a certain business in a certain part of the centre for five years or six years or whatever, and much are you willing to pay for it, and these are the terms and conditions and if you don't like the terms and conditions off you go and someone else will come in who will accept these terms and conditions. Is that overly cynical, or are there elements of truth in that?

MR McBEATH (PGA): There are certainly elements of truth in it that you're always under threat if you are negotiating, that if you don't take it somebody else will. That's certainly the case. I guess that's all subjective, isn't it, what's reasonable and unreasonable. I mean, if your carpet is worn out and got holes in it then you're a pretty poor businessman full stop if you don't do something about that. If your carpet is two years old and in very good condition but you've now reached the stage where the lease says after a certain period of time from the commencement of the lease you've got to do a complete fit-out and you say, "But the carpet is brand new. I only put it in because the last one wore out and I had to replace it anyway," and it doesn't matter, the lease says you've got to replace it, everything has got to go because that's the lease you've entered into, I think that's unreasonable. Where does

unconscionable conduct come in? I don't know.

MR SOMMARIVA (PGA): This is our final point that we wanted to touch on and that is we do believe that there are some clauses in some leases - not in all, but in some leases which we do believe are unconscionable, yet obviously there are issues with defining that term. For instance, relocation clauses would be an interesting example of that.

MR McBEATH (PGA): They're very difficult, I again brought up my own experience of being in a situation with a centre that spent nearly two years under reconstruction and suffered downturn in business which took a long time to recover without compensation. I'll be honest, I have spoken to a number of pharmacists who have certainly been treated much worse than I was treated in that situation, and I think there is an example in the paper submitted by the pharmacy guild and I was unaware of that and I mentioned that particular situation to Angelo, not knowing it was in the submissions beforehand, because in fact I was offered that site before a pharmacy went in there and I declined it. So I was fairly familiar with that particular site because I'd done all the research on it.

DR BYRON: But someone less familiar or less experienced who hadn't done as much research - - -

MR McBEATH (PGA): I don't know who they were and I can't comment on the background of the person who took it, other than to notice that hindsight is a great asset on my part, it was a mistake. I guess the difficulties one has is relocation and refit clauses can, if used in what the tenant deems an unreasonable manner are obviously issues. Centre refurbishment is always an issue. Rebuilding is an issue. The use of casual tenants in a centre whereby I suddenly find that at Christmas time I've got a retailer outside my front door selling what I'm selling in the way of Christmas gifts; he's got the same things out there that wasn't there two weeks ago. Those sort of issues become a problem and certainly not uncommon in small tenancies. Sometimes it's resolved, sometimes it's not. I have a couple of others here, if I may.

DR BYRON: Please go ahead.

MR McBEATH (PGA): One of them is the issue of outgoings. You mentioned before we pay the centre owners in basically two parts, we pay them a rental figure but, of course, we do pay a substantial figure for the operation or outgoings, as it's called, of a centre and the one I'm in it's around 20 per cent of my base rental. It's quite sizeable. Areas that I feel should not be included, that should be at the owner's costs, are: land tax is one, which is quite often a considerable amount of money. There is absolutely no incentive for the owner of a centre, in fact quite the contrary, to object to the land valuation on which land tax is paid and on which in fact rates are

paid because obviously the owner of the centre benefits from having the highest level possible valuation of the land because it increases the owner's asset. To me that is unreasonable. They're happy to have it valued at two million if it's worth a million, or whatever the numbers are, because the land tax is paid by the tenant, the rates are paid by the tenant, so it doesn't really matter much, but it looks good for them, and I don't think that should be included.

Similarly on could argue things like payroll tax on the basis that there's no incentive to control wages and I guess one could argue on a similar vein that the whole costs of operating the centre in terms of managing the centre and the people employed to manage the centre should really be at the cost of the landlord because the tenant has no say in whether the person operating a centre is doing a reasonable job or not, has no input into the selection of the person involved or their expertise. To me it's just a cost of running a business which the centre owner is doing, they're running a business for tenants. Well, if they want to run a business on a lease base, you run your part of the business and let the tenant run their part of the business.

DR BYRON: Is the logical consequence of that a shift of the gross rent where - - -

MR McBEATH (PGA): To me, yes.

DR BYRON: - - - if they were paying it they would be much more cognisant and be a little bit more diligent in minimising those costs rather than just signing off blank cheques and charging it back to you.

MR McBEATH (PGA): It makes sense that they would be more diligent. I would like to think that anyone running a competent business does try to manage all their costs. But where you can just pass those costs on at an argument that they're reasonable - that's a subjective assessment again.

DR BYRON: The other possible solution that we heard here yesterday was that the legislation should allow - say, if three or more of the tenants ask for it, then all the outgoings should be audited and not only in the sense that there were no arithmetic errors and so on, but that the costs were legitimately incurred and if there's a new contract for cleaning the centre and the charge is doubled or trebled, "We want to see the three quotes and make sure they chose the lowest quote and not the highest quote," or get an explanation why. Is that right to audit another way of getting the incentive structure right so that they really focus on it?

MR McBEATH (PGA): I don't really believe so because you really can't do much about it. In my own case the centres that I'm involved in those figures are audited but whether or not the decision to use a particular cleaner and incur an expense is a valid decision or not is something that you really can't determine. You can determine that the money was paid and that what appears to be due process has occurred but

whether or not it was a reasonable decision is again subjective, you know, what's reasonable? That's why I'm saying that I believe a lot of those costs should be the responsibility of the owner who would thereby be far more concerned about getting it right.

DR BYRON: I guess the counterargument of that is if the owner was going to be responsible for all the outgoings and so on, then presumably the rent would change.

MR McBEATH (PGA): You pay them anyway. What I'm saying is I've got a base rate of X and my occupancy cost is X plus 24 outgoings plus another 5 per cent for promotion. So effectively a base rent plus 25 per cent to occupy the site. That's the real rent, you know, how you disguise - just that one component is variable, being the outgoings is a variable amount depending on what has occurred during the year.

DR BYRON: Okay, thanks.

MR McBEATH (PGA): I think that's about all.

MR SOMMARIVA (PGA): We're happy to answer any further questions if you had anything further, Commissioner.

DR BYRON: There was just one more. We've had a few discussions here this week about goodwill and the difference, the profound difference between if you're in a strip and if you're in a shopping centre. I'd just like to get your reaction to my summary of what we've been hearing this week, that if you're in a strip and you might have a 10-year plus five plus five, et cetera, but if your lease isn't renewed you can hang a sign on the front of the shop that says, "We've moved across the road and down the street," and all your loyal customers who know you and you know their kids names and so on will follow you.

MR McBEATH (PGA): Yes.

DR BYRON: You have real goodwill that you can take with you because they're your customers and they will follow you. If, on the other hand, the situation is just that you've got five years and at the end of five years that lease expires, you may or may not be offered another lease, that suggests that the day your lease expires your business is worth approximately nothing unless there's something that you can move. If your customers will come with you that's fine, but in a traffic-dependant centre - - -

MR McBEATH (PGA): Often there is nowhere to move, even if you wanted to.

DR BYRON: But then the argument goes that even though businessman is thinking that the value of his business is going up every month because he's working so hard and building it up and so on, if you're getting one month closer to the expiry date on

your lease and the day your business is going to basically fold, the goodwill value is probably going down every month rather than going up because you're getting - - -

MR McBEATH (PGA): Certainly.

DR BYRON: - - - one day closer to the day it evaporates.

MR McBEATH (PGA): I would argue, as I mentioned before, on a five-year lease I don't think you've got any goodwill in the current situation in a pharmacy with the huge costs of setting up a business.

DR BYRON: And with the very high start-up costs and the compression of term, the ability to recoup those start-up costs in five years is rapidly evaporating. But what we should see then is that more and more people will do the sums like you do and just say, "That's not a viable business model," and eventually the centres will find that there are no pharmacies in any of their centres because nobody can make a quid under those terms and something will have to give, won't it?

MR McBEATH (PGA): I tend to think that might be happening but, unfortunately, in any industry where there's a very limited ability to open a pharmacy - which there is in the current environment - there tends to be always somebody who thinks they can make it work and I guess that applies to a lot of businesses. I would argue, as I did before, that five years was inadequate and I managed to obtain an eight-year lease in a business where I had been for 15 years. Pretty tough. If you're in a strip location, and I am currently in strip locations, I can generally get a commitment from the landlord that at the end of the lease there will be another one offered, in fact they'll often have five plus five plus five leases and the last one is up and I get on to the landlord and say, "Hey, can I have another 15-year lease because I'd really like to stay here," and the landlord is very happy to have me.

DR BYRON: Absolutely.

MR McBEATH (PGA): But in a shopping centre there is no way with two or three years out that I can get a shopping centre to commit to giving me a lease when I've got two or three years to go on my existing lease. That has been my experience.

DR BYRON: That really highlights the stark differences between being in a strip and being in a centre. They're really very, very different types of businesses.

MR McBEATH (PGA): Absolutely.

DR BYRON: But that also suggests a possible explanation to me that people who have been retailing in a strip move into a centre thinking that the same rules apply and they get a horrible surprise when they find out that the rules of the games are

quite different.

MR McBEATH (PGA): I'm sure that's occurred. I have seen the development of centres in the time that I have been in business - I've seen centres develop and I have observed people going from very good strips into very large centres with sometimes disastrous results often because the trading they expected wasn't there, the overheads are much higher than they were used to, the demands of the shopping centre owner were quite different to what they were used to, so I have seen that occur to the detriment and I have seen some very large pharmacies effectively go bankrupt or a number that I know have gone bankrupt in very large sites.

This is a commercial thing. We're talking here about what is reasonable and I think some of the things that are exist are unreasonable. I think some of the expenses given to a tenant are unreasonable in that outgoings area for reasons I've expounded. The lack of goodwill, I guess it comes down to, "Should a business expect to have goodwill at the end of it?" I think most of us do and certainly the owners of shopping centres do because they often change hands at considerable multiples of their actual worth, given the existing return and the return a new owner expects to get. They're not just sold for their real estate value, they're sold on a multiple. So is it unreasonable for the tenant to expect something similar? I would argue no. I think it is quite reasonable for a tenant to expect to have some goodwill and to have some assuredness of an ability to continue a successful business, because let's face it, if you've got an unsuccessful business and you're losing money, you tend not to seek a new lease.

DR BYRON: Yes. Are there any closing comments that either of you would like to make?

MR SOMMARIVA (PGA): No, I think most things have been covered this morning and I understand that they have also been covered over the last few days. So thank you again for the opportunity to address you.

MR McBEATH (PGA): Thank you for the opportunity.

DR BYRON: Thank you very much. It actually has been very, very helpful to have the specific experience. So thank you very much for taking the time and effort to come here today.

MR SOMMARIVA (PGA): Thanks, Commissioner.

DR BYRON: Hopefully we can take a short break of about 15 minutes for a cup of tea outside.

MR CASTLE (CFA): Thank you, Commissioner, we're here on behalf of Competitive Foods. My name is Tim Castle. I am counsel representing competitive. I'm joined here today by Ian Parker, who is the group general manager of Competitive Foods. My background is: the last 15 years as a barrister in commercial law acting in a range of cases from the very large to the small in the commercial area and Trade Practices area, so I have a reasonable breadth in that regard. Competitive Foods is a major private company which operates a number businesses, but two relevant for today are its ownership of the Hungry Jacks franchise operation here in Australia, under franchise from Burger King Corporation, and also the ownership of 50 KFC stores in Western Australia and the Northern Territory under franchise from Yum! Restaurants International.

What we'd like to do today is to engage with the Commission's draft report in relation to what is the hard bargaining issue and to look particularly at the unconscionable conduct remedies, so that's really the point at which I think we come into the Commission's hearings and inquiries. By way of background what brings us here is a very practical problem that we have faced in the franchise context but it's forced us at Competitive to really drill down and try and understand what the economic forces are that are operating and in doing so we have found that there is a common layer with what's happening in retail tenancy. So as we understand what the Commission's charter is, is to look at problems at the conceptual level and to identify what the problems are. Although the specific focus of your report is retail tenancy, then we're making the assumption that if the Commission identifies a particular problem in principle, although that might have implications in the retail tenancy, your report may well throw up a solution or an identification of a problem plus options which can be taken in other places into the franchise area.

That is important because you may or may not be aware that both Western Australia and South Australia at the moment have separate inquiries going into franchising and I think you will have seen from our most recent submissions that we are putting essentially the same propositions to you as we're putting to them, although they may have different outcomes so far as you're inquiries are concerned. The practical problem we face - I bought some photos because a picture can sometimes tell a thousand words. Perhaps if I can just hand them to you. These are photographs of one of the KFC stores which we operate at Rockingham. I'm happy to hold these up for the people who are here. The first is a photograph - everybody recognises KFC stores with the familiar bucket out the front. This was a competitive store at Rockingham, a place in Western Australia, and it was an operation that had been going for 30 years as a KFC store. The value of the store on a going concern basis is about two-plus million dollars.

The franchisor told us that it would not renew the franchise agreement when it expired, notwithstanding it was a very successful store, it had 40 people employed there directly, a myriad of other people of course employed providing services and

supplies to the store, so there is a wider ripple effect in relation to the operation of the store. The closure of the store occurred in circumstances where the franchisor said that they wanted to buy all of the KFC stores in Western Australia and the Northern Territory and that if Competitive wasn't prepared to sell those stores at a price which the franchisor said it wanted to pay, that the franchisor would simply not renew the franchise agreements on expiry.

The price the franchisor offered on our calculations was roughly half their going concern value and the difference was easily calculated. They said, "We will value the stores on the basis of their revenue up to their expiry dates," so discounted cash flow on a limited basis, whereas the going concern value is a multiple of their earnings. So the day before Rockingham closed the store's worth $2 million on a going concern basis, but on a DCF basis is only worth a dollar and that applied then across 50 stores gives you a very big difference.

That's the current state of the store now, employees gone, signs taken down, a steel fence around it, completely boarded up and there's no, as we see it, good reason for that store to have closed, people to be put out of work and the wider effects to have been felt within the community. We say that because the franchisor has put in a development application to open a store in the same block about three properties down from where this store is now. We also know, the franchisor told us, that they were quite happy to take over the store when it expired and take over the staff. So no good reason for that to happen, other than the fact that at renewal they could say, "We're not going to renew."

When I say we've drilled down into this issue, the issue which it throws up is the issue which is the first point we want to raise today, opportunism, the economic captive and so-called hard bargaining and I was interested to hear the exchange that you had, Commissioner, with the representatives of the Pharmacy Guild, where you put up in the tenancy context that, as you saw it, the two sides of the argument: there's the side which said, "Well, it's unfair that we have these advantages taken away," and the other side which says, "Well, you know what the terms and conditions were. If you don't like it, you shouldn't have gone into it." I think you call that the cynical view.

The question, as we see it, which I think really provides the way for the Commission to resolve this dilemma between the two competing views is to ask the question, "Which is the most economically efficient outcome?" and that ultimately is the decision which we think that the Commission should be focusing on is not so much judging between the different perspectives of fairness, the tenant and the landlord, but is the macro question, "Which is the most economically efficient outcome?" That is really, as we see it, the issue which we can drill down into when we look at this question of opportunism. What we'd like to suggest is that hard bargaining is really just a euphemism which needs to be unravelled a little bit,

drilling down to see what is really embodied within this term and what we will be putting and I hope to demonstrate to you shortly is that what passes for hard bargaining is really an economically inefficient outcome and that really one is not growing the pie, to use the very colloquial terms, but one is transferring wealth from one part of the pie to the other part of the pie, and that's a consequence of opportunistic behaviour.

The starting point for this discussion is to say - and I doubt there would be any dispute with this - that the point of an economic transaction is to - obviously an economic transaction is an exchange. You grow the pie if you create mutual benefits for the parties. That doesn't mean, of course, and this is again a basic proposition, that there may be inequalities between bargaining parties. You don't have perfect bargaining parties. That doesn't mean that because we can accept some inequality that we should accept all inequalities as producing an effective and economically efficient outcome. The Reid report at paragraph 6.32 I think hits the nail on the head and I don't have a copy of that but I know that that's a report which in general terms you'll be familiar with. What the Reid report says is that the underlying assumption in the doctrine in freedom of contract is that you have mutual agreements of fully informed individuals arising out of free choice, and it's the free choice issue which is at stake here. That free choice issue seems to come into the way the Commission has analysed in its draft report this issue of hard bargaining, and I refer here to page 106 of the report where the Commission talks about the fact that tenants have a bargaining chip. In the last paragraph above the draft finding there's a reference there:

> Given the low vacancy rates for retail premises in shopping centres, centre landlords may be able to drive a hard bargain, particularly if the centre tenant is heavily relying on foot traffic. The main bargaining chip for tenants is the ability to vote with their feet.

So the assumption which seems to be implicit in that argument is that because tenants have an option they have a free choice and they can vote with their feet, and if they have that free choice then from an economic standpoint you can say, well, the transaction which happens is efficient because there is free choice involved. We would argue that that's not as simple as is presented in page 106. You can take a very simple model, and this is the economic captive problem, is that let us assume for a tenant there's an opportunity cost of moving from their current location to their next location of $100. Then it would be a rational decision on the part of that tenant to pay up to the $100 in increased fees, however it be packaged, to the landlord. Once you recognise a tenant or a franchisee as an economic captive, then what you have in the renewal transaction is an ability for the landlord or the franchisor to take the $100 of value created by the tenant and put it in its own pocket. So in other words the renewal transaction doesn't grow the pie at all. The renewal transaction - and this is the opportunistic behaviour - is the occasion for a wealth transfer.

The landlord can then wield a very big stick or the franchisor can wield a very big stick by saying, "We won't renew," and they then put the tenant or the franchisee in the position of suffering loss through the opportunity cost which is suffered unless they give in to demands. If we come back to the central question that we started with first, is that an economically efficient outcome, and we would say, no, it's not. That sort of opportunistic behaviour which arises because someone is an economic captive is not something that should be countenanced as a matter of good policy.

In terms of opportunity cost, if we take the franchise situation because it is and it must be recognised a more extreme situation than that of the tenant, but it helps illustrate the principle. The opportunity cost for the franchisee is extreme. You used in the discussion with the pharmacy guild the fact that a tenant in a shopping strip can move two doors down and take their customers with them. Why are they able to do that? They're able to do that because the only input which they take from the landlord is the physical space. They provide all the other economic inputs themselves: the human capital, the name, and the financial capital. But with a franchisee - and this is why I say it's a more extreme case - the franchisee can't take anything. If there's a non-renewal of the franchise agreement then there's nothing left. So the opportunity cost is almost infinite because the franchisee - let us say that Rockingham was our only store, we were a sole franchisee of that store, the franchise agreement is not renewed. We can't go and set up as KFC anywhere else. We are subject to restraint of trade provisions in this case, but typically the franchisee will be - restraint of trade provision, there's nothing you can do. You can't move next door and set up as KFC.

DR BYRON: I have a question of clarification. Although I recognise strong parallels between franchise agreements and retail tenancy leases and so on, we have been contracting on the leases so I have to say I'm not totally across the franchising area, but I can see similarities at an intuitive level. If it's a fixed-term contract, doesn't that mean that whether it's for 10 years, or 30 years, or whatever, I know having entered this contract as a franchisee that the day I no longer have a franchise I no longer have a business?

MR CASTLE (CFA): Yes.

DR BYRON: That is the day no matter how long we've gone over the last 10, or 20, or 30 years, if we get to the point where I don't have a franchise agreement, I don't have a business and it's worth nothing. As you say, unlike the others, I can't take it away because of the intellectual property conditions of a franchise.

MR CASTLE (CFA): Yes.

DR BYRON: So I guess where I'm a little bit confused, on the one hand we're talking about valuing the business as a going concern, but if it's a business that's been built up

under a fixed-term franchise agreement, does it make sense to value it as an ongoing concern, because it has a fixed date known in advance under the agreement when it expires and the business basically evaporates.

MR CASTLE (CFA): It's a very good question. I understand the dilemma and I'll deal with it if I can. The question, if I could reframe it is how does the franchisee or tenant come to be an economic captive?

DR BYRON: Exactly.

MR CASTLE (CFA): How it comes to be an economic captive is because - and again if I can use the franchise situation to illustrate, but it has strong parallels in the tenancy. When you enter into a franchise agreement - let me go back a step. The contract analogy works very simply if I contract with you to sell a piece of land. If I contract with you to sell a piece of land, it's all set out in the contract. I hand over my money. You give me the land. I know exactly what it is that I'm - the value that we're exchanging. When I enter into a franchise agreement, I'm entering into an incomplete contract. It's incomplete because you the franchisor have the right to tell me to upgrade the system, to upgrade the fit-out, and to do various other things during the course of my franchise agreement. That is a sunk cost, that is an investment you make which occurs during the course of the agreement, but you don't know that, you can't quantify that in advance.

DR BYRON: You don't know in advance either the timing or the amount.

MR CASTLE (CFA): Correct, and you become economically captive. The moment you sign the franchise agreement you are bound by these contractual terms, and these contractual terms require you to do things which you can't quantify in advance. This is where the analogy with the strict law of contract breaks down, being the purchase of the house. I know exactly what I'm getting, and to take the house analogy let us say - and the principle of caveat emptor applies - if the house has got white ants in it and I haven't done a building inspection beforehand then that's my lookout, because I could have known that in advance. But what you can't know in advance is you can't know in advance what you're going to be required to spend and when you're going to be required to spend it to meet what the franchisor's demands are.

In our submission we actually to illustrate this point we put some numbers around the Rockingham case, the submission that was sent through to you yesterday, in paragraph 12. When the restaurant was opened, the initial building cost was $156,000 but the upgrades which followed in 85 and 98 were a further 410, 409 thousand dollars, so substantially more which you put in, but you put in when you're already committed. So it's really not good enough to say, "Well, you knew you were getting in for something and you can't count on getting that back because you've only got a fixed contractual term." So you become an economic captive not because of a decision which you make up front, but because of decisions which take place while you're already in the

contractual relationship.

Listening to what was said just a few moments ago by the pharmacy guild people, it sounds as though shopping centres are the same sort of thing, because the shopping centre owner can dictate to you questions of changes of fit-out. So although it's not quite same as our situation, perhaps it's less extreme, it's a similar issue. It comes back to the challenge I really put to the Commission up front: what's the most economically efficient outcome? If the law of the jungle applies at renewal time then what that's going to do is that is going to create a disincentive for investment during the term. In other words, if I am concerned as a franchisee that I won't recover the value, if I've got to write off or recover the value of my investment in upgrade, whether compulsory or voluntary, during the course of the contractual term and that is all, then I will not invest to the same extent as I would if I had some degree of comfort about what would happen when the term expires.

DR BYRON: I appreciate that. If the franchisor or in a different context the shopping centre owner was to ask for a major refit, an upgrade or something, when there was in fact only a couple of years to go on the lease, which couldn't possibly be recouped before the expiry date, I would have thought as an amateur that that would be an extremely unreasonable demand and the franchisor might well say, you know, "Unless I can get a guarantee of a longer term there's no way that I can spend half a million dollars now when there's only two years to go before the day my franchise ,or my lease, or both expire and my business evaporates. If you want me to make this investment, I have to have another eight years, another 10 years or whatever on the lease and/or franchise, otherwise it would be absurd for me to make this investment if I've only got a two-year life before the whole thing is gone."

MR CASTLE (CFA): That's right, and that's why I think that a very good outcome is an outcome which sees that sort of trade-off occurring, in other words, "You upgrade or you invest in the business and we will give you a renewal." One of the points that we make is that in the US the same franchisor who we have been dealing with has as one of the standard terms of their contract that there's an automatic 10-year right of renewal provided the franchisee invests in an upgrade of the store and is not in otherwise in breach of, so that is the economically sound outcome to achieve so that one gets a balancing.

DR BYRON: That's very similar to what has been advocated to us in regard to retail tenancy in the sense that, "I've been a good tenant for the last five years. I've always paid my rent on time. I should have an automatic right to another five-year lease unless there is some extremely good reason why the landlord needs vacant possession." It would seem to me that that may fundamentally change contracting. In the attachments at the back of your submission you talk about the contract being made between willing parties on both sides, and if it gets to the point where the first agreement has expired and we're now discussing a second agreement, the franchisee or the tenant says, "I would like to

stay on. I would like another agreement," the franchisor or the landlord says, "No, I would rather not enter into another agreement." Are we fundamentally changing the rules that says party A has to make a new contract because party B wants it irrespective of what party A thinks?

MR CASTLE (CFA): Not if the parties are both negotiating in good faith, and that's the element that's missing now. That's the element which is missing because of the economic captive. You see, there's not a level playing field in terms of the negotiation because the weaker party is captive to the stronger party in terms of whatever terms the stronger party wants to impose. That's played out if the stronger party is trying to get an extra benefit over and above let us say in the lease terms a market rent position, or in the franchise terms some extraneous benefit which they wouldn't be able to get if they were negotiating a fresh franchise agreement. That's the capture of the value, that's the transfer of the value. What we would say is that it couldn't be good faith to seek to use the unlevel playing field to capture additional value from the tenant or from the franchisee that they are otherwise not entitled to.

DR BYRON: If the franchisor has already said, "We don't intend to renew or offer" - I'm having problems with the semantics about the word "renew". Let's say, you know, to let the first agreement expire and to start a second agreement, "We're giving you advance notice that we are not going to enter into any more follow-up agreements." Is that akin to saying that you have noticed that it's now two years, five years, seven years, whatever, until the date when each of those businesses is going to cease to exist, and so in making your own internal management investment decisions, stop thinking about these as businesses that have a perpetual life and start thinking about businesses that have a fixed-term life and each of them is going to evaporate on a certain date and, you know, cut your cloth accordingly. It comes back to the question of the economic captive or as other people have said to us, you know, at the time of the second negotiation one party is very vulnerable, very exposed, they've got undepreciated assets, et cetera and our question is: how did they get into the situation where they're so vulnerable, exposed, and should they, could they have known that at the end of the fixed term they need to be in a situation where they are actually in a position to walk away if new terms cannot be negotiated for a fresh agreement.

Small traders seem to be coming to us and saying, "We thought our business was worth $1 million but I didn't get a new lease and so suddenly my business - poof, it's gone, I've just been robbed of $1 million." If they had had a different mindset and said, "I know that my business is going to be worthless the day the lease expires unless I can take it somewhere else. Every day that passes I'm one day closer to the day my business becomes worthless. I should be writing down its value each day rather than writing up its value and so that I'm absolutely no illusions if I can't reach a satisfactory negotiation, mutual agreement at that point, I have covered all my liabilities, I have paid off my debts, I have claimed all the tax deductions on the fit-out, et cetera, and I have no longer got myself into a vulnerable situation. I've got myself in a situation where I don't like it.

I can walk at no cost to myself."

MR CASTLE (CFA): Can I say that I understand the argument you're putting and there's a hidden assumption in there and the hidden assumption is that all of the investment decisions which are required in the tenancy are known right up-front when you sign the lease and that you're writing them off then progressively over the five years, so then you've freely entered into a known bargain at the start.

DR BYRON: You may have entered into a known but misunderstood bargain where it's really not going to be commercially viable to write down all those assets. I mean, we heard the case last Friday in Canberra of somebody who has borrowed money over 10 years on the life of their business, because the lease is only five years. If he doesn't get a second lease at the end of the fifth year, he's still got five years of debt to pay. He's got himself into a situation where of course he's over a barrel. He should never have been in that situation.

MR CASTLE (CFA): Sure. There's no doubt those situations exist but I don't think that's the situation we're really talking about. There are obviously situations where people have misunderstood in terms of the lease, they've misunderstood their rights at renewal, but where you have people who are required to make investments along the way, there should be incentives created for investment rather than disincentives and that's really our point.

DR BYRON: Sure.

MR CASTLE (CFA): Our point is, and I think it really follows from what you've said, if you can only write your investment through to the end of the lease or the end of the franchise, then your willingness to invest is going to be diminished, than if you believe that your investment can be recouped over a longer term.

DR BYRON: Perhaps you should not only believe that your investment can be recouped, you should make sure you've got a second contract, agreement or a lease - you know, some form of commercial contract - that enables you to write it off, rather than making an investment on the hope that the subsequent agreement will eventuate. Wouldn't it be much better to have that locked in in writing?

MR CASTLE (CFA): It would be if there was a level playing field perhaps at the very earlier time, but let us say the franchise situation - there's two issues; one is the reality of the initial bargain and the second is the working out of the incomplete contract. In the franchise situation, the initial bargain is presented on a take it or leave it basis. So to say that Mr and Mrs Average Franchisee or even a large company like Competitive Foods, in dealing with an even larger company, the Yum Corporation, is presented with a standard form contract which may or may not contain renewal rights - "And if you don't want to take it, well, we'll find somebody

else who does" - that's the first part. Now, the answer to that problem might be, "Well, you didn't have to enter that contract." But I think the more significant part of the answer is that the relational issues in the contract, where they have a contractual right, the stronger party has a contractual right to require you to spend money at different points in time, and you may wish to spend money. We don't just talk about the forced situations of investment but the voluntary incentives to invest.

In the case of a franchise situation - I don't know that a retail lease would be any different - a well-presented franchise store will generate more customers and sales and ultimately if you've got more sales, you've got more employment, you've got more supplies coming in, so you've got a ripple effect into the wider economy from investment. We should be creating incentives for that. So really, the economically efficient outcome is an outcome which encourages people to maximise their investment. We're not worried here about goodwill, we are worrying about investment during the term of the contract. The same thing in a shopping centre: we want to encourage tenants, not only to do the bare minimum but to invest more to drive more people to their shops, more employment, more shop staff are required, and they can take the risk. There's nothing wrong with people taking the risk but there will be a renewal in good faith. In other words, we're not talking about - and perhaps this is where it's slightly at cross-purposes - having compulsory rights of renewal, but we don't want to be in a situation as a franchisee that the renewal is an opportunity for the value that we've created to simply be taken up by somebody else, and the wealth transferred - so the wealth we've created - be transferred. This is the Rockingham situation.

DR BYRON: We understand that.

MR CASTLE (CFA): You understand the point. In fact one of the articles - and probably I should just take you to it very briefly which is in one of the articles in our bundle, tab 15 - it's an extract from Blair and Lafontaine's textbook, The Economics of Franchising, and what they build is they build a model, starting at page 264, to look at the rational decision that a franchisee will make and you will see the model at 10.2: the franchisee will invest over the course of the term an amount equal to the discounted rate of return, plus the salvage value on the assets.

DR BYRON: Yes.

MR CASTLE (CFA): Then at 10.3 on the next page, they then add to that but the more complex model is not only the investment during the term but also then the probability of a right of renewal and the returns that would be gained in the subsequent term. They come to the not surprising conclusion at the bottom of 266 that everything else constant, franchisees will be willing to invest more in the franchise (1) the longer of the original contract term; (2) the longer the renewal period and then (3) the higher the probability of renewal. So our point really is and

all we're arguing for is that a restraint be placed upon the decision of the stronger party at the time of renewal to cut out the economic captive transfer of wealth. In other words, as a franchisee, we might not be able to negotiate a contractual right of renewal, but what we can make a decision about is we know Rockingham is a good store, we know it's got great growth prospects because of the demographics, we've done all our market studies et cetera, and we think that there's a very high prospect that at the end of the initial term, that will get a renewal, provided we operate the restaurant well.

So incentive number 1 is to operate the restaurant well, incentive number 2 is to invest in it, assuming then that there will be good-faith conduct from the franchisor at the end of the term. All of those things are in fact played out at Rockingham. We have run a good store, we have invested in it, and they want to continue to run the store, but they don't want to pay for it. They don't want to renew and they in fact want to try and get some collateral benefit by saying, "We want to get the rest of your stores and we're going to threaten not to renew them," or, "We will not renew them unless you hand them over to us for a discounted value." Now, that's not good faith, so that distorts the economic decisions. You might then say in answer to that, "Why should you make the assumption that the franchisor will act in good faith towards you when it comes to renewal time?" and the answer to that is that we've made the assumption that the whole of the franchise relationship will be conducted in good faith. We invest in good faith, we continue to invest in good faith. We're not a partnership but the relationship is the key thing.

In the shopping centre, it's not that dissimilar. The shopping centre owner, there's good faith - I mean, it's a matter of New South Wales law, good faith is implicit in all our leasing contracts - but there's good faith that each of the shopping centre tenants will do their bit, if you like, to put it colloquially, for the shopping centre. So there's an element of good faith that happens there as well. Why should good faith suddenly stop? Why should the law of the jungle, as I call it, then apply some sort of laissez-faire description of contractual relations occur, which is not really the reality of what occurs at renewal. So coming back to what we said was the primary issue, what's the most economically efficient outcome? The most economically efficient outcome is to encourage investment.

Can I just refer to one item in your draft report at page 113. What you've said there in relation to retail tenancies, you've talked about the effect of the evidence, so this is more empirical evidence:

> Mandated renewal clauses are perceived to have the potential to place downward pressure on rents -

and there is international evidence to suggest that. Then the Commission says the reasons for this outcome is clear and then there's a reference to the possibility it's due

to the inability to replace poorly performing tenants. I want to suggest that there's a different explanation consistent with the argument that we've developed and that is that the reason - if you have mandated renewals the landlord can't transfer the benefit or surplus of value built up by the tenant - there's not this transfer of wealth - by accessing effectively the opportunity cost for the captive. In other words, what landlords are forced to do in this situation is they're forced to negotiate on the merits rather than on the inequality of bargaining strength. Now, I can't prove that but what I suggest for your consideration is that that's an equally plausible alternative for why lower rents arise where you have mandatory renewals or mandated renewals.

Interestingly there's a reference also to the fact of the ACT and South Australian acts where there's a right of first refusal. That is a particular way of introducing the good faith concept and I think what the Commission said was the Commission didn't accept the argument that this added to regulatory costs, it said there was just no evidence either way. If I could just refer to one other article which may provide some assistance in this area at tab 16 of our bundle - I won't take you to the specific page, but we've dealt with it in footnote 19 and 20 of our submission - and it's an article by Brickley and Others in the Journal of Law and Economics where they did some empirical studies into the effect of introducing provisions to regulate franchise agreements in the US and they came to the conclusion that where restrictions were introduced in effect to deal with opportunistic behaviour one of the consequences was that there was a transfer of wealth in the absence of regulation which didn't apply where there was regulation. In other words, it's a consistent piece of evidence, we would suggest, with the points that we put.

DR BYRON: We will certainly follow up on that.

MR CASTLE (CFA): There is one other point which I think is worth making again on the evidentiary point. In tab 3 of our bundle, and I will take you to this, opportunistic behaviour in the literature can occur during the term where there's the use of termination provisions to extract benefits and it can also occur at the end of the terms where there is the non-renewal. The franchising code which is part of the Trade Practices Act regulates the ability to terminate and it imposes certain restrictions on a franchisor's ability to terminate. What is interesting in this franchising survey, which was produced at the instance of the Franchise Council of Australia and that is a body which, if you look at the web site, clearly stands for the interests of franchisors, of which there are many in Australia, on page 8 the authors here note at the bottom of the page:

> Following the introduction of the franchising code of conduct in 1998 growth in total systems initially slowed but has again flourished.

You can see that paragraph at the bottom of the page, the conclusion that there was a flourishing of the franchising system. So again there's a piece of evidence that

introducing beneficial regulation doesn't in fact create regulatory costs but at least as this survey indicates, and this is the most up to date, that franchising has flourished. Part of our argument, and we will be putting this to the various franchising inquiries, and we've put it separately to the federal government as well, is that the scheme of regulation is incomplete in the franchising code, it only deals with opportunistic termination during the term, it needs to also deal with opportunistic conduct at the end of the term in relation to renewals. But, as I think I said earlier, we're dealing with a level of principle here and I think the principle is what we're really asking you to address. The consequences in franchising is obviously a matter for other bodies.

The other thing that I think should be said about opportunism - and there's another interesting statistic here, perhaps while we're on this document, at page 62. There's some statistics which are collected here about franchised unit changes and if you look in each - so it's 2005, 2004, over the page 2003. Midway down each box, "Franchise agreement not renewed when expired 3.7 per cent." So in fact there is a fairly low rate, empirically observed there's a low rate of non-renewals upon expiry. I think it's important to address two points here. The first is that where you have an economic captive who stands to lose everything such as in a franchise agreement, then the figures of non-renewal upon expiry will actually give a misleading impression in relation to the incidents of opportunistic behaviour. In other words, where you stand to lose everything and a very high opportunity cost of not giving into the franchisor's demands, whatever they happen to be, you'll give into them and that won't be reflected in the statistic.

So in other words, statistics like this, and there may be similar statistics in the leasing area, are going to hide the real incidence of opportunistic behaviour and the fact that in Rockingham the demands were such that Competitive did not accede to them means that Rockingham closed. But there are many other examples and one of them specifically is the one that went to the High Court. Have you been taken to the Berbartis case, have you been talked to about that?

DR BYRON: No.

MR CASTLE (CFA): That's the next thing we'll come to. It's a very good case where the tenant, faced with losing its business, rather than accept the non-renewal of its lease gave in to the conditions and so statistics like these would show there was a renewal of the tenancy, but it doesn't show on what terms that renewal occurred. So I suppose my point simply is one needs to treat these sort of statistics with a slight degree of caution in relation to opportunistic behaviour.

DR BYRON: As somebody said rather colourfully the other day, the patient is not dead, they're still alive in intensive care on life support.

MR CASTLE (CFA): I think there was an American expression about grabbing

people by a certain part of their anatomy and squeezing. Some might say that comes euphemistically within the hard bargaining area. Yes, so that's the first point. The second point is that the e more generally of opportunistic behaviour is very widely documented from Swanston, to Blunt, to the Reid committee, we're not dealing with a new problem. In fact one of the arguments that we put is really that there's been a fairly significant policy failure by the government over the last 30 years to deal with the problems of opportunistic behaviour, particularly in relation to franchise renewals. There have simply been too many inquiries which have come up with the same conclusions and a lack of will to action. In the Reid committee report at paragraph 3.81 what the Reid committee said was:

> The committee believes widespread abuses are occurring in practice. It is simply not credible to dismiss all the complaints made to this committee and to previous inquiries.

We see Rockingham as just being the last in a long succession of these documented way back to the Swanston - we've got the Swanston and Blunt extracts in the bundle. I can take you to them now if you'd like me to familiarise you with them.

DR BYRON: I'll follow them up later.

MR CASTLE (CFA): The only area where the government has acted was in the area of the petrol station franchises, and in fact we say that's the model of good regulation to the extent that what that model provides is it provided for - the provisions are here, I might as well take you to them very quickly at tab 13:

> A franchisor shall not fail or refuse to renew the franchise agreement except on the following grounds: (a) the existence of circumstances or an event of the kind referred to in paragraph 16 -

they're effectively termination events -

> (b) the franchisor proposes in good faith and in the normal course of business to vary provision of the agreement and the franchisee does not consent to the variation.

So that we say is a model of good regulation. It doesn't impose an obligation on anyone other than an obligation for a renewal in good faith so that when the parties come to the table the economic captive issue is really put to one side and there is good faith renewal. These provisions, as we've put in our submissions, attract through to the oil code which superseded this petroleum legislation. But with this one exception in the petrol station industry there has been a signal failure of governments to act on the basis of repeated reports, repeated recognition of

problems, and repeated proposals we suggest of the same solution time and time again.

DR BYRON: Can I just clarify on that, I understand I think quite reasonably well what you're saying, but can you explain or even speculate why governments have consistently declined to take the remedy that's been so frequently proposed by so many inquiries. Can you just bring me up to date on what reasons they've given for not implementing something like this in all the other areas, something about protection of property rights of one party or - - -

MR CASTLE (CFA): It could be. It could be that the stronger party organisations are better organised than the weaker party organisations. So it could be due to lobbying efforts, may be one possible explanation.

DR BYRON: But there hasn't been some particular fundamental point of principle about the sanctity of contracts or something?

MR CASTLE (CFA): The only point of principle which is raised is really the one that I think the Commission has expressed in its draft report, the hard bargaining issue, and the assertion of regulatory cost. But that's really why I suppose our challenge to the Commission here is to drill down beneath what we see as effectively platitudes and assertions by - of course if you're a stronger party of course you would say this will impose a regulatory cost burden. It's rational for you to say that because you want to protect your opportunity to take advantage of the wealth transfers which occur. The Reid committee - and I really commend the whole of chapter 3 of the Reid committee - - -

DR BYRON: Again, thanks.

MR CASTLE (CFA): - - - attempted to - I'm sorry to do this, I'm sorry to burden you with the reading but - - -

DR BYRON: I've read it a few times already so once more - - -

MR CASTLE (CFA): But the Reid committee talks about the false starts that occurred in this area and yet added its voice again to saying this problem has not been addressed.

DR BYRON: To come back to your specific case, the franchisor under the current rules of the game can look at what CFAL has been doing and say, "That's a nice business. We'd like to run that and therefore it's within our rights under the existing law to not sign another agreement and then we can get ourselves in that business." So if the law is changed now, does that retrospectively diminish the assets that the franchisor held that, you know, they used to have the right to in effect - I'm looking

for a substitute word for takeover - displace or replace and the new legislation would basically prevent that for all the reasons that you've given. That's what I was fishing for. Is there some fundamental point of principle that when politicians have had these arguments put before them they've basically said, "Well, we can't actually change the law of contracts that much"?

MR CASTLE (CFA): Can I answer that in two ways because I think the retrospectivity is an important question. That hasn't arisen and nothing I have seen has led me to conclude that that would be a reason which has been in the back of people's minds. Secondly, we in the course of our consideration of the proposed changes that we suggested to the government, sought advice in relation to this retrospectivity because there's the constitutional issue about acquisition of property on just terms, and our advice is that a law which regulates a future conduct is not a law that would be considered to contravene the retrospectivity rules in the sense that your appropriating someone's property, or alternatively you're not doing it on just terms. I just want to address it at the level of principle perhaps, rather than law. What you're really saying, the proposition you're really putting is that the bundle of rights the franchisor takes at the start of the franchise contract includes a free option to acquire the business on terms of the franchisor's choosing at renewal time.

DR BYRON: I guess you're right. That's what it amounts to, yes.

MR CASTLE (CFA): Or put another way, that the franchisor reserves to itself the right to act in bad faith at renewal time. In other words, good faith would suggest, we submit, that Rockingham would be renewed and would be open as a viable KFC restaurant today serving the good people of Rockingham. The effect of the retrospectivity argument is - and that's the good faith decision we say that should have been taken - but what the franchisor can do is act with what we say is bad faith by not renewing because it has an ulterior purpose, we say, and that's part of their bundle of contracting rights. Now, if that's the case, that's not spelled out anywhere. That's not in a disclosure document anywhere. In fact they're not going to say in a disclosure document, "We reserve the right to act in bad faith at the renewal period and take your restaurant from you for nothing because we're not going to renew you and use that as a bargaining chip."

DR BYRON: This is another sense in which the contract is incomplete at the beginning, that the franchisee might well reasonably understand that, "As long as I've done that thing right, I've met the terms, there should automatically be a renewal," and I can understand that position. The franchisor might well say in effect - your words - "I have the option at the end of the agreement to say, "Thank you very much, you've been terrific franchisees but I'm exercising my right to not renew and I'm now going to either give that franchise to somebody else or myself or a subsidiary." Is it necessarily bad faith, if they're very explicit, up-front and open about the fact that they would rather be running those businesses than having you running the

businesses? It may not be the outcome you want but that's not necessarily meaning that they are acting in bad faith, does it?

MR CASTLE (CFA): No, but let's come back to the policy issue. What's the economically desirable policy issue?

DR BYRON: I'm glad you keep coming back to that.

MR CASTLE (CFA): The hidden assumption in that question every time - I had to be repetitive - is that there's a one-off investment decision made at the front, because the other side of what you've just put to me is, "We're going to require you to act in good faith and the two of us will act in good faith the whole of the way through this term, but I'm reserving the right to act in bad faith at the end of the term." It's inconsistent, where you're encouraging people to invest, on the basis of a good-faith relationship, that one party says, "But there's one part of this relationship which is sacrosanct and we can act in bad faith." That's the point.

DR BYRON: We're probably repeating ourselves here.

MR CASTLE (CFA): Yes. But perhaps in fairness, another answer to your question is that the Reid committee in fact came to the answer to the problem a slightly different way and that really takes us into the remaining part of what we want to say and that is, the Reid committee said, "Look, we can address this by introducing our unfair conduct provision," and in a sense, the unfair conduct provision which they proposed would have provided the remedy if it worked. So I think what we've talked about is the problem of opportunism, economic captives and costs and benefits and the economic issues there.

The second part of what we want to talk about is the fact that section 51AC does not work. It needs to be reformed in its operation to achieve the design that the Reid committee put up for it. So there's a general problem I think with the unconscionable conduct provision and that's the lack of definition. That's the first issue. But there's a very specific problem with unconscionable conduct in our case, that unconscionable conduct does not apply as we see it to end of contract renewals and that's the effect of the High Court in Berbartis. I will take you to Berbartis. Have you had much dialogue with people about the unconscionable conduct provisions during the course of your hearings?

DR BYRON: Almost every - - -

MR CASTLE (CFA): I see. I'm not going to repeat it. The fact is that in your report, you say that there's better scope for understanding what it means and there should be measures to improve the clarity. I suppose we could say that the real problem is the definitional problem and that is that "unconscionable" is a legal term

of art and the problem that one faces as a lawyer - and I come then with the background as a barrister - is that courts, when they're confronted with new terms, say, "If this is a term which has an established meaning in law, then that's the starting point for our application of that to the new section."

If you look at the unconscionable conduct provisions in section 51AC, from a lawyer's point of view and one who has had to argue these sorts of things in court - and at tab 19 of our bundle is section 51AC - there are really two parts to this section. Subsection (1) says:

> A corporation must not in trade or commerce or in connection with (a) supply or (b) acquisition engage in conduct that is in all the circumstances unconscionable.

Then subsection (3) says:

> Without limiting the matters to which the court may have regard -

you have then got a series of factors, including factor (k) -

> acting in good faith.

But the way the legal mind attacks this is to say, "Well, do these factors exist?" "Yes, we can bring ourselves within one of these factors," and so we can show to the court the factors are satisfied. But that doesn't answer the question whether having satisfied the factor, you've still got a species of conduct you would call unconscionable, so it's a two-step process. It's really at the second step that you get into the very, very grey area where the court is going to start from - it could be called judicial conservatism, if you like, lawyers' conservatism, a term which has an established meaning, and apply it to a new situation. So that is the legal problem and that we think needs to be addressed as a definitional issue.

Now, the Reid committee, looking back over their report, they suggested "unfair", but there's a very helpful discussion in the Reid committee, including from various proposals I think put up by Professor Zumbo, about various different words which could be inserted which would give clarity around what is otherwise a very bare word, "unconscionable", which has a defined meaning, so that's the first point.

The second point is this issue of Berbartis; Berbartis is found behind tab 24. This was a case where the ACCC took, on the tenants' behalf, proceedings. At that stage it was brought under section 51AA. I should have just made reference to 51AA back at tab 19. Perhaps I should take you there so you can follow this part of the argument. Section 51AA, unlike 51AC, says that:

> A corporation must not engage in conduct that is unconscionable within the meaning of the unwritten law from time to time of the state and territories.

That was the original unconscionable conduct provision and then as a result of the Reid committee, 51AC was introduced as a small business protection. Now, there's a sort of partial definition of "unconscionable" within the meaning of the unwritten law. I appreciate that you're probably not as familiar with the finer points of equity law as - - -

DR BYRON: Absolutely.

MR CASTLE (CFA): - - - others may be and that may be to your benefit, but the unwritten law refers to a long history of legal decisions where the equity courts, the way it's said, mitigated the harshness of the common law. So people who suffered a special disability, people who acted under extreme situations of duress, could apply to the court for relief and that was put under the heading unconscionability. So I think there's not really any doubt that that's what 51AA means, that's unconscionable within the meaning of the unwritten law.

51AC doesn't have those qualifying words, but it still uses the word "unconscionable". So you've got this very funny situation which applies in the Act which creates - in my view and I think it's reflected in the tenor of the findings - uncertainty in operation. My own personal belief is that that may be an explanation why very few of these cases have ever been taken or pursued, because why would people spend the time and money, particularly tenants or franchisees, why would you spend the time and money seeking to have clarification of the law by the courts? This is an area where again as a matter of good regulatory policy, it should be dealt with by the parliament and not handballed to the courts to try and resolve, where really it's something that parliament should fix and that's a view which finds quite a bit of sympathy in the Reid committee, whereas the Reid committee was in fact quite firm on this at paragraph 621:

> The committee considers the primary responsibility for dealing with this situation rests with parliament and parliament would be neglecting its duty if it failed to deal with these injustices in the vain hope the courts might deal with them better.

So the Reid committee was quite strident in that respect. Coming back to Berbartis at tab 24 - and I'll try and finish this in about five or so minutes because I appreciate it's probably been a long morning for you and we're heading towards lunchtime - if you turn to the judgment of Gleeson CJ, paragraph 2, the chief justice has very neatly summarised the problem. What he is said is:

> The specific question is whether the lessors in the shopping centre - so that the landlords engaged in conduct that was unconscionable within the meaning of the unwritten law - in stipulating as a condition of their consent to a proposed renewal in contemplation of its assignment, a requirement that lessees would abandon certain claims against them.

So if one reads into the facts of this, a number of lessees at this particular shopping centre called something or other fair in Western Australia, believed they were being overcharged. They then took legal proceedings against the landlord to have that adjudicated. It went through various court battles. But at the time the court battles were still ongoing, the lease came up for renewal and the landlord said, "I'm not going to renew your lease unless you drop the court proceedings." So there we have in economic language clear opportunistic behaviour, extracting a benefit which they were not otherwise entitled to extract. What the chief justice then says continuing, Mr and Mrs Roberts I think were the name of the tenants:

> They had no option to renew their lease. The prospects of making an advantageous sale of their business depended upon the cooperation of the lessors -

we say economically captive -

> and they were not obliged to give. Considered objectively and with the benefit of hindsight -

but this is hindsight mind you -

> the lessee's claims were of little value. They regarded them as value but they considered in the circumstances they had no choice to give them up. The principle reason why they had no such choice was they had no option to renew their lease.

So in other words they were economically captive because the value of their business was such that here the opportunity cost to them was the value of the business and they were placed in a position, "Do we give up these claims or do we lose our lease renewal and the value of our business?" So they made a rational decision, but they made a rational decision in opportunistic circumstances. Had there been a good faith requirement there, or had unconscionability applied to that renewal situation then the landlord could not have requested that to occur. But what the High Court says and it does go on but at paragraph 15 the chief justice again deals with this:

> There was neither special disadvantage -

so that's tying into all the legal learning on the issue -

> on the lessees nor was there unconscientious conduct on the part of the lessors. All the people involved in the transaction were business people concerned to advance or protect their own financial interests. The critical disadvantage from the lessees suffered was that they had no legal entitlement to a renewal or extension of their lease and they depended upon the lessor's willingness to grant such an extension or renewal for their capacity to sell the goodwill of their business for a substantial price -

dropping down a few lines -

> They were at a distinct disadvantage but nothing special about it.

So this is a playing out, if you like, of the hard bargain scenario and the problem with this is if landlords and if franchisors have the opportunistic stick they can wave, you will distort investment decisions which take place during the term. What the High Court has clearly said in relation to 51AA is that somebody acting in these circumstances can act and will not be caught by the unconscionable conduct provision. There is an argument to say - and the argument appears in an article which I've extracted at tab 23 of the bundle - there's an argument to say, well, that decision of the High Court relates to 51AA, but 51AC may work wider. But the problem that you face - again, here you get into the uncertainty - is what is somebody in the position of a Competitive Foods or a Mr and Mrs Roberts to do? Are they to then engage in the costs and time of waiting to take this matter back to the High Court to see what the High Court has to say about it and go through all the intermediate steps?

If you look at the timing, the timing is very interesting. The conduct in the Roberts case occurred in 1997 and the High Court decision was handed down in April 2003. So there's six years, so anyone potentially wanting to use 51AC to take on a renewal case is potentially confronting all of that six years' worth of difficulty. So to come back to the point, this is not something that can simply be handballed to the court. The nettle has to be grasped by government. We say in the franchise situation of course we would like to see the franchise code amended, but we think that there's a very real benefit for the Commission here to make recommendations that the government deal with the economic captive situation generally, and specifically in relation to renewals and to bring that within the umbrella of the existing regulation. So put simply: make 51AC work the way it was intended to work and not let the situation continue, which is very unsatisfactory, people don't know what it means, but more specifically in the renewal case the High Court has given it a particular meaning which is really not consonant with, we submit, good policy in relation to opportunism and not consonant with at least the spirit if not the intention of what the Reid committee

had in mind.

So I suppose in summary, we're not really asking at least at the unconscionable conduct level the Productivity Commission to come out with anything revolutionary. What we're really asking is that drilling down into the problems and putting to one side the sort of euphemistic language of hard bargaining to identify the economically sound outcomes and then really to establish a platform for achieving it.

DR BYRON: That does seem to be well within our mandate.

MR CASTLE (CFA): That's why we've taken the time and considerable trouble to put forward a proposition to you even though recognising this is a retail tenancy inquiry, but the implications of what you do go a lot deeper and at the deeper level then spread out across a broader platform.

DR BYRON: Yes, absolutely, I certainly see the parallels.

MR CASTLE (CFA): Is there any specific you'd like to ask of us at this stage?

DR BYRON: I think all the questions that I had in mind after reading your submission of yesterday have already been answered in your presentation.

MR CASTLE (CFA): Ian has the practical perspective.

MR PARKER (CFA): That's right, we appreciate the time and the invitation to come along and talk to you. I think that it's important to consider our position in the context of the history of our business. This business has been in existence for 38 years. It began as a franchising business. It began with one KFC franchise in Perth 38 years ago and, as Tim said, today we have 50 KFC franchises, we have 300 Hungry Jack's stores. We have 65 franchised Hungry Jack's stores and we're looking to expand that component of our business. So we come to this environment as both a franchisor and a franchisee.

DR BYRON: I appreciate the balance that provides to your perspective.

MR PARKER (CFA): That's exactly right, and this particular store that we're talking about here, the particular franchise - and I might add that the context of our argument, and I'm pleased to hear you accept that, as germane to the scope of the Commission. The particular business that we had in Rockingham in Western Australia, we've had that business for 30 years. It was turning over $3.4 million, it was a profitable business. We have been held up by the franchisor in the Australian environment as an example of excellence, as a franchisee on a number of occasions our performance is better than the average. In spite of all of that to clearly demonstrate the economic captive argument, the franchisor has indicated to us that

they would like to be in that business and after a 38-year relationship they've indicated they would like to be in that business and they'd like to buy our business for half its value. So if that doesn't demonstrate economic captivity, I'm not sure I could find a better example for the Commission.

Tim has, I think, elegantly presented the argument and during the course of it he referred to the statistics relating to renewals and I noticed that you demonstrated some awareness and perhaps not a degree of cynicism but saw the need to understand those numbers in context.

DR BYRON: Not every renewal was on a basis that the franchisee was necessarily totally happy with.

MR PARKER (CFA): Absolutely right, and listening to the issues as presented by the guild, clearly they are in a similar set of circumstances where a shopping centre owner can provide a box, as you term it, someone builds a business in there over a period of five years and then that site becomes an asset that might be attractive to another pharmacy operator but at a higher rent, therefore the economic value has been transferred from the people who have built the business to the centre owner. What we're talking about here is not wildly dissimilar. These people are, in this instance the franchisor is looking to build a site within walking distance of where we are and therefore to benefit from the commercial value that we've built up in that particular site.

I make that reference to that material that's been presented to previous inquiries and has been referred to here because we are in fact a member of the franchise council of Australia and we know that to be a representative body of franchisors and in fact we know that their position is opposed to our position in this circumstance and it's purely by virtue of the fact that our organisation has the wherewithal and resources to bring the kinds of expertise that Tim Castle has demonstrated today to this argument because this in our view is clearly an issue that needs to be covered by government because people are being disadvantaged and the reality is those people don't have the resources that we have to create the attention, present the arguments, and follow through on the outcomes. As an economist I like to think that the way the argument has been presented to you seems logical and feasible. To me as a businessman I always seek the logical outcome and the logics of what the circumstances we've outlined to you, to me doesn't pass the smell test, if you like, it just is illogical and as I say, if it's happening to us it's obviously going to be happening to a number of other businesses who are operated by families and generally largely operated on family margins, not commercial margins, so they are much less able to stand up to the kinds of pressures that they may likely be being exposed to and therefore it seems reasonable that this kind of legislation should be given serious consideration by the appropriate authorities. That's my closing remark and we thank you for your invitation.

DR BYRON: Thank you very much. You've put your argument extremely clearly and thank you very much for bringing all that to our attention and we will consider it very seriously. So we're now going to adjourn and resume at 2.00. Thank you very much, ladies and gentlemen.

DR BYRON: Thank you very much, ladies and gentleman, if we can resume with the public hearings. We have representatives from the Newsagents Association of New South Wales and the ACT. Thank you very much for coming. If you could just introduce yourselves for the transcript and take us through the main points that you wanted to make particularly, you know, critique of our draft report and then we'd like to follow up some issues with you. Thanks for coming.

MR DAY (NANA): I'm a representative of the Newsagents Association of New South Wales and the ACT today. My background has been one of owning newsagencies, acting as a retail consultant, and a specialist newsagency broker over a period of 39 years. I won't break up into which ones and how long they all took, but that's just the basic background, and I've been asked here today to put a submission forward to the Commission. Some of the points that have been raised have been raised along the way and duplicated by many of the people who have come here representing small business. I don't see a necessity to go over a lot of those because I think it is already well documented. However, there are points that I hope will be treated in the light that they are different. I'd like to look at something more of a commercial reality base rather than a legal base today. But I'll just introduce to you Stan Cousins, if you'd like to give your background.

MR COUSINS (NANA): Thank you very much. My background is I was employed in major building construction for many years and 16 years ago I purchased a newsagency, a family business. I've been conducting that business ever since. I've been the president of the Newsagents Association of New South Wales for the last two years. Prior to that I was a regional chairman for a very big area between Goulburn and Liverpool basically in New South Wales. During that period I came across a great cross-section of newsagents and their various permutations and combinations in the complexities of their business including their leasing arrangements. I myself have been significantly injured in leasing arrangements and I bring probably a little bit more lateral thinking to a lot of areas because I've suffered personal experiences, one as a business person I've accepted and gone on with life with, but nonetheless they became building blocks in understanding other people's plight.

The association has an appointed broker. Graeme Day, he forgot to mention, was also CEO of our organisation at one stage. This organisation has been around since 1891. It covers all of New South Wales. We represent at all levels. We provide particularly in country and regional New South Wales quite an important function within the communities of those areas. We invited Graeme today because I believe that in the newsagency industry Graeme has probably got the broadest range of expertise in newsagency management through his brokerage arrangements, and he also has developed a very advanced way of analysing the businesses of newsagency and particularly in relation to their retail leasing arrangements, so that it's for me.

MR DAY (NANA): For those that listened earlier to the pharmaceutical guild

presentation of Peter McBeath and I've acknowledged that I went in my first shopping centre and Peter was the pharmacist in that shopping centre that opened at the same time in 1976, we've known each other a long time and it's a shame that we come to a meeting like this to renew the acquaintance. We probably should have done it many times earlier many years ago. However, a lot of what Peter had to say and I think that we can reflect on those years haven't changed, that unfortunately nothing has changed and it should have. So let's talk about some of the things there.

Bringing a point and I'd like to say this about our industry which is a bit particular because we're talking about commercial reality and the ability to negotiate a lease and everyone has a right to refusal and has a right to fail and we've all talked about that. We come from a particular industry that the government thought in 1980 was worthwhile giving for the public benefit an exemption to free enterprise if you like, in other words they allowed us to collusively control an industry and therefore we had a monopoly, and that's the government's term as well, when the TPC in those days - which is now the ACCC - granted us immunity from competition, you might like to put it that way. For 20 years we probably enjoyed that status. I don't know about how much of it was true, but for 20 years we enjoyed that status. In those 20 years that was the increase of shopping centres as we know them now. I don't really wish to go into general leases in strip shopping centres, or strips, or regional areas because I find there's a competition there between the landlords and vacancies and all that, that's not pertaining to what we're talking about in the shopping centres where they too have a monopoly. I'm used to talking about monopolies so I can understand theirs, very much so.

In that period of time we were granted a monopoly on the basis that there was a public benefit. Because it was low cost, we had low margins, and the pharmacy guild today put forward the case that some of their prescription margins are so low and some of the other items are low that now because of the cost of the rental he cannot give that public benefit and forward it to the consumer. The reason he can't do that is because he can't afford for the 2 per cent or whatever it is. Our authorisation was based on the fact that we had a large dissemination of product of information, magazines and newspapers, and we gave that at a low cost, so we were working on a very low margin and that was understood. The only way we could do that was being the only newsagent in that area and therefore everyone came to us, so we had a turnover and therefore we survived.

When shopping centres came into being we went into shopping centres as well because that's where the public benefit is, that's where the public go, that's where they're demanding to be, that's where they want this. The shopping centres wooed us because they wanted the traffic draw. They wanted us and our Lotto and our newspapers and they were aware of the monopoly not unlike, say, the post office is today. I don't say that we were given leases for that reason, but we were certainly the only ones in that shopping centre which gave us a turnover. In return the shopping centre would place us sometimes in the main in an area that was not very highly trafficked. That was to the shopping centre's advantage. It wasn't necessarily to our advantage, but it built up the

trade around certain areas. But because we had this monopoly people would still come to us and we existed and survived.

20 years later the ACCC deemed that our restrictive practices should be sort of admonished and away we'd go and be out in the free market. One of the changed circumstances where the media by expression through electronic media had grown. People in Internet, all sorts of reasons, can get information very, very quickly and therefore they didn't need to wait. We realised that we had been selling a product that was time-effective. It was a short shelf-life product and now there's a shorter shelf-life than us and the Commission decided that we should go onto the level playing field as everybody else, unfortunately for us. The landlords - and this is their right and I don't interfere with people wanting to do things in marketplaces providing it is a level playing field, but they decided that they would have more newsagencies in shopping centres as they developed. They knew that our product was sort of being proliferated in the area where Coles and Woolworths had newspapers, et cetera and therefore we're not maintaining the same I suppose advantage that we had before, or profitability.

This in some ways has weakened our strength, but I want to talk about how some of those practices come about. We've talked to shopping centres about our situation, not that we can't compete, it's just that we'd like them to understand what competition means to them and to us as well, because what they do is they put another product into the shopping centre which is another newsagency and that newsagency has got the same problem as what we have except they've duplicated it, so therefore now they have two newsagencies now that don't do so well. In fact sometimes both of them are operating in the red.

I wanted to talk about how this comes about and we mentioned this before and it becomes relevant to getting close to the term or the end of the lease. Today we get about six months' notice. We know when the lease is due but we get about six months' notice from the landlord to say that your lease is for renewal and terms and conditions and the letter comes out and you're invited to discuss that with the centre management. I believe that that notice is too short. When some of our incumbents in shopping centre newsagents have gone to the centre management wanting a longer term plan they have been palmed off with the excuse or the reasons, "We're not ready yet. A lot might be happening by then. We'll let you know. The normal term is six months before," or whatever. I think longer planning needs to be done. I'll have to concur with what Peter McBeath said about the lease of the shopping centre being too short. Five years is not enough to recover your money. In some cases the expenses is multimillion dollars. That can include goodwill and that has been an historic right of newsagents to have goodwill.

The second thing is the cost of the fit-out. Some fit-outs are 600,000 or $2000 per square metre is not uncommon to pay for a shopping centre, that's pretty low cost. Usually that is dictated by the shopping centre's architects of what sort of quality they

want, how much it should be and so on. So 2000 per square metre is going to cost you 600,000 for 300 square metres and that's a lot of money to recoup in a period of five years. I'd like to see something put in place, a mechanism that says, "What is your capital investment in our shopping centre? What are you spending? All right, we can amortise that under normal conditions of the accountancy practices over a period of the extension of the lease and give you a lease accordingly to amortise that investment." I don't see why that can't happen. It's a second criteria to a performance criteria which then can be judged as a separate instrument that the shopping centre can talk to that tenant about. But from a capital investment point of view, I can't see what that total capital can't be amortised over the length of the period using accountancy methods and standards. If it's written down at 22 per cent per annum or whatever it is, you can take that to instead of being a five-year straight lease it may be a 10-year, or 12-year, or whatever that period might be.

There's no such mechanism there and I doubt very much whether there would be any discussion about it. What happens now also is the financial institutions and I'd like to speak about the banks and the financial institutions because our industry has dealt with them for many, many years on a basis that we were once - and it's not difficult to say that today - but we were once safer than houses. A lot of people today will still think we must be, particularly if you live in America. The situation by saying that we're safer than houses, that we weren't allowed to have a debt on a house and buy a newsagency. You had to pay cash for the newsagency. That was prior to 1979. Banks would bankroll that and lend you two-thirds of the money. That has continued to a certain degree. Because of our industry when we can prove our profitability, they will lend money on that profitability and today they lend up to 60 per cent of our goodwill factor in purchasing a newsagency. However, with a five-year lease they can't do that. So what they do is they take add-weight security by asking you to put your house up, or some real estate investment, or something of that nature as well. So they take a percentage of the newsagency and a percentage of the house to lock in the total of their loan because five years isn't enough.

In the scheme of things economically and in a business situation, that basically is not very smart. It's not very smart for our economy and the fact that a person has to take a wage to pay back the housing loan that the bank has extended for them to buy the business, they have to take a wage which pays PAYG tax which means that they pay more tax, it's not tax deductible that part of the loan, and then they have to pay off the house. I see that that is anti-business, it's anti-growth, whereas if they had that term that they used to have, the business could make that tax deductible, it's a period of time that it can do it, it doesn't touch the assets of the house and environment, and I'd say basically it allows the entrepreneur to expand the business, which is good for the economy, because they know that they can get a tax deductible loan to make their business bigger or smarter.

So virtually a short lease has got a number of things against it from the

business point of view. If you have to get add-weight security it creates a double taxation. Banks don't like it for that particular reason either. It doesn't allow us to amortise our investment in a capital sense, and from the day that you have a lease which is included as part of the goodwill you have then got four years 394 days left and then each day it diminishes, and so does that proportion of goodwill in a prospective purchaser's eyes. There's no guarantee when introduced a perspective purchaser to the landlord that they will give you a new lease or they'll continue the current lease. You take that on risk. The lease can only have 12 months to run or two years to run. I find this dissatisfying in a business sense. I find it untenable for somebody to plan and produce a document to any financial institution that they can repay in that period of time, and I think it's an unfair advantage that shopping centres have.

Also at renewal there is a situation - and this is very blatant - where the shopping centre manager will say to the incumbent, "We know your lease is up. This is the new deal. We do have people that want your spot, so that's your deal." That is a fait accompli. It's a take it or leave it situation. You know darned well that the other person hasn't got the same at risk and I think under section 51AC - and the professor here earlier today mentioned 51AC and said that it was not definitive, and I believe it's not either, I tend to concur. When you've got that situation, you're under threat, you've got a house, you've got a mortgage on the business, you've got a certain condition and you know that the lease has gone up. You know your business, you know you're going to struggle, you know you're going to get less money in the next five years, maybe not really up to the basic wage, as we do have a case here today which the Commission has a copy of.

So you're drawing less than the basic wage but you sign on nonetheless because the threat of losing everything and going bankrupt and losing your house is far too great. I believe that there should be transparency at that point in time. Who is the other party that has come into the fray, that has invited themselves in there? What experiences do they have and should there be a performance criteria applied to the incumbent as well as the person coming in? The situation of the threat alone I think is gutter tactics. That is my personal opinion. We all know that centre managements want to better their environment and we know the reason why. They want to better it because they want to have their asset - and who doesn't in business - they want to have their asset built. They want their price-earnings to go higher and they want their ratio of goodwill as well. When they sell and buy that's how they do it. We have only seen 12 months ago Centro and its position in the marketplace and its perception and upon inspection of that of where it is today and we've seen what happens to their share price and their price-earnings ratio. The same thing happens in turn whereas our government happens to be not the shareholder and not what we've done wrong so much, but happens to be the control of the management of that shopping centre.

We'd like to see adequate disclosure about the offer that's been made and why is that something to do with us. Has that got something to do with the same disclosure as what other people are playing in the shopping centre? It's very easy for somebody from outside that hasn't risked their capital, haven't worked in the shopping centre, and to offer more. Just recently there's been a number of cases of that. I won't name names but there is a group of - shall we say a conglomerate newsagency that is starting and they are going to shopping centres and offering that they will take on for such-and-such a price in the lease and they put a franchisee in there. This price is often more than what the incumbent can pay. In that case, in the majority of those cases and I could name at least eight of them where the new franchisee has gone in and he is not making any money because the homework hasn't been done, as we've talked about the low cost of our profit margins. The newsagent that's incumbent who is already on the brink of not making too much money is now in the red., so you've got both of these two outlets in the red.

There I suppose is a way of survival in that and the way of survival is to cut down the stock that we were given in the authorisation in the first place to carry so much, which has got used to by the public and that's the proliferation of the actual articles that we do sell in those numbers in the magazines. We've got low margins but we do stock some four to five thousand titles of different magazines throughout the world and we did have until recently the highest reading per capita of population in the world apart from New Zealand, which is pretty high too, so they really can read over in New Zealand as well. All jokes aside, we do have that sort of readership in this country. It is now slowly but surely going away and it's not just all the Net that killed off the Bulletin. It's not just the availability of this information elsewhere that's killing it off. It is the fact that we don't have the ability to keep that magazine and keep that product alive because of the rent, so we're starting to look at what lower sales they are, where we're going to cut this product out, what would cut out, et cetera, et cetera, et cetera. I hardly see a public benefit in that at all, but if it's survival that's what we'll have to do.

A better way would be to talk to shopping centres and to be able to convince them and have an open discussion about the performance of our business. I'm not saying that the individual can't afford it, but whether our business can afford it. Our margins are fixed, our recommended retail prices are fixed, our wholesale rate is fixed. So it's very easy for us to produce a report and I thought maybe this was a way. So in a particular shopping centre where two of these newsagencies existed and neither of them are making any money, the shopping centre asked me could I produce such a report balanced on the fact of - and their rationale was this: that represents what we let out to you. We sell that space to you. It's called a lease and that ground is per square metres. "That's what you build your shop on." I think Peter alluded to the fact that it's three walls with an opening and that's about what they let out to us.

Now, they give us a base rent per square metre, they give us some outgoings and then we call that a gross rent per square metre. I was requested to do a report on

our sales per square metre, the profit margin of those sales per square metre per department and the overheads that existed from them, "Could you also get an up-to-date profit and loss certified statement from your accountant. We'd like to see a copy of all your till tapes. I know that we take your receipts in every month but we'd like to see a copy of all your till tapes to see that what you are giving us is correct because what we're trying to ascertain is where you're actually at." In other words, "We don't believe you, but we would like you to prove it," and I have no problem with that at all. So we did the report, we put it all in and the report broke into two three different areas.

The areas of wages, as everyone knows, can be attached to sales as a percentage or gross profit. The areas of wages were below any average, I know, because the owners were working for less than a basic wage and that's less than $18 an hour; as a shop assistant, senior wages with add-ons, is $20 an hour. There were other expenses we went through with a fine toothcomb and they came to less than 12 per cent which is quite remarkable for a retail store which is much less than the 20 per cent or 15 per cent that you could get away with if you trim things rather tightly. So the only other expenses left over as the return to the owner out of the gross profit or the distribution of that is the rent. The rent came to a whopping 60 per cent of the gross profit which translated those people that talk about occupancy costs to 26.6 per cent of product sales in occupancy cost. Anyone would say that is non-survival.

I had the fortune or misfortune or whatever, the opportunity - the other store that opened in the centre that belonged to the opposition, if you like, came to me to do the same report. They're in the same boat. I didn't cross that confidentiality with the shopping centre management when we went to the report. I said, "We've completed your report and it's interesting to note that we did meet your sales criteria," which was $8000 per square metre per annum. "They are meeting that. They've been excellent traders of yours for 18 years in two different centres. You've praised them for that. We'd like to talk to you about a reduction in rent because there are certain changed circumstances on your behalf. For two years, while you were building the second part of the centre, we had a loss of trade, no compensation. We went to you and explained to you that we'd like to be first to be considered if another newsagency was going to be put into that centre." They said, "Not a problem, we don't see one happening but if we do get one, we'll let you know." That came back as an oversight, with, "Sorry, we didn't think that about that at the time. Centre management was away on holidays," or whatever.

I handed the report in. Did I get an answer from it? No, instead, what happened is that centre management said, "Why don't you sell your business?" I said, "It's only losing $60,000 a year. I can't see anyone paying $700,000 to buy a business that's losing $60,000 a year and the owners are getting less than what they should as a basic wage." It's a non-event. They said, "Do you want to get out of

your lease?" I said, "We don't know what terms you mean by that." So they sent a letter and it's called a deed of release which means that you can get out of your lease, providing they find another tenant or we find another tenant to take it over. We have to make good that original site which is 50 to 60 thousand dollars to clean it up, take the lot out, make it all spick and span, so that's another $60,000. We can sell our stock off to him. If we like, we can take our fixtures and fittings and pay for the removal of same; end of story. That wasn't very nice.

The alternative, after saying that was not on, was, "We can't give you a lease reduction because the leasing asset division won't allow it. We have our price. We've got to get that return on that rent and that's it. By the way, you signed the lease." My client was absolutely astounded by that remark. The next situation that came is that they were offered $2000 per month for a period of four months. That's $8000 in total, an average of $500 a week that the tenant had to spend on promotion, advertising the store to get the turnover up. Now, come on, this is a commercial reality. $500 a week? Where do you think he could spend that? What do you think you're really going to generate by that? I don't believe that any shopping centre of that size could be viewed as anything else but arrogant. Purposely, their whole idea was to get rid of that tenant on their terms and there was no conciliation, nor was there any arbitration offered to make it of better use.

I rang them before this presentation today, last night actually, and they have got a new offer involved and that is, they can give away the majority of their space to another tenant. However, they still have to pay the same amount of rent per square metre. Now, at the moment, they've got 150 square metres, so if we halve that, say, to 75 square metres and the rate - it's still got to be paid at the same rate. It's impossible; it even makes it worse.

I don't know what legislation can come into that factor but we talk about "unless it's 51AC" because I think it's a gross misuse of market power. It's unconscionable conduct if that's what's quoted there, if that's what 51AC means. I'd like to see before a lease is started - and I know that most leases are there and renewal of leases is probably the biggest problem, fresh leases when you come in, it's rather a different ballgame, but when you're there already, you've got a track record. You've given them some sort of money and you've both made money, but I don't know anyone that's making money proportionately today as to what they were when they started 15, 18, 20 years ago - and I say proportionately - but the centre managers are making much more proportionately than what they were in those days.

I believe that if you start a new lease that performance criteria needs to be in place and it could be tabled and documented. I do understand small business and I do know that they don't often understand their square metres, that they haven't got an accountancy degree and they don't have a business degree. I understand that perfectly, but they have a talent. They know how to make cakes, they know how to

do this, they know how to do something else. They know how to sell newspapers and magazines. They have their talent. But perhaps if it was agreed upon that it would be a criteria, the place to start is, "This is the cost per square metre. That's how many square metres you've got. Could you give us a plan of how many sales that you need to make to make that work?" We're not saying that centre management takes any notice of that commercial reality. What I'm saying is that the person that comes in should be made aware of what their achievement or task has to be, rather than, "This is the foot traffic we've got coming through here and it's 10,000 in this door and 20,000 in this door," which means absolute zip. We can't analyse that. We can't do anything with it. Unless it's comparable with something of last year and then you can see that it's gone up or down, there is no relevance to quoting how much foot traffic you've got. But if they were to look at how much per square metre you needed, they may even consider in a businesslike manner, if they've got that, that they need that tenant because it is a draw for them and therefore they are unrealistic in what their expectancies per square metre are. That, I think, is a commercial approach.

Of course, it doesn't deny that we still should have access, as so many other people have mentioned, to the fact of what do they let their space out to other people for so we can have a comparison, because it's quite unfair to be able to let something out per square metre to you when they could let it out to somebody else, and they play this magnificent game, "Well, we'll let you get in here because we need you, but we'll put it up on this person over here." It's all a game of find the pea. We don't know where the pea is when they move the thimble around. All we know when they pick it up, we're not under that pea, we're different.

I'd like to see that disclosure and that transparency would be there 12 months to two years before the lease expires. One reason for that is that it gives time for the incumbent if it's not going and it gives intention to the centre management that if you're not performing well they've got a chance to tell you then, not six months beforehand. It gives you time if you are and you know that you can't afford what's envisaged, it gives you time to look around, to re-establish yourself, where you're going to move to. Six months is far too short.

Another example of this particular situation and misuse of market power - and this is rather an interesting case of a major shopping centre and I have a bit of sympathy for the major shopping centre in this base too, but there was a resolve - and it could have been resolved and it was put to them and for some reason it was ignored and I think - I know the reason but because it's not tangible I can't state that I know it. It was a situation in a major shopping centre where the tenant went through some hard times. Whether it's the tenant's fault or it's not, I'm not going to go there, but he couldn't pay the rent and he spoke to the landlord and said that, "I'm slipping into arrears. I'm going to sell my business because I've got financial difficulties in such a way. But we are covered, I can give you some mortgage on my house, I can give you this or whatever."

Whatever had happened, they agreed. They agreed to allow him to get a chance to sell his business to get their money back and they let him go into arrears in the rent to a tune of, say, $80,000.

He came to me, the tenant, and asked me to put it for sale under an expression of interest, et cetera, so that he could clear his debt. There's two newsagencies in this very large centre. I put an ad in the paper, but while I was putting an ad in the paper I noticed in the same paper - which is a provincial newspaper - there was an advertisement for a newsagency for that centre. It was saying that, "We have an availability in the shopping centre and it's a franchise." So I spoke to the shopping centre management about this and said, "We're going to a lot of trouble to get you a buyer and we have got one, but also we find that somebody else is advertising that there is going to be a shop in the centre. Is this a third newsagency you're proposing, or is it going to be this person? Is it your sale is not going to go through?" They said, "We don't know about that," and they refused to comment.

We get a letter from them. The sale was proceeding and it was due to be finished on 30 June and we got a letter from them a week beforehand saying that they are going to terminate the lease because it's out of order, $80,000 is owed in arrears, et cetera, et cetera, and it will be terminated as from such-and-such a date, which is a few days hence, it was about three days forward. So they weren't honouring it to 30 June. We had a buyer. The buyer was virtually approved by the centre management, previous experience and everything else like that. It would enable the incumbent to pay off the debt, sell to somebody else that had been approved by the centre, and have a little bit left over, what I call through due process a natural justice.

The centre management decided that they would call up the lease, so I rang the area manager and talked to them and I said, "Is that what you're doing?" and he said, "Yes, that's what we're doing." I said, "Well, why not wait a week?" "Sorry, we've talked to our lawyers and that's it." I have an experience in liquidations and I have done many over the last 20 years and I rang the liquidator and we appointed a receiver that night. That means that that is a higher court than what this particular shopping centre could deal with and we processed the sale through the liquidator. Really, do we have to go to that level to protect a decent transaction in a marketplace? That is what I find is the sort of things when you have somebody in the wings and there's no transparency, nobody knows about it, and it's working against the person that's incumbent that's paying the very rent and they have their livelihood at risk. That is also something I'd like to say that supports more transparency in the investment light.

MR COUSINS (NANA): I'd just like to sort of come over the top of that at the end. Overall newsagents in New South Wales and the ACT and probably nationally are looking for more equity in the deal, more like a partnership, a true partnership, like a successful marriage. The attitude which there's a couple of examples there and we get them regularly, "It's my house and I can do what I like," is not the way that business can

be done and communities can develop and sustain useful facilities such as a newsagency. Part of it, if you want to go back into money terms, is respecting goodwill. There are numerous examples of centre managers who are there to improve the return for the investor - understood - who have little regard for the goodwill that the people particularly in cottage industries like ours - and that's what they basically are, mums and dads and families - little regard for the personal liabilities they have for the investment that they've put into the businesses such as their houses, et cetera.

One of the classic examples that really stood out in my mind and I saw as a tragedy was the example at Burwood. There we had a large shopping centre. The owner of the shopping centre had the prerogative to demolish the shopping centre. But there I saw owners of small business - cottage type people, their houses on the line, their family involved - lose 600,000 plus in goodwill and sent them to the streets. We all understand that it is their house, they have the prerogative to do that, but somewhere or other there was damage to these people and then eventually the community - I think he went to social security, so there's even damage there, someone had to pay. Surely civilised societies don't need to behave like that and there needs to be some civil controls. We've seen an attempt through the Trade Practices legislation, unconscionable conduct, unfortunately a lot of those cases haven't got up to set the benchmarks for future rulings.

I would hope that forums such as these will go forward with a lot of the information they've gathered and develop a future strategy so we can act a little bit more what I call civilised in business. It might be the Rio Tintos and BHPs can get brutal with each other and everything else, but we're not talking about that scenario. We're talking about a level where it's mum and dad and the family, whether it be a pharmacy or a newsagency, those small businesses that customers enjoy to come to and provide a real benefit. We particularly see that benefit in country and regional Australia which is still providing the work, it's keeping a lot of our communities together. The banks have left and everything else. Sometimes we even see this brutalness in those areas where a large shopping centre has been built out of town and then they roll through the rest of the people.

I think it's a true reflection to say, I mentioned earlier I had a background in major building construction, in fact my last project was a rather joyous one, it was the restoration of the Sydney GPO in Martin Place, and in there we had a lot of exposure to heritage items and a lot of exposure to the public because of Martin Place and its precinct and I learnt very much in that in contract law about risk analysis and risk sharing. Somehow or other, the risk sharing isn't there when you particularly get to the large shopping centres. So to cottage people going into business has become a gamble, not just the risk; it's even gone deeper.

I also have seen, and there's emphasis on, shopping centres per se, like the large shopping centres in regional areas. There are also other examples of similar behaviour even in what you might call local centres. I would like the Commission to

look at - and I apologise for not doing a submission on this and I apologise for not fully understanding the scope of the exercise at hand, I run a 24/7 business myself, so I'm not always available - but I've even seen in local centres where you have typically a milk bar and a little cluster of shops with a carpark and a small supermarket such as you find in the areas around Canberra - whether it be at Kambah or over at Dickson or whatever else - you find if one person ends up taking control of a site and that site under planning principles - and this is not just in Canberra this occurs, it's in modern planning principles - then has all of the retail space that you want to operate a business in that locality, then he in essence inherits a monopoly. I've seen real examples - and I must say I've personally experienced real examples - of then an abuse of market power because that person happens to own the whole parcel and there's nowhere else to go. So it gets to the exercise Graeme was talking about earlier, it's a take it or leave it, "I've got you. I know what your assets entail. I know you haven't got any portability to open up a business nearby, so I want you." I personally shut my business over that scenario after trying to have meaningful negotiations.

Now, initially I thought this would be at the local planning level and the concepts of planning at local government, but really, those things must have a right to prevail because there's a lot of other legitimate reasons why that area and that locality has only been given the right to retail because you didn't want a whole lot of shops around the neighbourhood and people hanging around at night; it is all controlled in one precinct and I see that, legitimate. By the same token though, I find once having obtained that site, then those owners then have inherited a reason for being less unconscionable because they've inherited a dominance in the marketplace and they're controlling a marketplace. That's happening in a lot of small areas. We have major problems in the shopping centres, the big ones, but we also have these problems as well down at the local centre level.

I'd like to thank the Commission for the privilege to make a presentation today on behalf of our members. Thank you for your time.

MR DAY (NANA): Just one summary there, I'm sorry.

DR BYRON: Please.

MR DAY (NANA): I wanted Stan to give his own personal experience about that and I also want to say on both sides of it that this is a discretionary power that the shopping centres have got. I'm not saying that all the landlords are bad; in fact, I now want to introduce one that currently we're dealing with on behalf of the client. The shopping centre has taken - it's not as bad as the previous one. Their occupancy cost is only 17 per cent and we'd like to see it around about the 12s or the 10s if we could get there, of course. I'd like it to be 8 or 9, but however, commercial reality says that if you're doing 12 or 13 per cent on real product, you're getting there.

The shopping centre, this particular one, is doing 16, 17 per cent. I talked to the owner and he wasn't doing very well and they were also asked for a report on it. We found that the trader himself is not trading as well as what he should. There's a little bit of ignorance there. He didn't know what to do and so on and so forth, but nonetheless the rent was quite expensive. So what the shopping centre manager did is they're given an eight-week period and part of that eight-week period, if they've paid for a promotion, it's costing the shopping centre some six to eight thousand dollars for the promotion, to get people to go in there and promote it. They've given them a rent-free period of three weeks which is also part of a goodwill gesture but also it's monitored. It's based on a performance and that performance has been going on for a period of time now and we're happy to say that because of the shopping centre giving this assistance and trying to help out that it has turned it around, that we're now running it around about 11 per cent occupancy cost which the centre is delighted about and so is the owner. So it's a discretionary power that these people have. They can also give it a choice and they can say, "Look, we've given you a chance." But when they have the absolute power and say, "We're not taking any notice of that because we ignore it and now here is your deed of release," and all the rest of it, because of what else they have got, it's not in the spirit of what it's all about. It's not in the spirit of business and it's only going to go on and on and on.

What I'd like to see is some sort of - I don't know about legislation but some sort of framework there that there can be, as I said, a better way of this negotiation, so that there are responsibilities that are more equal. They talk about equal playing fields or level playing fields these days, and "level playing fields" is just an expression that everyone is used to. It usually boils down to whether you've got the same rules when you're on the playing field, it's not the playing field itself that's not level and it's not the players in there because the players are never level. There's always a different talent on each side, arguing the best that they possibly can, but the rules should be the same for both, otherwise you don't have a match. You don't have the football game. The playing field can be level; the rules have got to be the same and that's what I'd like to say.

DR BYRON: Thank you very much for that. Actually the other day I said it's like you've got two teams on the football field but one side think they're playing soccer and the other side think they're playing gridiron and you can pick up the ball and throw it in any direction and everybody can crash-tackle a guy whether he's got the ball or not. But you're right, they've got to have the same understanding of this joint exercise that they're both involved in and it does seem to me that in some cases, particularly if the retailer has previous experience in this trip, where apparently the rules of the game are quite different, you move into the centre and you think you're still playing under the same rules but actually it's a different game in the centre.

MR DAY (NANA): It is.

DR BYRON: That's probably a good start into some of the follow-up questions I wanted to ask you. Your introductory comments about the change with the expiry of the authorisation from Trade Practices and so on, it seems to me that you're getting competition not only from other newsagents in the area or within a single centre, but now you've got supermarkets that are selling newspapers and magazines and gift cards and all those other sorts of lines and as you mentioned, you've even got competition from the electronic media in terms of - - -

MR DAY (NANA): Yes, that's a fact of life.

DR BYRON: - - - not only electronic news but also electronic magazines and subscriber newsletters and things, so that people may well decide they don't need to buy a newspaper or a magazine, they get it over the Internet. We've had a lot of discussion over the last few days whether for many of the small family businesses, you know, people have been saying to us here, "What's happening to the butcher, the greengrocer, the candlestick maker?" These small family businesses seem to be being squeezed in all directions. Is that happening to newsagents?

MR DAY (NANA): If we put it another way, if I say yes, but I'll qualify the "yes", there is a change. There's a whole generational change as well that are being brought up - they don't give greeting cards, they send texts on the telephone and they send some message on the email or whatever it is and that's evolving too. The electronic media in itself is evolving within itself. What you did yesterday on electronic media - you've now got a blog and you've got something else and something else will be tomorrow; that's society. Therefore, we accept that and we adapt. Our major product is settling. The biggest change we had was the proliferation of outlets, there's no doubt about that, because the availability - which we always had exclusivity to - we don't have a complaint about that. We've had to embrace that and get on with it because that's the rules, we accept that. But we're still tied to a little bit of that. What we want is a deeper understanding of this partnership as you just said, that they have similar rules as what we can on the bigger thing. We'll handle our problem and we're not saying it's centre management's fault because they put another newsagent in. We just think that's very bad economics on their behalf. They should know, they get this data that - Peter McBeath said he gives in his sales figures every month to them. They know darned well what we're all turning over and they know the profitability. They know what their sales data nationally is per square metre. So the criteria should be as good for the goose as what it is for the gander, so the guy coming in should have to prove that criteria too, or the guy that's in there should have to say, "Well, how are you going?" and he can prove that he's doing all right. Why should he be sacrificed at whim, "We've got a space. We want another $1600 per square metre, or whatever it is, and we're going to put them in." They too have to do their homework. They expect it of us.

DR BYRON: That leads into the next thing I wanted to ask you about. I mean, you

made a very good argument about disclosure of what everybody else is paying and why isn't there a publicly readily accessible database so you can look up and find out other people's leases, what they're paying. But the question I guess is, let's imagine that that happened tomorrow, would it actually solve the problems, how much difference would it make? Couldn't the centre managers just say to you, "Look, it doesn't matter how much the cake shop over there is paying. I want X dollars from you and if you don't pay that I'm going to bring in somebody who will." So even though you could actually say, "Oh, but he's only paying half X, he's only paying a quarter of X, he's only paying that," it doesn't matter, you know, I know that you're making money and even if you didn't disclose the turnover figures, you know, I can see how many people are going into your shop and coming out with stuff under their arms, so I've got a pretty good idea that you're trading well and I think you can afford to pay more and it's my job to try and wring it out of you.

So hypothetically even if you could get access to all the other people's rents, information, and if you didn't have to disclose turnover any more, couldn't they still try and wring out of you as much as they can get?

MR DAY (NANA): They do that now of course and that is commercial reality, but the point that I'm making also, there's also a performance base on it too. It comes to a time when you can't afford that and they've gone over the mark, so you want some sort of mechanism where you can negotiate and say, "Look, I've shown you that I make so much profit per square metre. I take out your rent and everything and so much. That's an industry standard. This is where we're out now. It doesn't make any money. Do you want our type of shop in rather than the take it or leave it?" Can't we have some sort of arbiter that can sit down and discuss this so that then they know that they're not only throwing you out and your livelihood and losing all the money, the person they're putting in your place is going to end up the same track three years later.

DR BYRON: Or worse.

MR DAY (NANA): Or worse, exactly, because they didn't have the experience.

DR BYRON: Which leads into your other comments about some sort of framework and Professor Zumbo this morning was talking about a requirement for people to negotiate in good faith. What you're basically saying is that even when you go to them with all the facts and it's all absolutely kosher and this is the evidence, I can prove that people aren't even making wages, they can't possibly keep paying this sort of rent, presumably if you went to mediation or something like that and there's a requirement there that both sides must negotiate in good faith, the management couldn't say, "Well, we refuse to take any notice of this."

MR DAY (NANA): That's right.

DR BYRON: So does the mediation process and a requirement for good faith give you any way of getting bona fide negotiations?

MR DAY (NANA): I think it's a start. I think we need to break down this discretionary power that the shopping centre has in the fact that if it can go to mediation and we can talk about it and you can get there. The performance level with a mediator there, the mediator can say, "Well, they've met your performance. What do you say about that?" and that's going to be an interesting answer. What do they say about that?

DR BYRON: Yes, if you can demonstrate that they're meeting the sales targets per square metre and that their costs are very low, they've obviously - - -

MR DAY (NANA): Or for reasons that they're not meeting it.

DR BYRON: They've trimmed everything they can possibly trim and it's a well run shop and it simply doesn't support the current rent level, presumably if that went to mediation you might get somewhere. What I want to know is have you tried that and it didn't work?

MR DAY (NANA): Can't get there.

MR COUSINS (NANA): If I may suggest, one of the trip points in Graeme's presentation was that if these things were set up from day 1 so they don't become a point down the track when the lease is getting renewed. So you're going in on a business plan arrangement that you both share those goals and then if at some point down the track there's a problem, at least there's a reference point that's away from the heat of the moment that can be the start of a proper discussion. I think that's the constructive approach to it.

DR BYRON: The rules of the game need to be specified at the start.

MR DAY (NANA): We've got to make up our minds whether the people that own shopping centres do in fact own the shopping centre business, or whether they're just in property business wanting a return on their investment and it's in leases.

DR BYRON: As I've been saying to a lot of other people, or a lot of other people have been saying it to us here, it's getting to the point where the small business in a centre is almost like being a subcontractor - - -

MR DAY (NANA): More like a dinosaur. He's not going to be in existence. I know what you mean.

DR BYRON: Whether it's in the food court or whether they're saying, "Okay, you can be the pharmacist on the third floor of the mall for the next five years, but at the end of

that five years we'll basically put it up for auction again," and you look at the sums and say, "Well, if I've got to spend this much for the fit-up and this much to stock the store and I've got to pay that much in rent and outgoings," and you say, "No, I'm sorry, I can't go into it on that basis. If it's only five years, either the cost of starting up has to be a lot lower, or the rent has to be a lot lower, or the term has to be a lot longer," but if that's the deal and everything is spelt out people can do their sums and say, "Well, not on."

MR DAY (NANA): That's exactly right.

MR COUSINS (NANA): We're not against people taking risks, but we're against people gambling. So if the whole thing is dimensioned up front then people know the ball game. That's what your saying.

DR BYRON: Yes, okay. Just out of curiosity, if I wanted to take my superannuation payout and go and buy myself a newsagency, I mean it would be a stupid question to say how much is a newsagency worth in a major shopping centre, because that's like how long is a piece of string - - -

MR DAY (NANA): I could give you a rough estimate depending on where it was, yes.

DR BYRON: For a particular part of Sydney, say, what I would pay to buy into a newsagency business with a certain period of a lease remaining if I was in a shopping centre compared to if I was in a strip, you know, half a mile away.

MR DAY (NANA): Okay, they're worked out on price-earnings. In a shopping centre because of the fact that a lot of them don't have home delivery they get a higher price-earnings, but then that's taken away by the risk of the lease. So it all comes into this sort of add a bit, take away a bit. But to answer your question we have shops in shopping centres for sale as low as $125,000 up to $3.7 million, with the majority being $750,000 to the 3 million mark. You can't amortise $3 million over a five-year lease. I've done the sums on it. You can't make that sort of money.

DR BYRON: Yes, how can you possibly pay 3 million if you've only got a guaranteed life of the business?

MR DAY (NANA): That's right, he signs the lease and then he says prayers every day, believe me, I tell you. Then the next time, "Am I going to do it again?" and it makes it very difficult for him to sell. So the lease actually forces the price of his goodwill and the price-earnings and sometimes if it forces it below that available goodwill to recover he's forced to say, "Well, I may as well spend another five years here and put it away in my superannuation and only pay 15 per cent for it for the next five years. I've got a better return than what I have by selling it because I'm losing money by selling the business because I can't replace it. I can't get the money back that I could get the same return from, but I can't get the return because the lease won't let me." I mean, it's a circle

so that's why I go back to the original capital investment must be amortised over the term of the lease. It's a capital investment that the centre does dearly want because the centre wants to know that person has got capitalisation, they want to know they're spending that sort of money on it. It's making their centre look good. Despite the fact that they say it's their customer, clearly it's not. They've got a role, that they attract people to the centre, but if the trader is not very nice and doesn't have the right product there, it's not their customer. So it's teamwork there to make it work that way and the centre would then say, "Well, if you're not performing very well and we don't like you, we get rid of you," and they do, and also if you don't make any money means also that you shouldn't be there because the marketplace has decided for you that you're not good, so that's - - -

DR BYRON: I'm glad you mentioned the case where the management took a more positive and constructive - - -

MR DAY (NANA): Yes.

DR BYRON: We've been told that that happens but it's nice to hear from the tenant's side that it does actually happen.

MR DAY (NANA): Yes, he was delighted, so were we, and so was the landlord. He's delighted too because he's got the tenant happy.

DR BYRON: That's the classic sort of win-win - - -

MR DAY (NANA): It certainly is, yes. It's very rare though. The point I'm saying is it's so illustrative that this is discretionary. The landlord could say, "I can help you, I can work it all out." This guy had a few brains and he also had a bit of go in him and he said, "Okay, we'll give it a go." We've given him reports every couple of weeks on how the progress is going and it's going well.

MR COUSINS (NANA): He also lives in the same town as the person who's having hardship; it's a country area, so there's a little bit of that too.

MR DAY (NANA): No, he doesn't - the landlord, sorry, wrong one. No, this is a big national landlord actually, a huge national landlord, and one of the biggest players in the game and I just found that that particular chief executive of that company was quite accommodating for commercial reasons. But he liked the idea that the newsagent was going to look at his square metres and the return and the space allocation that he's put into his product. I mean, this is not rocket science. Retail is very, very tough. It's a business and it's very competitive in itself. You don't need to be screwed - excuse me - by the landlord or have this horrible dark cloud over your head every night that you go to bed and wonder if it's worthwhile waking up in the morning, every day. It's not like a gaol sentence where it gets

closer to freedom; every day he gets closer to the death row. It's the worst way around.

MR COUSINS (NANA): One of the reasons they're still interested is of course the lotteries, because that's still, for legitimate reasons, fairly well regulated, but there's a real lack of perception about what lotteries do for newsagencies. A lot of it is lottery sales only, add-on sales are diminishing and it's 7 per cent gross, so that doesn't sort of hold up on the square metreage rate when you apply it across the - - -

MR DAY (NANA): We take that out of the product sale when we're negotiating.

MR COUSINS (NANA): Exactly.

MR DAY (NANA): I find if you can get to that level with somebody that wants to - and it's all about this discretionary power again, if they want to - but if there's a mechanism there that doesn't give them that discretionary power to say, "Look, I'm not interested, no matter how much and how well you're performing, I don't like the cut of your jib, it's Tuesday and I don't like Tuesdays, go away," for whatever reason, or, "I've got somebody else out there that's a bit more exciting than what you are and we've done a deal nationally and he's got to come in, so you've got to go out," I don't know the reasons, but he's got that power; it's so discretionary that it's not funny. It's equally discretionary when somebody comes along and says, "Yes, we'll help you." I find that refreshing as well. I think we need something, like the professor said earlier, that's there, that's a little bit more of a guideline - the rules that we were talking about on that playing field - saying, "These are the rules."

DR BYRON: Okay, thank you very much. It's been extremely helpful and interesting.

MR DAY (NANA): Thank you very much.

DR BYRON: That brings us to the end of the advertised agenda but we always give an opportunity for anybody in the room who wants to come forward and add something or respond to something they have heard or if there was something they meant to say that they had forgotten. Going once, going twice, are we all done? Okay, thank you very much, ladies and gentlemen. We're going to resume the public hearing in Brisbane on Monday morning. Thank you very much for your attendance and for your terrific participation. Thank you.

AT 3.16 PM THE INQUIRY WAS ADJOURNED UNTIL
MONDAY, 11 FEBRUARY 2008

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