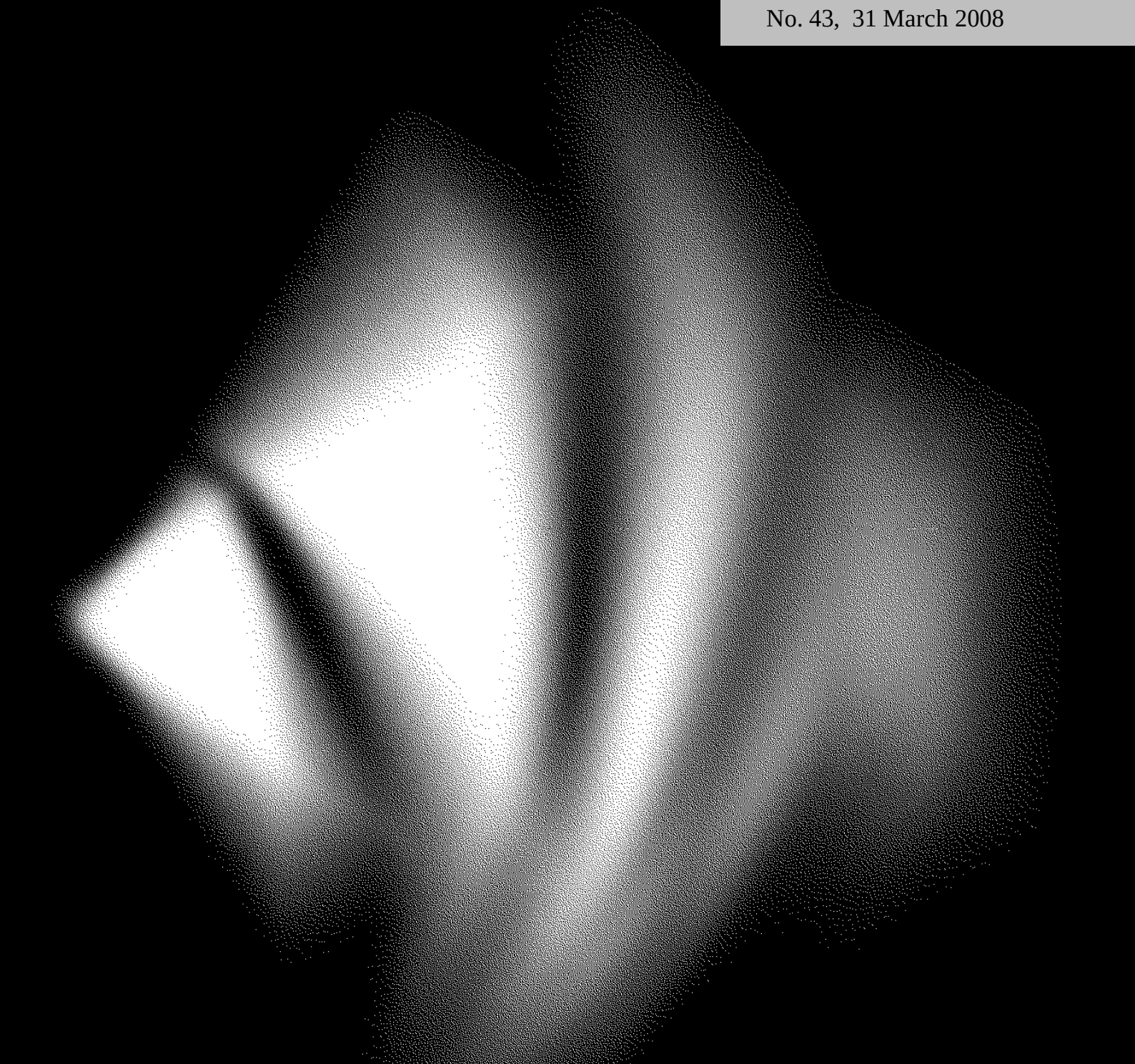
Australian Government
Productivity Commission

The Market for Retail Tenancy Leases in Australia

Productivity Commission
Inquiry Report

No. 43, 31 March 2008



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The Productivity Commission

The Productivity Commission, an independent agency, is the Australian Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by consideration for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

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The Honourable Wayne Swan MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer,

In accordance with Section 11 of the *Productivity Commission Act 1998*, I have pleasure in submitting to you the Commission's report on *The Market for Retail Tenancy Leases in Australia*.

Yours sincerely

Neil Byron
Presiding Commissioner

Terms of reference

I, PETER COSTELLO, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request the Productivity Commission to undertake an inquiry into the market for retail tenancy leases in Australia. The Commission is to hold hearings for the purpose of the inquiry and is to report within six months of receipt of this terms of reference.

In undertaking the inquiry, the Commission is to examine:

1. the structure and functioning of the retail tenancy market in Australia, including the role of retail tenancies as a source of income for landlords, investors and tenants and the relationships with the broader market for commercial tenancies;
2. any competition, regulatory and access constraints on the economically efficient operation of the market;
3. the extent of any information asymmetry between landlords and retail tenants and the impacts on business operation;
4. scope for reform of retail tenancy regulation to improve economic performance, including:
    - differences in retail tenancy regulation between States and Territories, and the scope for nationally agreed regulations and approaches; and
    - the extent and adequacy of dispute resolution systems for landlords and retail tenants, including differences in dispute resolution frameworks between the States and Territories;
5. the appropriateness and transparency of the key factors that are taken into account in determining retail tenancy rents;
6. the appropriateness and transparency of provisions in retail leases to determine rights when the lease ends; and
7. any measures to improve overall transparency and competitiveness of the market for retail tenancy leases.

The Commission is requested to:

- make recommendations for improving the operation of the retail tenancy market; and
- identify, and where practicable quantify, the likely benefits and costs of its recommendations for retail tenants, landlords, investors and the community generally.

In undertaking the review, the Commission is to advertise nationally, invite submissions, hold public hearings and consult with key interest groups and affected parties, including retail tenants and property advocates.

The Commission is to produce both a draft and a final report. The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's final report.

PETER COSTELLO

[received 21 June 2007]

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Abbreviations and explanations

Abbreviations

ABN	Australian Business Number
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ADT	Administrative Decisions Tribunal
ANF	Australian Newsagents' Federation
ANRA	Australian National Retailers Association
API	Australian Property Institute
ARA	Australian Retailers Association
ATO	Australian Taxation Office
BFSO	Banking and Financial Services Ombudsman
BGRA	Bulky Goods Retailers Association
BOMA	Building Owners and Managers Association
CBD	Central Business District
CEPR	Centre for Economic Policy Research
CFSPM	Colonial First State Property Management
COAG	Council of Australian Governments
COSBOA	Council of Small Business of Australia
CPI	Consumer Price Index
DEH	Department of Environment and Heritage
DFOs	Direct Factory Outlets
DUAP	Department of Urban Affairs and Planning
FAC	Franchise Advisory Centre
GLA	gross lettable area
GPT	The GPT Group
GST	Goods and Services Tax
LIS	Leasing Information Services

LIV	Law Institute of Victoria
NARGA	National Association of Retail Grocers of Australia
NRA	National Retail Association
NSW	New South Wales
NT	Northern Territory
OECD	Organisation for Economic Co-operation and Development
PC	Productivity Commission
PCA	Property Council of Australia
QIC	Queensland Investment Corporation
Qld	Queensland
REIA	Real Estate Institute of Australia
RICS	Royal Institution of Chartered Surveyors
RTAWA	Retail Traders' Association of Western Australia
SA	South Australia
SAT	State Administrative Tribunal
SBDC	Small Business Development Corporation
SCCA	Shopping Centre Council of Australia
SCISR	Standing Committee on Industry, Science and Resources
SRASA	State Retailers' Association of SA, Inc
SSRA	Southern Sydney Retailers Association
States	States and Territories
Tas	Tasmania
TPA	*Trade Practices Act 1974*
VCAT	Victorian Civil and Administrative Tribunal
Vic	Victoria
WA	Western Australia
WARA	Western Australia Retailers' Association

Explanations

Billion	The convention used for a billion is a thousand million (10^9).
Findings	*Findings in the body of the report are paragraphs highlighted using italics, as this is.*
Recommendations	***Recommendations in the body of the report are highlighted using bold italics, as this is.***

OVERVIEW

Key points

- The market for retail tenancies is dynamic and complex. It is an amalgam of large and small businesses participating as landlords and tenants.
  - There are around 290 000 retail tenancy leases in Australia with up to 58 000 written each year.
  - About one fifth of leases are in shopping centres with the remainder in retail shopping strips and other retail formats.
- Retail tenancy leases — legally binding documents that define the relationship between the landlord and tenant — are governed by State and Territory retail tenancy legislation.
- The main intention of specific retail tenancy legislation is to address bargaining imbalances between large shopping centre landlords and small retailers.
  - The legislation is highly prescriptive and has grown in volume — now amounting to some 700 pages across jurisdictions.
  - Significant and widening differences between jurisdictions persist, despite attempts at harmonisation.
  - Aspects of the legislation have constrained the market, lowered productivity and added to compliance and administrative costs.
- Nevertheless, a number of innovations appear to have been useful, in particular,
  - simple, low cost and accessible dispute resolution; disclosure statements; lease information; and the encouragement of registration of leases in some jurisdictions.
- In an environment where the market is working reasonably well overall, further attempts to prescribe lease terms and conditions would not improve outcomes.
- The Commission considers the most fruitful approach to improving the operation of the retail tenancy market and reducing costs would be to:
  - further improve transparency, disclosure and dispute resolution, to reduce information imbalances and unwind constraints on efficient decision making;
  - reduce the prescriptiveness of legislation and move to a nationally consistent retail lease framework, to increase efficiency and reduce costs; and
  - adopt a more focused approach to the shopping centre segment of the market, through the introduction of a national shopping centre code of conduct, to ease tensions and reduce costs in that segment and to support the move to less prescriptive legislation and national consistency.
- In addition, the potential to relax planning and zoning controls that limit competition and restrict retail space and its utilisation warrants further examination.

Overview

This inquiry examines the operation of the retail tenancy market in Australia. It assesses the operation of the market, attempted remedies and solutions to difficulties encountered by small retailers, and identifies possibilities for change.

The inquiry follows significant reviews and legislative activity focusing on retail tenancies dating back to the 1980s. These sought to redress a suite of problems experienced by small tenants widely believed to be due to imbalances in bargaining power between small retail tenants and large landlords. Over this period, there has also been progressive strengthening of the (Commonwealth) Trade Practices Act (TPA) and associated State fair trading acts intended to promote competition and fair trade.

The key questions faced by the Commission in this inquiry include:

- Is there evidence of significant failings in the retail tenancy market that reduce economic efficiency?
- Is there evidence that regulations to date have been effective in addressing perceived problems (including 'fairness') and improving efficiency?
- Are there new *or* different approaches that could generate net economic and social benefits?

The Commission has sought to take a broad view of these issues. It appreciated participants relaying their experiences and providing their perspectives on how the market is operating. The Commission became acutely aware of the commitment required to be a successful retailer, the stiff competition for the consumer dollar and the commercial risk faced in retailing. It heard that there are many traps for both new and more experienced retailers, and that downsides can be financially and personally devastating.

What are retail tenancy leases and how are they regulated?

Most retail business is conducted from premises covered by retail leases; a minority are covered by commercial leases and owner occupation. Retail and commercial leases are legally binding documents that define the relationship between a lessor (the landlord) and a retailer (the lessee or tenant). They cover a wide range of

matters including parties to the lease, lettable space, rent, lease terms, relocation, redevelopment, quality and maintenance of premises, rent reviews, fit-outs and expiry.

Retail tenancy leases differ from other commercial tenancy leases in that they are governed by specific State and Territory legislation and, in Tasmania, by a code of practice. Before the introduction of specific retail tenancy legislation, all retail tenancy leases were treated under law as standard commercial leases. In many countries similar to Australia, they still are.

Retail tenancy legislation covers matters such as information disclosure, lease terms, security bonds, unlawful threats, exclusion clauses and warranties. Associated dispute resolution processes provide tenants and landlords with access to low cost mediation, conciliation or arbitration before proceeding to a tribunal or court. The total volume of legislation is now some 700 pages across all jurisdictions.

While the legislation was mainly intended to deal with the relationship between shopping centre landlords and specialty tenants, the legislation applies more widely to all landlords (large and small) offering retail tenancies and, in some cases, to 'large' national tenants (depending on location of the business, floor space and activity levels). 'Bulky goods' and 'direct factory outlets' are generally not covered by retail tenancy legislation.

The TPA also contains provisions relevant to retail tenancy arrangements: Part IVA prohibits unconscionable conduct in business transactions (s. 51AC); Part IVB enables the establishment and enforcement of industry codes of conduct; Subdivision B enables collective bargaining; and Part V prohibits misleading and deceptive conduct.

Until 2001-02, jurisdictions met regularly with the aim of harmonising legislation, but these meetings were discontinued. Although the broad architecture of retail tenancy legislation or codes is similar across Australia, there are significant differences in detailed provisions and application between jurisdictions, and indications are that policies and regulations across jurisdictions will diverge further.

The market for retail tenancy leases

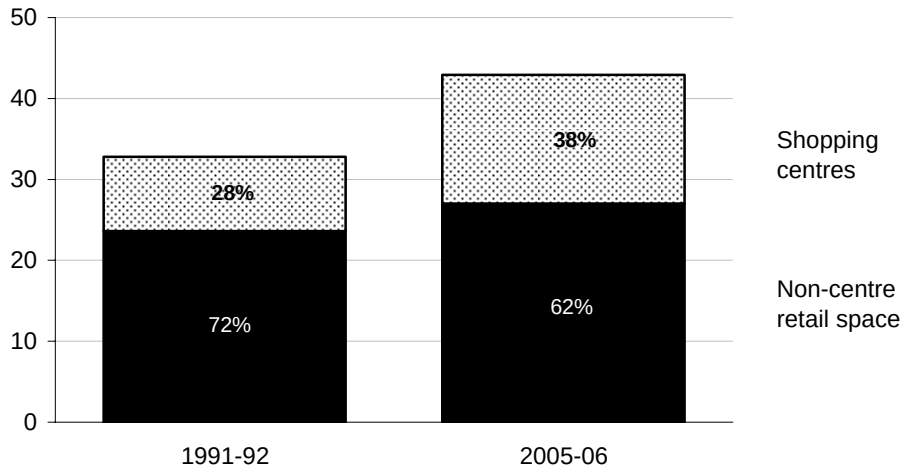
The market for retail tenancies is a dynamic and complex amalgam of small and large businesses participating in the market as landlords and tenants. The Commission has estimated that there are around 290 000 retail tenancy leases currently in Australia, with some 58 000 new leases written each year.

Broadly, retail tenancies provide for retail space in a range of premises from shopping strips (or high streets), to neighbourhood centres and larger regional centres. Also, a growing number of retail outlets handle bulky goods or act as direct factory outlets. Shopping centres — a retail concentration in an enclosed space with some common public facilities — have been the main contributors to retail space growth over the past decade or so. There are currently around 1360 shopping centres in Australia contributing nearly 40 per cent of total retail space, up from nearly 30 per cent in the early 1990s.

Around 60 000 retail tenancy leases — about one fifth of the total — are located in shopping centres.

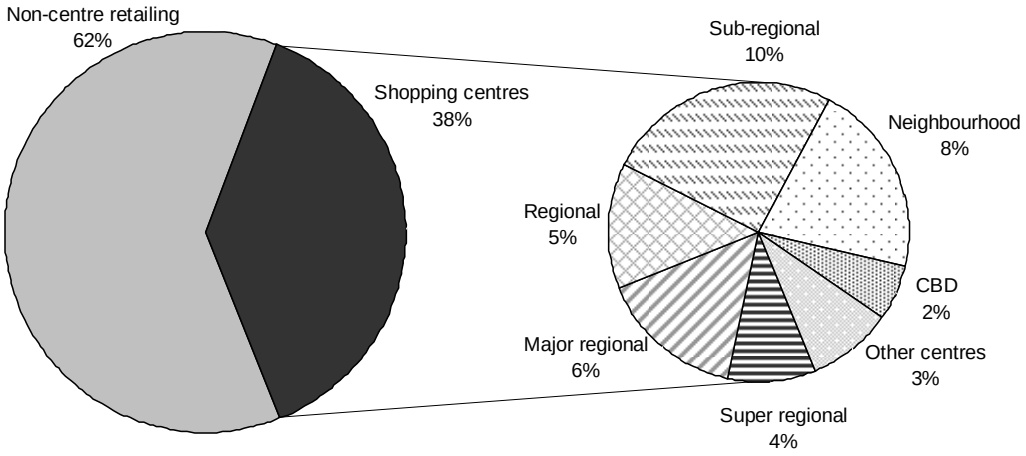
Figure 1 **Retail space in Australia, 1991-92 to 2005-06**

Million square metres of gross lettable retail space



There is significant diversity amongst shopping centres. The largest (that is 'super regional') shopping centres are substantially owned by 6 companies/trusts, account for around 1 per cent of the number of shopping centres, and contribute about 10 per cent of lettable retail space of centres — just under 4 per cent of all retail space. Neighbourhood centres are diversely owned, account for about 60 per cent of all shopping centres, but provide only around 20 per cent of the lettable area of centres — 8 per cent of all retail space. These proportions differ markedly between states.

Figure 2 **Shopping centres in Australia, 2006**
Per cent of centre retail space



Evidence of negotiating imbalances?

This inquiry stemmed from concerns among small retail tenants about leases over which they feel they have little or no control. Despite the now substantial body of retail tenancy legislation, these concerns are little different from earlier concerns that arose with:

- the emergence and rapid growth of the shopping centre model;
- the lack of familiarity of retailers with the shopping centre environment compared to familiar shopping strip and arcade formats, that often have dispersed ownership of retail space; and
- the lack of low cost, accessible and effective disputes mechanisms appropriate for managing disputes between well resourced and organised landlords and often small, demoralised specialty tenants.

The basic negotiating balance between landlords and tenants is determined by supply and demand conditions in the market, and individuals' assessment of their market prospects.

The retail market operates within the confines of zoning and planning controls. While such controls can have merit in preserving public amenity and contributing to the cost-effective use of public infrastructure, their application can limit competition and erode the efficient operation of the market for retail tenancies. They restrict the number and use of sites, can confer some negotiating power on incumbent landlords and retail tenants, and restrict commercial opportunities of others. Zoning and

planning controls can particularly advantage owners that have control over large conglomerations of retail space located some distance from competitors and their tenants. They can also disadvantage businesses that wish to gain access to additional space.

Where the tenant and landlord are of similar size and there is competitive provision of retail space, there is no evidence of an imbalance in bargaining position (for example, there are many small landlords and small tenants on retail strips, and large tenants dealing with large landlords).

Where there is a large landlord of a centre which is a drawcard to the consuming public, and many small existing and prospective specialty tenants competing for limited retail space, imbalances in negotiating power can exist. Large centre landlords who are able to offer contracts on a 'take it or leave it' basis, provide a clear indication that demand for such retail space has been outstripping supply.

However, large shopping centre landlords do not always hold the negotiating power. Where the supply of retail space (such as after a redevelopment) increases or if a landlord desires a particular product line or trader, incentives and concessions may be initially used to draw businesses into centres. Such offers indicate a tenant being in an initial position of relative negotiating strength. However, such negotiating strength may only be transitory and not persist through time (due to changes in consumer preferences, saturation of the market or general increases in competition for scarce retail space).

For centre landlords, there is a strong commercial incentive to maintain the attractiveness of their centre(s) and to choose the most successful mix of retailers so as to achieve the highest return possible from their investment and that of the ultimate owners — individual shareholders, superannuation funds and other investors. Centre shopping environments favoured by consumers enhance a landlord's negotiating power.

Retailers — especially those who do not operate 'drawcard' or 'destination' outlets but rely on passing traffic for custom — have an incentive to locate within shopping centres to take advantage of proximity to customer traffic and centre management. Tenants are also advantaged if other tenants of a centre are able to draw customer traffic. However, achieving a lease within a centre (or other retail space) does not grant a tenant the right to hoped for returns or to trade at the site beyond the lease. This means that the business may have little or no enduring goodwill. A tenant's success and negotiating position will therefore depend on their individual offering and the matching of that offering with the shopping environment offered by the landlord.

Many of the perceptions of shopping centres' 'misuse' of negotiating power stem from a lack of understanding or acceptance that the business model of a retail shopping centre is fundamentally different from traditional retail strips. Retailers who sign a lease in a large managed shopping centre without realising that the 'rules of the game' are very different, are at a disadvantage and can be seriously disappointed, if not financially devastated. Retailers who do understand the shopping centre model, and work within it, can prosper. Well managed shopping centres can unify a large and divergent group of tenants, and help centre trade. In return, tenants in centres generally pay higher rents and outgoing expenses than similar tenants in a shopping strip, and forego some independence in operating their business.

Retailers have a strong incentive to balance their trading prospects in a centre against the cost and term of occupancy, opportunities elsewhere and the risks of both business success and failure, before commitment. An informed tenant should know at what point a lease becomes unsustainable for their business model — tenants have the choice to bid for and sign a lease, or not. The ultimate bargaining chip is to walk away, but the Commission heard that, a significant number of tenants are reluctant to exercise this option. This can be because of the strong entrepreneurial spirit required to be a successful retailer and a desire to secure a particular location. It can also be that some retailers, in their desire to achieve a foothold in a shopping centre (or other retail precinct), do not fully weigh up trading prospects, obligations and alternatives before committing to tenancy contracts. This strengthens the landlord's hand in lease negotiations.

Market tensions may arise

The Commission was also made aware that tensions in the landlord-tenant relationship can and do arise, including when:

- retailer expectations of performance are not realised (for example, because foot traffic and sales projections do not eventuate);
- retailer expectations of a new lease at the expiry of a fixed-term lease (often 5 years) or the continuance of current lease conditions, are not realised;
- differences in information held on site rental and centre performance is perceived to disadvantage a retailer at lease negotiations;
- the reporting of each retailer's individual turnover data to centre management is perceived to disadvantage a retailer in subsequent negotiations with landlords; and
- the trading opportunities of tenants are adversely affected by renovation or refurbishment activity in shopping centres or changes in tenancy mix.

Many of these tensions arise from market processes, are not confined to shopping centres and do not indicate a failing in the market. However, the difficulties are perceived to be greatest in relation to shopping centre tenancies because of the control exercised by large and identifiable landlords over centre operations, the attractiveness of centre locations to many retailers, and stiff competition for the consumer dollar.

Effectiveness of legislative and other developments

The regulatory and other changes to date have been premised on the expectation that government action could redress imbalances of negotiating power between small tenants and large landlords, reduce tensions and significantly improve the operation of the retail tenancy market. The Commission has found mixed evidence to support this expectation.

Features that have not been effective

The current legislation has attempted to prescribe matters that would normally be the subject of negotiation, such as lease terms, first rights of refusal and occupancy costs. It has also attempted to circumvent matters that are subject to common law such as lease assignment. While well intentioned, the Commission did not receive convincing evidence during the inquiry or from its own research to support the view that these measures have influenced the supply and demand for retail space and helped redress negotiating imbalances between tenants and landlords. If anything, the more prescriptive measures have favoured the well informed and those with strong legal support.

In addition, the current approach has:

- widened the gap between retail and commercial leases, and between States, as landlord and tenant interests seek legislation on matters that would normally be subject to commercial negotiation;
- failed to fully educate small retailers about the significant differences between a centre and traditional shopping strip retailing;
- constrained commercial decision making as businesses endeavour to comply with legislated provisions rather than their commercial best interests; and
- added to business and compliance costs as businesses study the implications of the legislation, accommodate those matters in leases and participate in State and Commonwealth reviews.

Features of the current system that are working reasonably well

There are a number of innovations and practices of the current system that have been useful and are working to reduce tensions and improve the operation of the market. These do not seek to prescribe the terms of contracts, but rather enhance landlords' and tenants' ability to operate effectively in the market. They include:

- disclosure requirements on lessees and lessors to encourage better informed decision making and contracting;
- education and advisory programs by State and Commonwealth governments, and the industry itself, designed to address information gaps and improve decision making, particularly amongst less experienced small businesses;
- the registration of leases in some jurisdictions under property law which, as a by-product, provides a source of market information about lease terms and conditions; and
- low cost and accessible dispute resolution alternatives that reduce waste associated with lingering commercial disputes, particularly for small business.

In addition, the 'unconscionable conduct' provisions of the TPA and State fair trading acts seek to prohibit actions that unreasonably exploit differences in negotiating position and offend good conscience in the circumstances. While some suggested that the current concept of unconscionable conduct sets too high a hurdle, given the substantial incentive for centre landlords to settle an accusation of unconscionable conduct before it proceeds to court, the Commission's assessment is that the current provisions are influencing conduct and reducing costs associated with unnecessary disputation.

Active lease advisory services have evolved

The market has also responded to information gaps. A very active leasing advisory service industry has developed to advise prospective tenants on business plans and leasing conditions, and to provide negotiation services. In addition, a substantial range of information about retail tenancy leases and costs is also available on a fee-for-service basis. This information covers shopping centres and other retail property.

The advisory sector appears to be mainly serving the better informed and more experienced segment of the market, although some small and/or inexperienced tenants also use services to support dealings with large landlords and to manage risk.

Information and advisory services have emerged to fill a market need — improving decision making and the operation of the market for retail tenancies. However, this area still needs to evolve further, as there are substantial differences in the quality and usefulness of the advice being offered.

Collective bargaining holds little promise

Collective bargaining is also available under the TPA with accessibility improved from 1 January 2007. However, strong commonality of interest between tenants is rare with the highly atomistic and competitive nature of retailing placing limits on the usefulness of the provision. The Commission's assessment therefore is that collective bargaining by small retailers negotiating with large shopping centres is unlikely to substantially address any negotiating imbalances, particularly as they may affect contract terms and conditions critical to an individual tenancy.

Is change warranted?

Competitive pressures, difficulties in lease negotiations and the certainty that some businesses will fail have led many participants to suggest that there are fundamental failings in the market. It was also suggested that these warrant continued government intervention to modify conduct and redress negotiating imbalances, and thereby reduce tensions.

Across the economy, large and small firms in all sectors trade without special regulation detailing the terms of their business relationship. The Commission did not find strong evidence that the difference in the size of market participants in the retail tenancy sector distorts the efficient operation of the market. Overall, the market is working reasonably well — hard bargaining and varying business fortunes should not be confused with market failure warranting government intervention to set lease terms and conditions. Generally,

- there is no convincing evidence that systemic imbalance of bargaining position exists outside of shopping centres;
- in larger shopping centres, there is stiff competition by tenants for high quality retail space and competition by landlords for the best tenants, reflected by relatively low vacancy rates and high rates of lease renewals;
- the more desirable tenants and shopping locations are able to negotiate more favourable lease terms and conditions;
- the incidence of business failure in the retail sector is not exceptional compared to other service activities; and

- formal disputes are relatively few and widely dispersed both geographically and according to shopping formats.

In this environment, it is unlikely that market tensions will be resolved or eliminated by government intervention into contracts through retail tenancy or other regulation. Regulation is not a good substitute for due diligence, the appropriate use of commercial lease advisory services and lease information — and sound business judgement. Nevertheless, there is room to improve the regulatory framework and market information, and some change is warranted. Change should be focused on:

- improving, where practicable and cost effective, education, information and dispute resolution procedures;
- moving more towards self regulation rather than continued reliance on government legislation; and
- removing the more restrictive elements of retail tenancy legislation, including divisions between jurisdictions and the broader market for commercial tenancies, that impede contracting between firms.

What principles should guide change?

Regulation should not be used to:

- substitute for business decision making and risk taking, particularly to compensate for changes in competitive pressures arising from developments in the retail tenancy market structure; or
- give advantage to specific market participants, such as particular businesses currently operating in shopping centres.

In addition, retail tenancy regulation should not be used to compensate for the effects of restrictions on land use, variations in the level of general economic activity or changes in consumer taste. These matters should be addressed directly or left to the market.

The Commission identified options that, if implemented, are most likely to improve efficiency in the operation of the retail tenancy market, allow firms greater flexibility to adjust to changes in consumer preferences and general economic conditions, and reduce administrative, compliance and information costs.

Principles for assessing regulation of retail tenancies

To ensure the efficient and fair operation of the retail tenancy market and facilitate commerce, regulations should:

- not extend or overlap with current laws governing all commercial transactions (including common law and the TPA) unless there is a clear net benefit to the community;
- not unduly restrict the provision or the conditions (and hence availability) of retail tenancy space;
- ensure all lease conditions (rights and responsibilities) are clear and transparent to lessees and lessors and that lease and property rights are clearly defined;
- not restrict commercial decision making including through:
  - arbitrary regulatory distinctions between businesses (whether landlord or tenant) based on the type or level of activity, or geographic location;
  - prescriptive rent setting or mandated rent setting processes; and
  - limitations on the flexibility of landlords and tenants to decide whether or not to re-enter a new lease agreement.
- not provide opportunities for market participants to shift risks associated with letting retail space or undertaking retail business;
- ensure that those significantly involved in the negotiation and management of a lease are subject to unconscionable conduct provisions and legal proceedings, but not overly prescribe levels of 'unconscionable' behaviour in a manner that would reduce the efficient operation of the market;
- not restrict the commercial provision of market information;
- provide affordable and accessible dispute resolution and judicial processes; and
- be the minimum necessary and not unduly add to administrative and compliance costs.

What action could improve the operation of the retail tenancy market?

The legislative changes proposed by some participants would entail even more regulation prescribing lease terms and conditions, and the relationship between landlord and tenant. The existing approach has not 'fixed' many of the 'problems' it has sought to address, but rather has added complexity, inconsistency and increased compliance and administrative costs. It discriminates against market entrants and market participants outside the target group and does not fit well with the broader market for commercial tenancies. It also has raised expectations amongst some businesses and their advisors, of the scope for government regulation to affect commercial realities in their favour.

The case for greater prescriptiveness of lease terms and conditions in tenancy legislation is weak. Instead, an alternative approach is warranted. Such an approach would maintain, and where practicable, improve the features of the current system that are working reasonably well — dispute resolution and information, and disclosure — but also:

- progressively unwind provisions in retail tenancy legislation in each State and Territory in areas that have sought to prescribe lease terms and conditions, such as minimum lease terms for firms covered by the legislation; and
- move, where practicable, towards national consistency in legislation.

The Commission also considers that the shopping centre section of the leasing market — the focus of most legislative activity seeking to prescribe leasing terms and conditions — could be instrumental in the reform process and reduce tensions associated with transactions between well resourced landlords and small less experienced retailers. This could be achieved by developing a *voluntary* national shopping centre code of conduct. Such a code would be a better focused and more cost effective alternative than retail tenancy legislation for outlining rules of engagement between centre landlords and retailers.

The Commission considers that this alternative approach offers the best prospects for reducing tensions and improving efficiency in the retail tenancy market. Coincidentally, it would improve the alignment of regulations and practices governing retail tenancies with those governing tenancies in the broader market for commercial tenancies. It would not eliminate 'hard bargaining', errors of judgement, risk, financial success or failure — or disappointment.

The Commission's recommendations recognise that retail tenancy regulation is a State and Territory matter, as is regulation of the broader market for commercial leases and real property. Nevertheless, many landlords and tenants operate in the tenancy (and property) market on a national basis and advised that nationally consistent regulation would lower compliance costs and was strongly favoured.

Submissions favouring a nationally consistent approach also alluded to the dangers of burdensome compliance costs that may arise from a reform path involving overlapping national and state frameworks — they expressed a preference for the current 'dog's breakfast' of state legislation rather than a piecemeal overlapping national/state framework. The Commission therefore considers change should be implemented progressively and focus on what may be achieved in the immediate future (up to 2 years), medium term (2 to 5 years) and longer term (beyond 5 years). Within this framework, the introduction of a shopping centre code of conduct, which has a national focus, should be synchronised with the removal of the restrictive/overlapping elements of State and Territory retail tenancy legislation.

Measures for the immediate future

As indicated, the Commission's preferred approach to retail tenancy regulation involves less prescriptive retail tenancy legislation, greater alignment with the law governing commercial tenancies and, where practicable, greater national consistency. Reform towards the Commission's preferred framework needs to be deliberate and progressive and avoid piecemeal overlapping national/state measures.

Accordingly, in the immediate future, States and Territories should not pursue measures that increase the prescriptiveness of retail tenancy legislation nor further widen the gap between the retail tenancy market and the broader market for commercial tenancies.

The pause in legislative change would parallel measures to improve: transparency and accessibility of lease information; market information; and national consistency of lease information. They would be a precursor to the introduction of *less* restrictive provisions in tenancies legislation and, where practicable, a move towards nationally consistent regulation.

Improve transparency and accessibility of lease information

Despite past efforts, there are still knowledge and information gaps (often with small landlords and tenants) that contribute to poor decision making and tension. Possibilities for further development include:

- greater use of simple language in tenancy documentation; and
- improving links between relevant agencies dealing with tenancy matters, including between land title offices and retail tenancy agencies.

While the Commission does not see a need for substantial additional measures to increase information and knowledge in the retail tenancy market, there is scope for refinement — focusing on simplification, disclosure and accessibility of existing services. The industry itself can play a large part in this.

RECOMMENDATION 1

State and Territory governments should take early actions to further improve transparency and accessibility in the retail tenancy market. They should:

- ***Encourage the use of simple (plain English) language in all tenancy documentation.***
- ***Provide clear and obvious contact points for information on lease negotiation, lease registration and dispute resolution.***
- ***Encourage a one page summary of all key lease terms and conditions to be included in retail lease documentation.***

The main direct benefit would come from reduced tension associated with poor understanding of lease obligations and associated costs, and efficiency improvements through better informed retail tenants and landlords.

Improve tenancy market information

To provide information about the tenancy market and redress information imbalances between small tenants and centre landlords, it was widely suggested that either lease registration with land titles offices be mandated or that key lease details (a one page summary or epitome) be made publicly available. While the decision whether to register (or lodge) a lease or make details available to third parties is a commercial one by the contracting parties, the Commission considers that wider availability of key lease details would contribute market information and be widely used, and should be facilitated. The wide support by tenant and landlord interests during the inquiry, suggests a high level of voluntary participation would be achieved. Tenant organisations should encourage members to lodge lease details and landlords should facilitate prompt lodgement.

RECOMMENDATION 2

To increase the transparency of the market, State and Territory governments should, as soon as practicable, facilitate the lodgement by market participants of a standard one page lease summary at a publicly accessible site.

Because practices concerning the collection of lease information differ between jurisdictions, the Commission considers the method adopted for lodgement should be tailored to the practices of individual jurisdictions. In the longer term, a single national data base may emerge.

Improve national consistency of lease information

A common concern raised by businesses that operate across jurisdiction boundaries, was the additional costs imposed by the need to tailor leases to the different requirements of respective state regulations. In the immediate future, the first step towards national consistency could be achieved through national reference disclosure statements and tenancy leases. These should focus on establishing transparency of lease obligations on a nationally consistent basis, but avoid prescribing lease terms and conditions — matters properly the subject of commercial negotiation.

The Commission also notes that while a significant amount of information is available on tenancy disputes, it is not readily available in a format that enables a broad analysis of the Australian tenancy market. Nationally consistent information on disputes would enable evaluation of the dispute resolution processes and the nature and causes of disputes.

RECOMMENDATION 3

State and Territory governments, in conjunction with the Commonwealth, should seek to improve the consistency and administration of lease information across jurisdictions in order to lower compliance and administration costs. They should:

- ***Encourage the development of a national reference lease with a set of items (and terminology) to be included in all retail tenancy leases and in tenant and landlord disclosure statements.***
- ***Institute nationally consistent reporting by administering authorities on the incidence of tenancy enquiries, complaints and dispute resolution.***

The groundwork for a national tenancy framework would provide potential benefits in the short term through improved information about lease obligations and sources of disputation on a nationally consistent basis. Over the longer term, this could lead to more efficient investment decisions and reductions in administrative and compliance costs.

Improve clarity of unconscionable conduct

The Commission's assessment is that measures to improve clarity, such as detailing the significance of differences in jurisdiction-specific provisions and, where practicable, alignment of legislation, could lower the cost of disputation and be beneficial..

RECOMMENDATION 4

The significance of jurisdictional differences in the provisions for unconscionable conduct, as applying to retail tenancies, should be detailed by State and Territory governments in conjunction with the Commonwealth, and aligned, where practicable.

Because of the strong incentive on businesses to settle disputes involving claims of unconscionability before proceeding to tribunal or court, the Commission does not see an imperative for government to contrive to bring cases before the courts.

Measures to reduce tensions and improve efficiency

As a next step towards improving the operation of the retail tenancy market in Australia, changes should focus on a national shopping centre code of conduct to ease tensions in the operation of the retail tenancy market and to facilitate the removal of those aspects of tenancy regulation that attempt to prescribe commercial outcomes and drive a wedge between the retail tenancy and commercial property markets. Work toward these measures should be initiated as soon as practicable to enable implementation over the next two to three years.

Voluntary national code of conduct for shopping centre leases

Retail tenancy within shopping centres often involves quite different arrangements to retail tenancy in other settings. Furthermore, the majority of concerns and suggestions for change that were raised by participants to this inquiry (and previous inquiries and reviews), relate to retail tenancy in shopping centres which, as noted, comprise around 20 per cent of retail tenancies, and have little relevance to other retail formats.

The Commission considers that a voluntary national code that seeks to establish good leasing practices (the objective of the original retail tenancy legislation) has merit as a strategy for addressing conduct issues. Such a code would involve landlords and tenants setting out their own 'rules of the game' focusing on issues of acceptable processes and transparency (but avoiding interfering in the commercial relationships between landlords and tenants). It could moderate the adversarial nature of relationships and the more extreme negotiating tactics.

A voluntary code would have the benefit of acting as a readily identifiable signal to prospective traders of a willingness to conduct business according to agreed and transparent standards. It would also not require arbitrary coverage definitions as any

landlord or tenant could join. While a number of models for the implementation of codes exist, in view of the likely national importance of the code, the Commission considers that it would be most appropriate for the code to be 'prescribed' under the Trade Practices Act. As a prescribed code, it would be enforceable by the Australian Competition and Consumer Commission (ACCC).

RECOMMENDATION 5

State and Territory governments in conjunction with the Commonwealth should facilitate the introduction, by landlords and tenant organisations in the industry, of a voluntary national code of conduct for shopping centre leases that is enforceable by the ACCC. The code should:

- ***include provisions for standards of fair trading, standards of transparency, lodgement of leases, information provision and dispute resolution; and***
- ***avoid intrusions on normal commercial decision making in matters such as minimum lease terms, rent levels, and availability of a new lease.***

The code of conduct for shopping centre leases, as part of a new streamlined regulatory framework, could potentially lower transaction, compliance and administrative costs of operating in the retail tenancy market. The parts of the legislation that seek to govern conduct, contract terms and conditions in current State and Territory regulation would become redundant and should be repealed coincident with the centre code coming into effect.

The focus of tenancy legislation could appropriately shift from shopping centres to the tenancy market more generally.

Remove constraints on commercial decision making

As a complementary measure to the introduction of the shopping centre code of conduct and to achieve more significant progress towards improving the operation of the retail tenancy market in Australia, the Commission recommends more substantial changes to reduce the restrictiveness of retail tenancy legislation to business, reduce costs of overlapping state frameworks and move further towards a nationally consistent commercial leasing framework.

Changes would involve State and Territory governments relaxing key restrictions on commercial decision making in retail tenancy legislation, including those relating to minimum lease terms, preferential rights of renewal, lease assignment and outgoings.

RECOMMENDATION 6

State and Territory governments should remove those key restrictions in retail tenancy legislation that provide no improvement in operational efficiency, compared with the broader market for commercial tenancies.

Further medium term options to lower costs and improve efficiency

To move further towards national consistency, the Commission recommends model retail tenancy legislation be developed. Such a model and its provisions would be available to be adopted in each State and Territory jurisdiction. The framework would include legislation-consistent lease contracts and disclosure statements.

RECOMMENDATION 7

As unnecessarily prescriptive elements of retail tenancy legislation are removed, State and Territory governments should seek, where practicable over the medium term, to establish nationally consistent model legislation for retail tenancies, available to be adopted in each jurisdiction.

In addition, the Commission considers that there is scope to increase retailing opportunities and competition in the retail tenancies market for the benefit of new entrants to the sector and consumers more generally. While recognising the merits of zoning and planning controls in enhancing public amenity and economising on the use of public infrastructure, the application of such controls restrict the availability of retail space and can reduce competition. The Commission therefore suggests that State and Territory governments examine the potential to relax those zoning and planning controls that unduly restrict the availability of retail space and the conditions under which it is utilised.

RECOMMENDATION 8

While recognising the merits of planning and zoning controls in preserving public amenity, States and Territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation.

Longer-term options

In the longer run, the Commission considers that the most appropriate option for lowering compliance and administrative costs associated with separate retail tenancy regulations in each jurisdiction, is to adopt a nationally consistent

framework. Recognising that tenancy and real property are state responsibilities, the most appropriate approach to achieving a nationally consistent framework is for jurisdictions to adopt the provisions of agreed nationally consistent legislation for retail tenancies.

Economic impacts of the recommendations

Reforming the retail tenancy market is likely to improve the efficiency of its operation and lead to benefits for the Australian economy, including consumers. Although difficult to quantify, the Commission received ample evidence that aspects of the current framework with its focus on prescribing lease terms and conditions and legislative differences across jurisdictions impede business and raise costs. The Commission also found that there are knowledge and information gaps in the sector that add to difficulties of lease negotiation, raising costs and potentially lowering operational efficiency. These costs could be substantial and contribute to the overall regulatory burden on business. Addressing these gaps and shortcomings is likely to increase flexibility in lease terms, improve business and government decision making and lower administrative and compliance costs.

1 Introduction

The market for retail tenancies involves dynamic and complex interactions of small and large businesses participating in the market as retail tenants and landlords. Depending on the format and the range of facilities offered, retail tenancies can be broadly divided into shopping strips (or high streets), neighbourhood centres and regional centres. There are also specialist centres that handle 'bulky goods' or act as 'direct factory outlets'.

The State and Territory governments have regulatory responsibility for this market, and all (with the exception of Tasmania) have specific retail tenancy legislation. In Tasmania, a regulated code of practice applies.

This inquiry examines the effectiveness of this regulation, and whether changes that could be introduced would lead to improvements in the operation of the market and benefit the Australian community as a whole.

The terms of reference for this inquiry were released on 21 June 2007, in a joint press release from the Treasurer and the Minister for Small Business. In brief, the Commission has been asked to:

- make recommendations for improving the retail tenancy market in Australia; and
- identify and, where practicable, quantify the likely benefits and costs of those recommendations for retail tenants, landlords, investors and the community generally.

The detailed terms of reference are on page IV.

1.1 Background and recent regulatory developments

Retail tenancy leases are the most common means to provide access to premises for the conduct of a 'retail' business alongside commercial leases and owner occupation of retail premises. Retail (and commercial) leases are legally binding documents that set out the terms of a contractual agreement between a lessor (the landlord) and a lessee (the retailer or tenant). They cover a wide range of matters including lettable space, rent, lease terms, relocation, redevelopment, quality and maintenance of premises, rent reviews and fit-outs. In signing a retail lease, the tenant is

contracting to pay the agreed rent and the landlord agrees to provide access and 'quiet enjoyment' of the premises for the full term of the lease, subject to the specific details in the lease.

Retail tenancy leases are a form of business contract that have attracted specific legislative and regulatory arrangements. Retail tenancy legislation was first introduced in Queensland (1984), followed by Western Australia (1985), Victoria and South Australia (both in 1986) (table 1.1). Legislation in New South Wales came into force in 1994, after the perceived failure of a voluntary code of conduct, followed by the Australian Capital Territory in 2001. The Northern Territory is the most recent jurisdiction to introduce legislation (in 2003). Prior to the introduction of specific retail tenancy legislation, retail leases were treated under law as standard commercial leases, as occurs in other countries such as New Zealand and the United States.

Table 1.1 **Retail tenancy legislation by State**

State/Territory	*Legislation*	*Original date commenced*	*Number of amendments*[a]	*Date last amendment commenced*
New South Wales	*Retail Leases Act 1994*	1 August 1994	5	1 Jan 2006
Victoria	*Retail Tenancies Act 1986* replaced by the *Retail Leases Act 2003*	21 Sept 1987	7	23 Nov 2005
Queensland	*Retail Shop Leases Act 1984* replaced by the *Retail Shop Leases Act 1994*	12 March 1984	8	3 April 2006
South Australia[b]	*Retail and Commercial Leases Act 1995*	30 June 1995	3	6 Dec 2001
Western Australia	*Commercial Tenancy (Retail Shops) Agreements Act 1985* incorporating the *Retail Shops and Fair Trading Legislation Amendment Act (2006)*	1 Sept 1985	3	11 May 2007
Tasmania	*Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998*	1 Sept 1998	1	–
Australian Capital Territory	*Leases (Commercial and Retail) Act 2001*	1 July 2002	..	–
Northern Territory	*Business Tenancies (Fair Dealings) Act 2003*	1 July 2004	..	–

a Includes either direct amendment acts or replacement acts, but excludes trading hour amendments. **b** South Australia introduced a commercial tenancy component to its *Landlord and Tenant Act 1936* in 1986.

The intention of specific retail tenancy regulation was to address perceived imbalances in bargaining power between shopping centre landlords and small retail

tenants. With the emergence of shopping centres as a preferred format of retail activity, concerns over this imbalance heightened. For example, the second reading of the Queensland *Retail Shop Leases Act Amendment Bill 1985* (a year after the original was introduced) spoke of 'unacceptable power vested in the landlord'. Similarly, the stated objective of the New South Wales *Retail Leases Act 1994* was to 'provide protection for small and medium size retailers operating in shopping centres' (Independent Pricing and Regulatory Tribunal 2006, p. 241).

In most States and Territories, retail tenancy regulation includes dispute resolution processes. These generally enable disputes between landlords and tenants to be referred to mediation or conciliation before proceeding (if unresolved) to a tribunal or court.

While the Australian Government has no retail tenancy legislation, the *Trade Practices Act 1974* (TPA) contains provisions relevant to retail tenancy arrangements. Part IVA of the TPA contains laws prohibiting unconscionable conduct, including unconscionable conduct in business transactions (section 51AC). Part IVB enables the establishment of industry codes and prohibits the contravention of any applicable industry code.

To date, numerous reviews at both the State and Commonwealth level have sought to alter the legislation in response to stakeholder concerns. For example, the House of Representatives' Standing Committee on Industry, Science and Resources (SCISR 1997) report *Finding a Balance: Towards Fair Trading in Australia* (the 'Reid Committee' report — box 1.1) led to the introduction of 'unconscionable conduct' in the TPA after findings that small businesses were often disadvantaged in their dealings with big businesses. Subsequently, States and Territories have drawn-down the unconscionable conduct provisions of the TPA (or similar provisions) into their respective legislation.

At the State and Territory level, there have been a total of 27 amendments (including replacement Acts) since the legislation was first introduced (see table 1.1). Some amendments arose from reviews which were conducted in response to mandatory sunset and review provisions. Others were driven by stakeholder concerns that the legislation did not adequately deal with the imbalances in negotiating power in the retail tenancy market. There has been a presumption that increasingly complex and prescriptive regulation could effectively and appropriately deal with such concerns.

These reviews and initiatives were accompanied by numerous changes to the retail tenancy Acts themselves. In New South Wales, for example, along with five direct changes to the *Retail Leases Act 1994* since 1996, a further 11 changes were brought about by the establishment of other pieces of legislation.

Box 1.1 **The Reid Committee report**

In May 1997, the House of Representatives' Standing Committee on Industry, Science and Resources released a report on fair trading in Australia called *Finding a Balance: Towards Fair Trading in Australia*. The report examined:

- business conduct issues arising out of commercial dealings between firms including, but not limited to, franchising and retail tenancy; and
- the economic and social implications of major business conduct issues particularly whether certain commercial practices might lead to sub-optimal economic outcomes.

The committee was also asked to examine whether the issues identified warranted intervention and to suggest options if intervention was found to be justified.

In total, 30 recommendations for change were put forward by the committee, including 12 specifically relating to the market for retail tenancies.

The legislative changes have led to increasingly complex and prescriptive legislation. However, concerns continue to be expressed about the adequacy and extent of the current legislative and regulatory arrangements. For example, the Franchise Council of Australia (FCA) stated that:

> … monopolies like shopping centres operate with inordinate power knowing the turnover of all tenants and thus knowing what a retailer can afford to pay. They use this knowledge to manipulate the market. (FCA 2007, p. 1)

The Council of Small Business of Australia (COSBOA) added concerns over the 'fairness' of the market:

> It is important that market power is not used unconscionably in retail leasing negotiations. The best result would be a fair and more efficient market place for retail tenants and their customers. (COSBOA 2007, p. 1)

Similarly, the Australian National Retailers Association (ANRA) said:

> … it is not just small businesses facing challenges when entering into commercial leases. ANRA's members, many of whom are considered 'anchor tenants', are also experiencing ongoing difficulties when entering into or renegotiating retail tenancy agreements … In the current environment, retail tenants are forced to accept leases with a range of charges, terms and conditions without being able to assess their impact upon their businesses. Competition and opportunities to negotiate on a level platform do not exist. (submission no. 92, p. 3)

The Shopping Centre Council of Australia (SCCA) raised different concerns over the heightened level of retail tenancy legislation in Australia, stating:

> As a result of this intervention the market for retail tenancy leases in Australia is now heavily regulated. We are unaware of any other country in the world with such a highly

> regulated retail tenancy market. In all States and Territories there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease. (submission no. 83, p. 7)

Allegations about excessive red tape were expressed by smaller landlords. For example, one small landlord stated:

> The NSW Government 2006 legislation for retail leases, whilst being drawn up with good intentions, is excessive in its rulings and counter productive. We are led to believe that governments want to minimise red tape, yet I find that with this legislation, the opposite occurs. (confidential submission)

When announcing the inquiry, the Australian Government Minister for Small Business and Tourism and the Treasurer at the time highlighted issues of bargaining power and consistency of legislation in explaining the motivation behind the call for the inquiry:

> Small business tenants are telling me that they are worried about the difficulties they face when presented with commercial leases over which they feel they have little or no control.…Other concerns include the range of disparate retail tenancy laws between states and territories… (Bailey 2007, p.1)

In assessing these concerns, consideration should be given to whether there are constraints on the efficient operation of the market and what possible changes by industry and government may be pursued to address them.

The Commission has been asked to make recommendations to improve the operation of the retail tenancy market.

1.2 Recognising constraints on economic efficiency in retail tenancy

It is apparent from evidence tendered to this inquiry that major shopping centre owners, in particular, have strong negotiating power (and hence influence over contract terms) in their dealings with retail tenants, particularly the small and/or inexperienced. However, the existence of a strong negotiating position by some market participants, does not itself provide evidence of inefficiency in the operation of the retail tenancy market (see box 1.2 for details on efficient markets).

It also needs to be recognised that the market for retail tenancies extends to a much broader set of tenant-landlord relations than those that occur in shopping centres (such as those that occur on shopping strips and commercial tenancies more generally). Thus, retail tenancy regulation must be evaluated in this broader context.

Box 1.2 **When are markets efficient?**

The 'market' is the term used to describe the mechanism that allocates resources between competing uses. Given competing uses for resources, a number of combinations of use exist that generate a range of different payoffs. An efficient market is one which allocates these resources so that the community receives the highest possible net return.

To arrive at an efficient outcome, firms within the market must make the best use of available labour, financial and other resources. That is, the least amount of resources are used to produce the greatest amount of goods and services possible in accordance with economically-feasible technological and management standards. Also, firms in an efficient market will have a strong incentive to maintain, and improve on, the best possible use of resources over time.

More generally, it needs to be recognised that considerable differences in negotiating power are not a unique feature of the retail tenancy market. Such imbalances are common in many other markets, with firms large and small, and with a range of negotiating power, trading efficiently without industry-specific regulation prescribing the terms of their relationship. Accordingly, it is not readily evident that differences in size or negotiating power constrain the efficient operation of the retail tenancy market, or indeed of other markets.

It is therefore important to look beyond firm size and negotiating power to assess efficient market operation. This should encompass factors which might arise from market or regulatory failure.

In the case of the retail tenancy market, constraints to the economically efficient operation of the retail tenancy market could possibly stem from:

- unjustified restrictions on the supply of retail space;
- asymmetries in information available to the parties to a lease;
- differences in the capacity or motivation of market participants to analyse available information or seek advice;
- 'rigidities' in legislation and the market that lead to terms and conditions in retail leases that systematically and substantially favour one party over another or that create undue complexity and compliance costs;
- inconsistencies between legislation in different jurisdictions adding to compliance costs for business; and
- impediments to the cost-effective resolution of disputes.

It needs to be established that such potential impediments to the efficient operation of the market create actual inefficiencies, and that these can be corrected. Information gaps, for example, can be a significant constraint to efficient market operation (one party to a transaction may have greater knowledge than the other), but this is a common feature in markets and such information gaps will not necessarily be corrected by government intervention.

It is also important to note that evidence of impediments to efficient market operation, does not necessarily imply market failure or a need for government intervention. For government intervention to be justified, it must be established that the net benefit of government action is positive. That is, the benefit from government action, less the regulatory and compliance costs incurred to achieve that benefit, is larger than the cost to the community of the original perceived market failure.

This latter assessment needs to take account of possible 'perverse' outcomes from unwarranted or poorly designed interventions by well intentioned governments. For example, there could be a 'moral hazard' if small tenants were led to believe the government would protect their business, and this, in turn, resulted in parties being less cautious and diligent about their contracts than otherwise.

1.3 Relation to other inquiries

The inquiry into the market for retail tenancies has links with the Commission's current inquiry into Australia's consumer policy framework (PC 2007). For example, both inquiries explore the notion of unconscionable conduct that exists within the TPA to protect business (in this case, those with retail tenancies) and consumers (the focus of the consumer policy framework inquiry) from unconscionable behaviour.

This inquiry examines the market for retail tenancies and investigates, amongst other things, unconscionable conduct provisions and how these specifically relate to the interactions of businesses with other businesses. The case for change and the relative costs and benefits may well differ from those proposed in regard to reforming Australia's consumer policy framework, where the focus is on the interactions not just between businesses, but between businesses and consumers.

The findings of the retail tenancy inquiry will also provide input into the Commission's annual review of regulatory burdens on business which, in 2008, will focus on manufacturing and distributive trades (PC 2008).

1.4 Study procedures

The Commission received the terms of reference for this inquiry on 21 June 2007 and issued a circular on 29 June 2007 detailing the terms of reference and information sought from industry participants. A draft report was released in December 2007 to allow interested parties to comment on the Commission's preliminary analysis and findings. Public hearings were subsequently held in Canberra (4 participants), Sydney (17 participants), Brisbane (5 participants), Melbourne (14 participants), Perth (7 participants) and Adelaide (3 participants) during February 2008. The names of participants are listed in appendix A. This final report takes into consideration the views expressed at those hearings and those expressed in submissions received before and after the draft report.

In total, 211 submissions were received, including 69 in response to the draft report. Of these submissions, 75 were received from tenants (mainly operating from shopping centres), 57 were from organisations representing tenants, 20 were from owners/operators of large shopping centres and their representatives, and 3 were received from small landlords, with the remainder contributed by government agencies, real estate agencies and other interested parties (appendix A).

In preparing this report, the Commission also conducted visits to stakeholders across Australia and undertook relevant research. Apart from meeting with many individual traders and centre managers, the Commission consulted with: government agencies including the Australian Government's Office for Small Business, the Treasury, and the Australian Competition and Consumer Commission, State and Territory registrars and administering agencies; key industry/professional groups across jurisdictions; and academics specialising in small business and retail tenancy matters. Visits covered each jurisdiction, except Tasmania and the Northern Territory, for which telephone hook ups with relevant authorities were conducted in the course of the inquiry (appendix A).

Further, the Commission is grateful to the tenants and landlords who generously related their experiences and provided their perspective of the market and its operation. The Commission became acutely aware of the commitment required to be a successful retailer, the stiff competition for the consumer dollar and the commercial risk faced in retailing. The Commission heard that there are many traps for both new and more experienced participants in the sector, and that downsides can be financially and personally devastating.

1.5 Structure of the report

The remainder of this report is structured as follows. Chapter 2 provides an overview of the key characteristics and changes that have occurred in the retail tenancy market over recent decades. Chapters 3 and 4 explore the evolution of the current legislative and regulatory framework and the reasons for its development and the dispute resolution processes used by each jurisdiction, respectively. Principles for evaluating legislation and regulation in the retail tenancy market are developed in chapter 5. Participants' views about the operation of the retail tenancy market, supporting evidence and possibilities for change as suggested in the submissions to this inquiry are presented in chapters 6 to 9, while chapter 10 presents some alternative approaches considered by the Commission. Chapter 11 details the Commission's recommendations for improving the operation of the retail tenancy market.

2 Market for retail tenancy leases

This chapter examines the scope and nature of the retail tenancy market to provide some context for the assessment of potential constraints on the efficient operation of the market and possibilities for change.

Section 2.1 discusses the range of premises and businesses that are included in the market in relation to the type of goods and services retailed, and the size, experience and resources of market participants. Section 2.2 considers the availability and use of retail space for different types of premises. Ownership and management of retail space and the businesses that use the space are also discussed. Finally, section 2.3 reports on how these differences relate to current vacancy rates and the ability of businesses to enter or leave different parts of the retail tenancy market.

2.1 Scope of the market

Businesses operating from retail premises

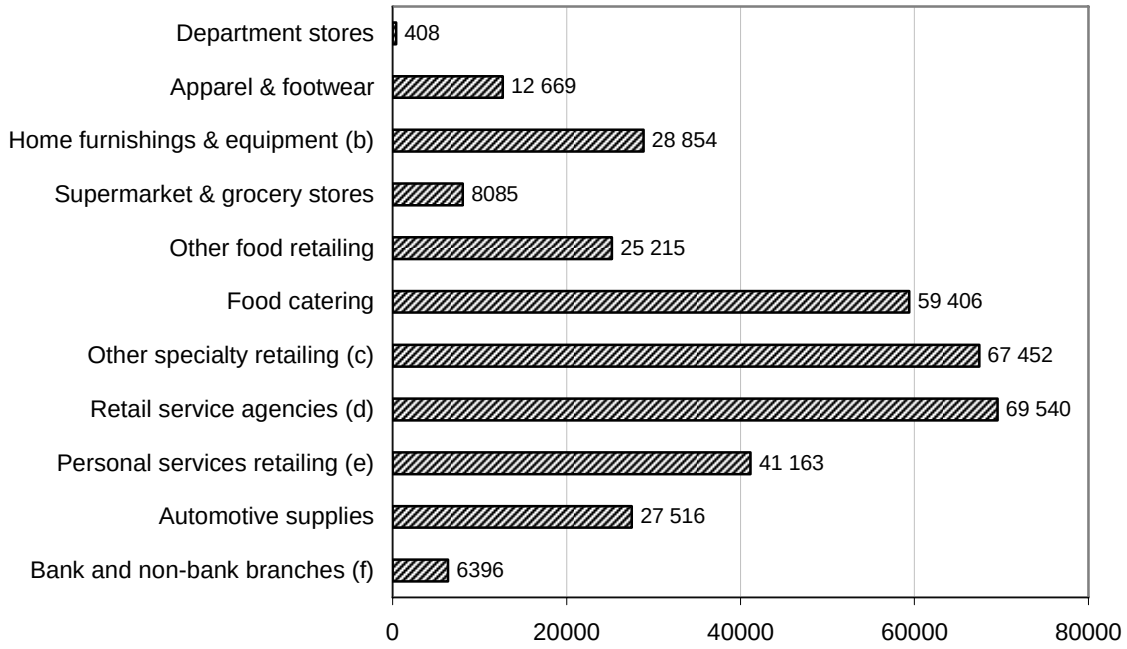
The market for retail tenancies exists to provide space for the provision of all manner of final goods and services in a retail format to the general public, including individual household and business customers.[1] Retail space may be owned by the retailer, but usually is provided by landlords in many formats including stand-alone premises, neighbourhood shops and large shopping centres.

There may be up to 350 000 businesses currently operating from retail premises including department stores, supermarkets, specialty retailers, retail service providers, and branches of banks and non-bank financial institutions (figure 2.1). The most prevalent activities of businesses operating from retail space are food catering (such as cafes and restaurants), 'other' specialties (such as recorded music, leisure products and books and stationery) and retail service establishments (such as

[1] The concept of 'retail' used here is broader than the concept of 'retail trade' adopted by the Australian Bureau of Statistics (ABS). The ABS (2006) defines retail trade to cover the provision of *goods* without 'significant transformation' to the general public. The broader concept adopted in this inquiry focuses on retail space used in the provision of *goods and services* to the general public in a retail format (such as a shop or store) and encompasses both traditional 'retailers' and also 'non-retailers' who operate from retail space.

travel agents, post offices and real estate agents). Together these three groups account for over half of all businesses operating from retail space.

Figure 2.1 **Businesses using retail space in Australia, June 2006**
Number[a]



a A business is defined by the ABS to include both entities that are registered as an Australian Business Unit and larger more complex entities that the ABS defines as a 'business' on the basis of their 'type of activitiy'. Because businesses may operate from more than one location (that is 'establishments') they may have more than one retail tenancy. **b** Includes fabric and soft good retailing, furniture, floor coverings, domestic hardware and houseware and domestic appliance retailing. **c** Includes retailing of recorded music, leisure products, books and stationery, photographic equipment, marine equipment, pharmaceutical and cosmetics, antiques and used goods, garden equipment, flowers, jewellery, retailing nec. and household equipment repairs. **d** Includes agencies for travel, post, telecommunication, real estate and insurance. **e** Includes optometry and optical dispensing, lotteries, video hire outlets, personal and household goods hiring, laundries and drycleaners, film processing, hairdressing and beauty salons, and personal services nec. **f** Refers to the number of branches, as reported by the Reserve Bank of Australia, rather than the number of businesses published by the ABS.

Sources: ABS (*Counts of Australian businesses, including entries and exits, June 2003 to June 2006*, Cat. no. 8165.0, Canberra); Reserve Bank of Australia (2007).

Of the businesses that use retail space, a proportion own the premises from which they operate and therefore do not have a lease. For other businesses, the size, location and its ownership structure (such as a public company) will determine whether they are required to enter into a lease that is regulated by relevant State or Territory retail tenancy legislation or enter into a commercial lease (Minter Ellison 2006). For example, leases of some larger furniture stores and hardware stores may not be within the jurisdiction of retail tenancy legislation because the floor area exceeds a legislated cut-off size (typically 1000 square metres). Similarly, a branch of a bank can be required to have a retail tenancy lease if located in a shopping centre, but a commercial lease if located elsewhere.

There are estimated to be around 290 000 retail tenancy leases in Australia (table 2.1), with an estimated 58 000 new (or renegotiated) leases each year. Just under 20 per cent of leases are for retail space located within shopping centres (box 2.1).

Table 2.1 **Estimated number of leases by State, 2006-07**

Jurisdiction	*Number of leases under tenancy regulation*
	'000
New South Wales	97
Victoria	72
Queensland	52
South Australia	20
Western Australia	35
Tasmania	6
Northern Territory	3
Australian Capital Territory	6
Australia	**290**

Source: Productivity Commission estimates, see box 2.1.

FINDING

There are an estimated 290 000 retail tenancy leases in Australia. Just under 20 per cent of these are for businesses located within shopping centres.

Box 2.1 **Estimating the number of leases for retail space**

There are no consistent statistics on the number of leases for retail space across Australia. However, the number of businesses using retail space in Australia (350 000) potentially stands as an upper limit to the number of leases. Some of these businesses are owner-occupiers and therefore do not have leases. Further, a subset of these will be larger businesses that may have a commercial rather than retail lease.

Some information is available on leases held by smaller businesses that use retail space. In Victoria, leases for retail space under the *Retail Leases Act 2003* are required to be notified to the Office of the Victorian Small Business Commissioner when the lease is established or renewed. In recent years, the number of notified leases has been around 14 500 each year. Assuming an average lease term of five years, this suggests that there are around 72 500 leases regulated under retail tenancy legislation in Victoria. Given that Victoria's share of the Australian economy (as measured by gross state product) was around 25 per cent in 2006-07, and extrapolating to a national basis, this suggests there could be close to 290 000 leases regulated by retail tenancy legislation across Australia. The number of leases under retail tenancy legislation in other jurisdictions can be similarly estimated from each State's share of the national economy.

Based on figure 2.1, about 192 000 of the 290 000 leases across Australia would be held by firms retailing goods and 98 000 by firms providing retail services. This is broadly consistent with the estimate of the Shopping Centre Council of Australia of around 180 000 to 200 000 'retailers' with retail leases (submission no. 83, p. 10).

Almost 60 000 businesses (or just under 20 per cent) that use retail space are estimated to be located within shopping centres, as defined by the Property Council of Australia (PCA). The remainder are located in retail strips and stand-alone retail premises such as bulky good sites and direct factory outlet sites. This is consistent with the Shopping Centre Council of Australia estimate that shopping centres make up only 19 per cent of all retail locations (submission no. 83, p. 10).

Based on the Victorian small business numbers and extrapolating nationally, the number of new leases negotiated each year is estimated to be around 58 000.

Sources: Office of the Victorian Small Business Commissioner (2007); ABS (*Australian National Accounts: State Accounts*, Cat. no. 5220.0, Canberra); Productivity Commission estimates.

Participants in the retail tenancy market

Businesses participating in the retail tenancy market are diverse in terms of size, experience and resources. Ownership and management of both lessors and lessees can span sole ownership by an individual with minimal education and experience, to small syndicates of informed professionals, to large multinational corporations with extensive experience and resources. The interaction of businesses in the market for retail tenancies is illustrated in box 2.2.

While relative size is often the focus of perceived concerns in the relationship between landlord and tenants in the retail tenancy market, there are many other influences including business experience and acumen, information and understanding, due diligence on their own behalf and the use of specialist advice. In addition to these influences, the relationship is influenced by general market conditions including the level of consumer demand and consumer preferences for particular products and shopping formats, and the supply, format and location of available space.

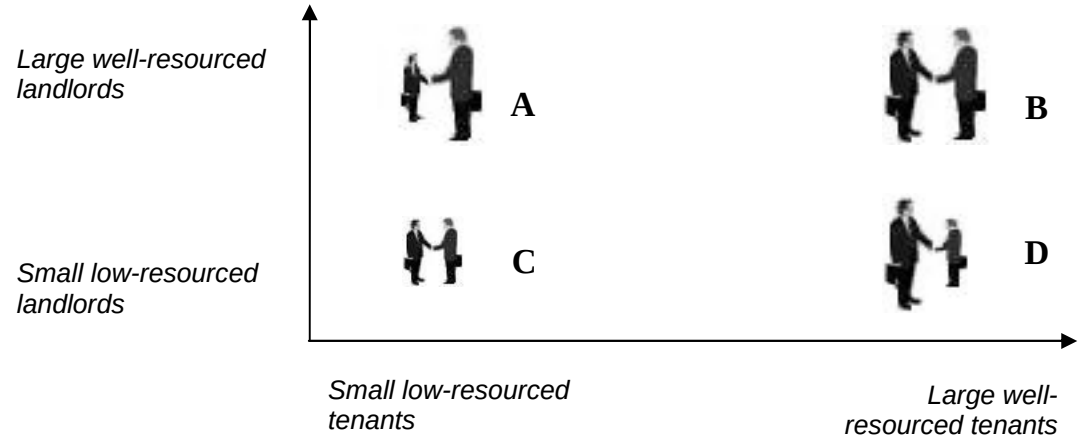
Changes in retail formats

The market for retail tenancies is complex and dynamic (box 2.3). The traditional form of retailing based on retail strips or high street shopping has gradually moved towards greater concentrations of shopping under single ownership (as in supermarkets and departments stores) and single management (as in shopping centres). The grouping of small retailers within shopping centres with a single and often 'large' landlord has become more commonplace since the 1950s and 1960s. Nevertheless, while this concentration has been occurring in one part of the market, other shopping formats (such as 'bulky good', 'direct factory outlet' and internet shopping) have also emerged.

FINDING

The retail tenancy market comprises a wide range of businesses that vary in terms of the format of retail space provided, goods or services retailed, their size, experience and resources.

Box 2.2 **Interaction of businesses in the retail tenancy market**



- Case A represents relatively 'small' tenants operating in a competitive/atomistic market, located in retail premises operated by a 'large' landlord. While the individual tenant may have virtually no influence on the shopping environment or the way it is managed, the tenant can choose whether or not to pursue such a tenancy under the conditions offered. Tenants can also inform themselves of the implications of a lease through their own business acumen, information and understanding and due diligence, and through specialist advice. Some tenants may have trading skills or product lines highly sought after by centre managers and therefore may have some strength in negotiations with a landlord.
- Case B represents large tenants interacting with large, well-resourced landlords. Both have the means and experience to look after their own interests.
- Case C represents small low-resourced landlords interacting with small low-resourced tenants. Each is on a roughly equal footing in terms of size, although both groups may need to seek advice on the implications of lease obligations, complex legislation and documentation. The negotiating position of each will also be influenced by market conditions and the business acumen and knowledge of individual traders.
- Case D represents large tenants interacting with relatively small landlords. This situation may occur, for example, in smaller centres or in country areas, but is not very common because of the substantial investment required to provide retail space for larger tenants. The landlord's negotiating position will be heavily influenced by market conditions and the attractiveness of the property on offer relative to other available retail space.

Although there are invariably some tensions in situations B, C and D, it is the perceived bargaining imbalance in case A that has formed the basis for government intervention in the retail tenancy market. Indeed, most retail tenancy legislation has been introduced to deal with case A, though it also applies to case C which is, in fact, much more common. Cases B and D, with large tenants are generally excluded in the coverage of tenancy legislation, on the basis of either floor space used or turnover.

Box 2.3 **The changing face of retailing**

The traditional layout of retail space in many countries, including Australia, has been town centres with streets lined with retailers. In such a setting, there are potentially many owners of retail space and a large number of tenants. In Australia, a trend from this so-called 'shopping strip' or 'high street' arrangement to arcades and department stores began in the late nineteenth century. This was facilitated by the supply of adjacent retail space with the same owner and the capacity to construct larger stores.

'Chain stores', characterised by a single owner (often a corporation) with a number of similar stores in separate locations or markets, emerged gradually in the early 1900s, and proliferated from the 1950s with an expansion of shopping into suburbs and regional centres. 'Shopping centres' offering retailing and public facilities in an enclosed space with car parking, emerged in the 1950s and 1960s with urban expansion, increased use of cars, and consumer demands for 'one-stop' shopping in a comfortable and accessible environment. Scarcity of city-centre land and the increased scope that shopping centres (often multi-storey) provide to co-locate a large number and variety of retail outlets, gave further impetus to the growth in shopping centres. With this expansion, tenancy models of a single landlord with many tenants became more commonplace.

Nevertheless, other retail store-based formats have also experienced substantial growth, including: 'direct factory' outlets which spread in popularity and number during the 1970s and 1980s; 'bulky good' outlets which have enjoyed rapid growth in recent times; outdoor coffee/food retailing in shopping strips, promenades and other locations; boutique/trendy clothes stores in high profile shopping strips; and convenience stores (often in association with petrol retailing).

There has also been a growth in non-store formats such as street markets and electronic retailing. Shopping centres and department stores have responded to this growth by including speciality areas within their centres and stores and, in some cases, offering internet purchasing.

Despite very strong growth in non-store retailing in recent years (off a small base), store-based retailing remains overwhelmingly the dominant form of retailing. For example, store-based retail sales represented an estimated 96.5 per cent of total retail sales of merchandised goods in Australia in 2005.

Sources: Kingston (1994); DEH (2001); Euromonitor International (2006); submission no. 112, p. 5.

2.2 Provision and use of retail space

In 2005-06, it is estimated that there were around 45 million square metres of retail space in Australia, up from an estimated 33 million square metres in 1991-92 (figure 2.2). The Shopping Centre Council of Australia (SCCA) estimated that a further 1.1 million square metres of retail space was under construction around

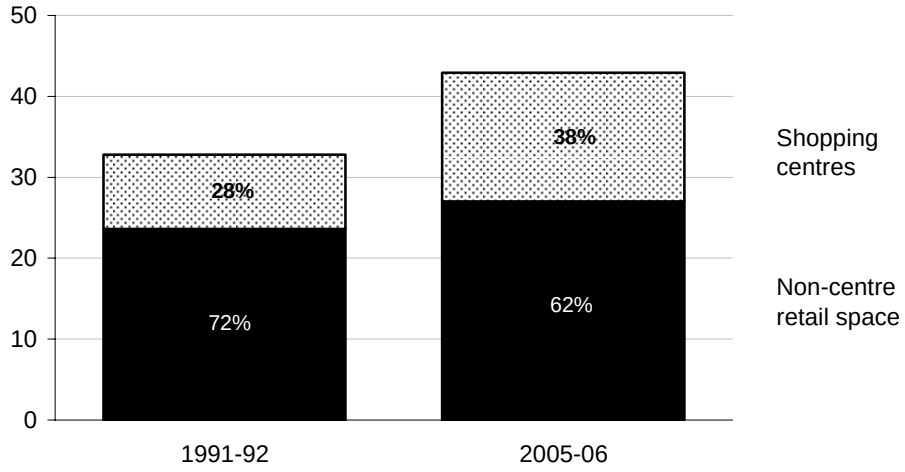
Australia in early 2007 (submission no. 83, p. 51). Most retail space is located outside of shopping centres in retail strips or, increasingly, in stand-alone premises such as 'bulky goods' sites and 'direct factory outlets'. The Bulky Goods Retailers Association submitted that the increase in floor space of Australia's key bulky goods retailers over the period from 2004 to 2007, exceeds that typically contained in five regional shopping centres (submission no. 126). Jones Lang LaSalle (2005) similarly estimated that bulky goods was likely to account for about 40 per cent of new retail space supply in 2005-06.

Reflecting above average growth in shopping centres as a major retail format, the contribution of shopping centres to total retail space increased from 28 per cent in the early 1990s to 38 per cent in 2005-06. Shopping centres also accounted for around 40 per cent of the value of all sales by retail businesses in 2005-06 (submission no. 83, p. 2). However, not all of these retail sales or retail space relate to businesses with retail leases — as discussed in section 2.1, many businesses in centres operate with a commercial lease and are not covered by the retail tenancy legislation. Nevertheless, the majority of submissions received in this inquiry relate to shopping centre tenancies.

FINDING

While most retailing occurs outside of shopping centres, centres nevertheless represent a growing share of the total market. Within the non-centre retail market, stand-alone bulky goods sites and direct factory outlets are increasing in importance relative to retail strips.

Figure 2.2 **Retail space in Australia, 1991-92 and 2005-06**
Per cent of total retail space provided



Sources: Submission no. 83, p. 13; PCA (2006).

Shopping centres

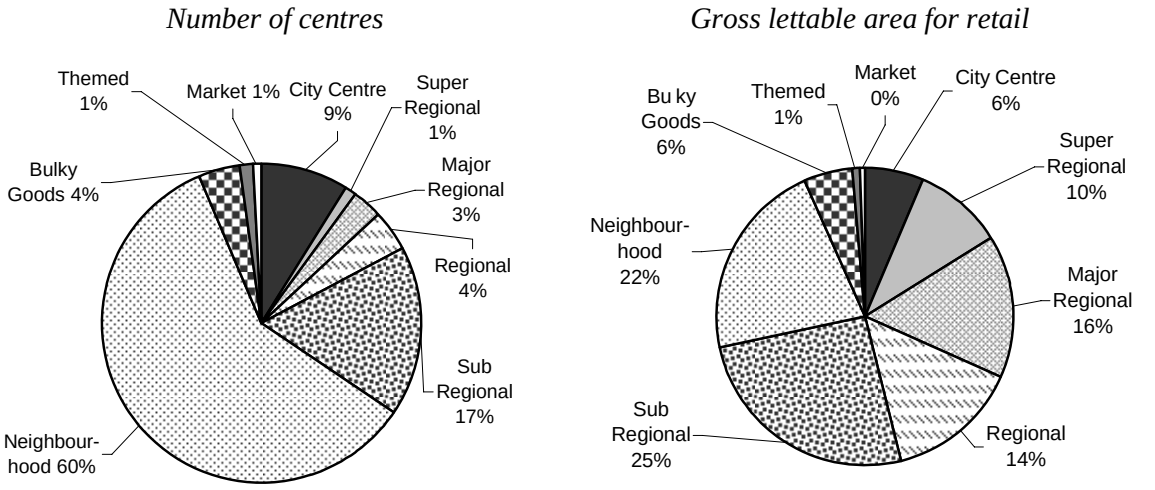
A broad perspective

Australia currently has some 1360 shopping centres, with around 16 million square metres of retail floor space operating in various types of centres (box 2.4).

While over half of Australia's shopping centres (60 per cent) are neighbourhood centres, they account for less than one quarter of retail space (figure 2.3). On the other hand, regional shopping centres (including regional and super, major and sub regional centres), account for one quarter of the number of centres, but provide 65 per cent of retail space in shopping centres or 25 per cent of all retail space. The largest shopping centres — super regional centres — while accounting for only 1 per cent of the number of centres, contribute 10 per cent of shopping centre lettable space — 4 per cent of all retail space.

The mix of centres offering retail space has varied over time. Urbis JHD (2007a) observed that, over the past decade, regional centres have declined in terms of their share of retail centre floor space while sub-regional centres and supermarket based centres have expanded. The SCCA submitted that this is likely to be due to several factors (submission no. 83). First, with the construction of new centres largely limited to those regional areas that have rapidly expanding populations, existing sub-regional and neighbourhood centres have been refurbished and extended. Second, the number of available anchor tenants in Australia is relatively low, restricting opportunities for the establishment of new shopping centres, as currently conceived.

Figure 2.3 **Predominance of types of shopping centres in Australia, 2006**



Source: PCA (2006).

Box 2.4 What is a shopping centre?

A shopping centre is a retail concentration in an enclosed space with some common public facilities. Shopping centres are differentiated according to the physical size of the retail concentration and the number and type of tenants. The following types of shopping centres are defined by the PCA (2006):

City Centre: an arcade or mall development, owned by one company, firm or person and promoted as an entity within a major Central Business District (CBD). Total retail gross lettable area (GLA) exceeds 1000 square metres and the centre is typically dominated by specialty shops and has a frontage onto a mall or major road.

Super regional centre: a major shopping centre aimed at one-stop shopping for all needs. Total retail GLA exceeds 85 000 square metres and the centre typically includes several comprehensive department stores, supermarkets, and around 250 specialty shops, in addition to a range of entertainment and leisure attractions.

Major regional centre: a major shopping centre incorporating at least one comprehensive department store, several discount department stores and supermarkets and around 150 specialty shops, in addition to some entertainment and leisure attractions. Total retail GLA generally ranges from 50 000 to 85 000 square metres.

Regional centre: a retail centre with an extensive coverage of retail needs. Total retail GLA generally ranges from 30 000 to 50 000 square metres and the centre typically includes a comprehensive department store, discount department store, supermarket and at least 100 specialty shops.

Subregional centre: a shopping centre that is typically dominated by at least one discount department store or major supermarket, but also includes 40 or more specialty shops. Total retail GLA is typically 10 000 to 30 000 square metres.

Neighbourhood centre: a local shopping centre comprising a supermarket and up to 35 specialty shops. These centres are typically located in residential areas and cater for basic day-to-day retail needs. Total retail GLA is usually less than 10 000 square metres.

Bulky goods centre: a medium to large shopping centre that is dominated by bulky goods retailers (furniture, white goods and other homewares), but may contain a small number of specialty shops. These centres are typically purpose-built and are located adjacent to large regional centres or in non-traditional retail locations.

Themed centre: a specialty shopping centre, located primarily in resort areas to cater for tourist needs.

Market: a covered centre of at least 5000 square metres dominated by food retailing with at least 50 stalls or outlets. It may operate on a permanent or irregular basis.

Outlet centre: a medium to large sized shopping centre which generally comprises specialty shops selling stock at discounted prices.

Source: PCA (2006).

Regional differences

As well as being variable over time, there are marked differences in the mix of shopping centres providing retail space across jurisdictions (figure 2.4). For example, in States and Territories with less concentrated populations, most retail space is located in neighbourhood shopping centres. On the other hand, the relative importance of super regional, major and regional centres tends to be greatest in the more populous jurisdictions — New South Wales, Victoria and Queensland — and in the Australian Capital Territory.

Ownership and management of retail space

Who owns retail space in the strips and other non-centre locations?

The ownership of retail space in shopping strips, stand-alone bulky goods stores, direct factory outlets and other non-centre formats is widely dispersed and involves firms of all sizes and levels of skill, from small family investor/operators to large corporations. With respect to retail shopping strips, the National Retail Association note that:

> … the majority of retail premises in Australia are in 'main street' locations, with widely dispersed property ownerships, and generally substantially lower sales and rentals. (submission no. 47, p. 6)

The relationship between landlord and tenant in these cases may be defined more by local market conditions and expectations than by the relative size, resources or experience of either party. There is often a large number of landlords competing for tenants within a given area.

Figure 2.4 **Retail space by type of shopping centre and jurisdiction, 2006**
Proportion of total gross lettable area for retail

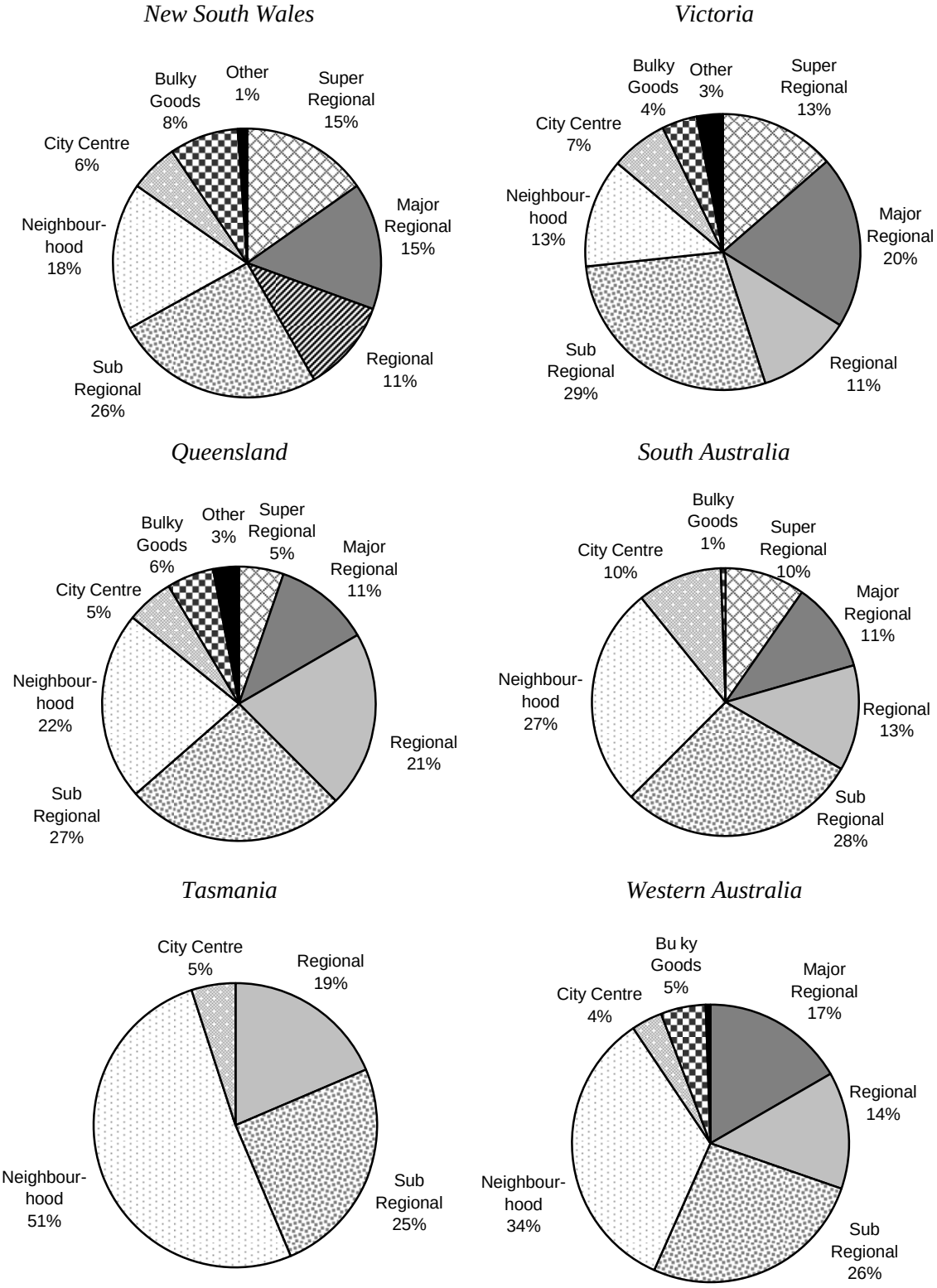


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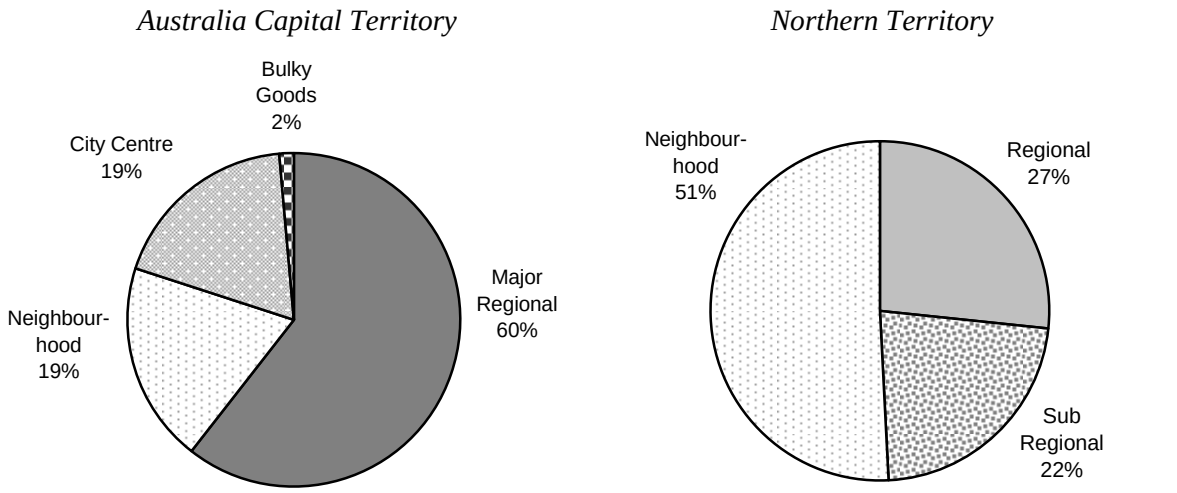
Table 2.4 **(continued)**



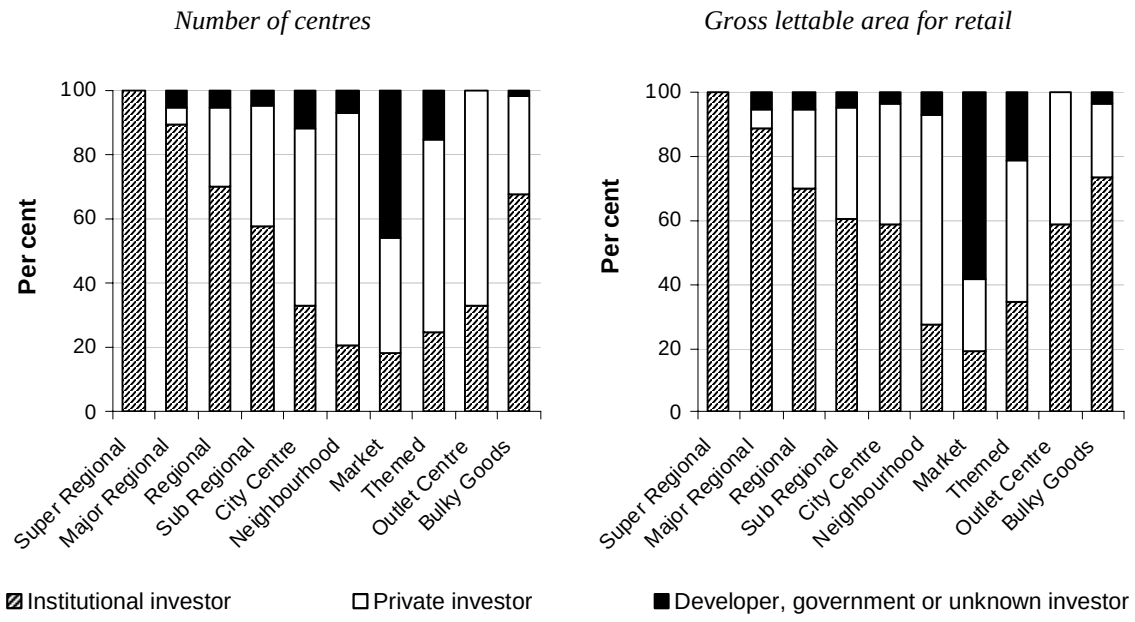
Source: PCA (2006).

Who owns the shopping centres?

The ownership structure of Australia's shopping centres is complex. The SCCA estimates that there are in excess of 500 separate owners of shopping centres around Australia (submission no. 83, p. 11). An estimated 63 per cent of all retail space in centres is owned by institutional or company investors, 31 per cent by private investors/owner occupiers, with the remainder owned by other parties, including developers and governments.

The prevalence of institutional and company investors as landlords for retail tenants is much higher in larger shopping centres — the super and major regional centres and the bulky goods and outlet centres (figure 2.2). Ownership of the larger aggregations of retail space is concentrated in the hands of a small number of large companies or investment funds. For example, 6 companies/funds own 85 per cent of the retail space in Australia's 15 super-regional centres. In this context, the Westfield Group is the largest shopping centre owner in Australia, with a financial interest in 44 centres, covering over 3.3 million square metres of leasable area and almost 10 000 retail outlets in 2006 (submission no. 85, p. 4).

Figure 2.5 **Shopping centre owners by type of centre, 2006**



Source: PCA (2006).

In contrast, the neighbourhood, city centre and themed centres are more likely to be owned by private investors, while the market centres are largely owned by developers, government or other investors. Each of the 31 market and themed shopping centres in Australia has a different owner.

On another level, the 'owners' of many of Australia's shopping centres (particularly the larger centres) can be considered to be the millions of individuals who indirectly invest in shopping centres via numerous trusts and funds, or own shares in public companies that directly invest in centres. The predominance of property trusts and funds as owners of retail space has expanded in recent years with the growth in superannuation funds. This has financial benefits for centres in terms of an increased capacity to raise capital for centre expansion and redevelopment (box 2.1). As a consequence, many companies now own shopping centres via funds and trusts rather than through more direct ownership arrangements. For example, unlisted and listed property trusts purchased over two-thirds of all retail properties sold in 2006 (SCCA 2007). One of Australia's largest wholesale funds managers is Queensland Investment Corporation (QIC), with ten Australian superannuation funds (representing 4.2 million individual investors) investing in its 'Property' or 'Shopping Centre Funds' (submission no. 46, p. 1). Similarly, Westfield point out that it has 131 000 security holders — 75 per cent of whom are institutional investors, with the remaining 25 per cent comprising individuals, companies or privately managed superannuation funds (submission no. 85, p. 4).

Box 2.5 **Investment in shopping centres**

With opportunities to construct new shopping centres largely confined to new growth areas and land releases, most additions to retail supply in recent years have been in the form of extensions and refurbishments to existing centres. Frank Knight observed:

> Refurbishment and reconfiguration together with active management continues to be a crucial requirement for owners of secondary centres wishing to remain competitive. (submission no. 79, p. 10)

The SCCA reports that, at any given time, the equivalent of up to 10 per cent of a property's value could be expended annually on maintenance or upgrades (SCCA 2003). Indeed, the larger shopping centre owners report continuing expansion and redevelopment of their centres. GPT Group reports current and planned developments of $1.5 billion (compared with a retail portfolio in Australia of $3.5 billion at the end of 2006) (GPT 2006). Similarly, Centro Properties Group completed developments of $426 million in 2006 and has a further $362 million of developments that are either underway or have received board approval (Centro 2006). The total value of the Centro retail investment portfolio in Australia was $3.1 billion at the end of 2006. Further, the Coles Group invests over $400 million each year in new and replacement stores, refurbishments and shopping centre acquisitions and developments (submission no. 48).

The timing, nature and extent of investment in retail space may be affected by the scope for the centre owner to pass on redevelopment costs to tenants. Under State and Territory retail tenancy legislation, capital expenditure generally cannot be charged to tenants, but repairs and maintenance of existing structures and equipment can be. Additional costs associated with refurbishment that shopping centre owners incur include compensation payments to tenants who are either relocated or otherwise adversely affected during refurbishment.

Concentration of 'ownership' in shopping centres varies widely between jurisdictions. Tasmania, the Australian Capital Territory and the Northern Territory have the highest share of gross lettable area for retail space owned (and managed) by a single company (table 2.2). At most, around 30 per cent of centre retail space in a state is held by a single business — this level of concentration of ownership is not considered to be especially high.

It would be expected that in smaller regional communities which have less demand for, and supply of retail space, that ownership of that space could be highly concentrated. However, concentration of ownership of retail space within a localised region does not necessarily equate to market dominance in the control of retail space. A retail area with highly concentrated ownership may effectively be in competition with other providers of retail space if potential tenants are able to move to other sites and customers are willing and able to travel between retail locations.

There is some evidence that customers are willing to travel for some distance to undertake their shopping, expanding the potential for competition between retail locations. For example, around 80 per cent of households in Melbourne and the Australian Capital Territory travel up to 15 minutes (by any transport means) from their home in order to undertake their main household shopping for food and groceries (ABS 1994 and ABS 1997a). In regional Victoria and Tasmania, households generally travel for a slightly longer period to undertake household grocery shopping (ABS 1997b). Households may be willing to travel even further when shopping for large non-consumables or specialty items.

The potential for competition between providers of retail space within a region is evidenced by PCA data for two larger regional communities. In far north Queensland (around Cairns), the largest two shopping centre owners each have 22 per cent of total centre retail space, with the remaining 56 per cent of space distributed between 13 owners. In the Central Western region of New South Wales (around Dubbo and Bathurst), 63 per cent of centre retail space is distributed fairly evenly between five owners, with the remainder of centre space held by a further five owners.

The managers of retail space

Many retail tenants have little contact with the 'owner' of the premises — negotiations and practical operation of the lease are typically handled by a manager under delegation from the owner. This distinction between owner and manager introduces a crucial third party to retail tenancy operations.

The type of retail manager is typically aligned with the type of space leased. For example, space in a retail strip, if not managed by the owner/investor, is more likely to be managed by a local real estate firm than by a larger corporation. In contrast, shopping centres that are owned by large corporations or institutions tend to be either managed internally by a related entity, or else by separate specialist corporations or institutions engaged as managers. Available information indicates that the largest four managers of shopping centre retail space collectively manage 36 per cent of gross lettable space in centres across Australia (table 2.2).

Table 2.2 **Shopping centre owners and managers by jurisdiction, 2006**

Top 4 owners and managers, in terms of quantity of gross lettable retail space[a]

	Owners	*% total retail GLA*	*Managers*	*% total retail GLA*
New South Wales	Westfield group	18	Westfield group	21
	Centro group	7	Centro group	7
	AMP group	6	AMP group	7
	Stockland group	5	Stockland group	6
Victoria	Colonial group	16	Gandel Retail Management	16
	Centro group	13	Centro group	13
	Westfield group	9	Westfield group	11
	GPT group	9	GPT group	8
Queensland	Yu Feng Group	11	Retail First	12
	Westfield group	7	Gandel Retail Management	8
	Centro group	7	Centro Properties group	7
	Stockland group	6	Westfield group	6
South Australia	Colonial group	15	Westfield group	20
	Centro group	12	Savills	16
	Australian Prime Property Fund Retail	10	Gandel Retail Management	15
			Centro Properties group	12
	Westfield group	5		
Western Australia	Centro group	14	Savills	13
	Westfield group	10	Centro Properties group	11
	Perron Investments	4	Westfield group	8
	Macquarie	4	Jones Lang LaSalle	8
Tasmania	Centro group	30	Centro group	30
	Colonial group	19	Gandel Retail Management	19
	Northgate Property Syndicate	12	Jones Lang LaSalle	15
			Burgess Rawson	8
	Glenorchy Plaza	5		
Northern Territory	GPT group	27	GPT group	27
	Joondanna Investments	13	Joondanna Investments	13
	Jape Nominees	12	Jape Nominees	12
	Yeperenye	6	LJ Hooker Group	9
Australian Capital Territory	Westfield group	31	Westfield group	41
	Leda group	20	Leda group	20
	QIC group	18	QIC group	18
	Christodoulou	3	Savills	4
Australia	Westfield group	11	Westfield group	14
	Centro group	9	Centro group	9
	Colonial group	7	Gandel Retail Management	8
	GPT group	5	AMP group	5

[a] The GLA of retail space for centres that are jointly owned is allocated equally between owners. Owners and managers are grouped for presentation purposes on the basis of organisation name.

Source: PCA (2006).

With the growth in shopping centres as a major retail format over recent decades, there has been a fundamental shift in the way in which much of Australia's retail space is managed. In retail strips, there tends to be little intervention by the landlord's managers in the operation of the retail business utilising that space. In contrast, retail tenants in shopping centres (particularly specialty retail tenants in the larger centres) operate in a micro-managed environment. For these tenants, not only is the provision of retail space managed, but typically their lease provides for the centre manager to exercise some control over the commercial operation of the retail business itself.

FINDING

Concentration of ownership and management is not especially high at a State, Territory or regional level, although localised dominance of particular owners and managers may be more apparent in smaller communities.

Use of retail space

Businesses that use retail space are typically categorised by their physical size and type of activity and, in shopping centres, their potential for drawing large numbers of customers into a retail area. Broadly, tenants are described as being either a 'major' tenant or a 'specialty' tenant in a shopping location.

Major tenants

Major tenants are larger-sized retailers that attract significant numbers of customers to a shopping area and include supermarkets, department and variety stores. Major tenants operate in either retail strips or centres. In shopping centres, the largest of the major tenants are referred to as 'anchor tenants'. Anchor tenants typically occupy about 75 per cent of the available tenancy space in shopping centres and are seen to be an essential base around which the centre is developed. As noted by Stockland:

> … anchor tenants are of paramount importance to the development and sustainability of shopping centres. In essence, a shopping centre is built around anchor tenants. (submission no. 88, p. 15)

In 2006, there were about 2300 major tenants in Australia's shopping centres. Up to 80 per cent of foot traffic in a shopping centre is estimated to be made up of customers who have come to the centre to shop at a department store or discount department store (SCISR 1997, p. 18).

The length of leases for major tenants ranges up to 40 years, although shorter terms, for example 15 to 25 years, are common. For example, the Coles Group submitted that leases and options for its stores can extend out to 40 years (submission no. 48). The longer duration leases provide stability in use of the relevant retail space to other retailers dependent on the foot traffic generated and to investors.

In Australia, there are only a small number of potential anchor tenants for shopping centres (submission no. 83) — only two major chains of department stores (Myer and David Jones) and three major chains of discount department stores (Big W, KMart and Target). This provides these tenants with a strong bargaining position in centre development, negotiation of their own tenancy conditions and conditions in the remainder of the centre in which they are located (especially when KMart and Target are owned by the same parent organisation). In particular, the anchor tenants can have some sway in determining the mix and location of smaller retailers within the shopping centre (SCISR 1997 p. 18).

Typically, leases of major tenants for retail space are not covered by State or Territory retail tenancy legislation, although coverage varies according to store size and corporate status of the business (for example, whether or not the business is a publically listed company).

Specialty tenants

A specialty tenant is a 'non-major' tenant that typically occupies less than 400 square metres and specialises in a narrow range of merchandise with an emphasis on product knowledge and customer service (PCA 2006). Specialty tenants provide a shopping region with product and service variety, and 'character'. The nature of specialty retailers in a region often reflects the socio-economic status of the expected customer base, but can, in turn, influence the type of customers attracted to a shopping area.

The total number of specialty tenants is estimated at around 290 000 businesses in 2006 (table 2.1). Of these, about 57 000 specialty tenants, including retail trade and retail service businesses (such as travel agents, banks, Medicare and post offices) are located within Australia's shopping centres (table 2.3). Specialty tenants occupy about 42 per cent of retail space in centres across Australia, although there is some variability between states. The proportion of centre space used by specialty retailers is, on average, significantly lower in Tasmania and the Northern Territory than elsewhere in Australia.

The amount of available retail tenancy space occupied by specialty shops also varies considerably between types of shopping centres. In the larger centres, specialty shops typically occupy about 35 to 40 per cent of the gross lettable area

for retail (figure 2.6). In the smaller centres, the share of total retail space occupied by specialty shops is much higher — up to 90 per cent in themed centres. The Commission found this pattern to be largely consistent across States and Territories, within each particular category of shopping centre.

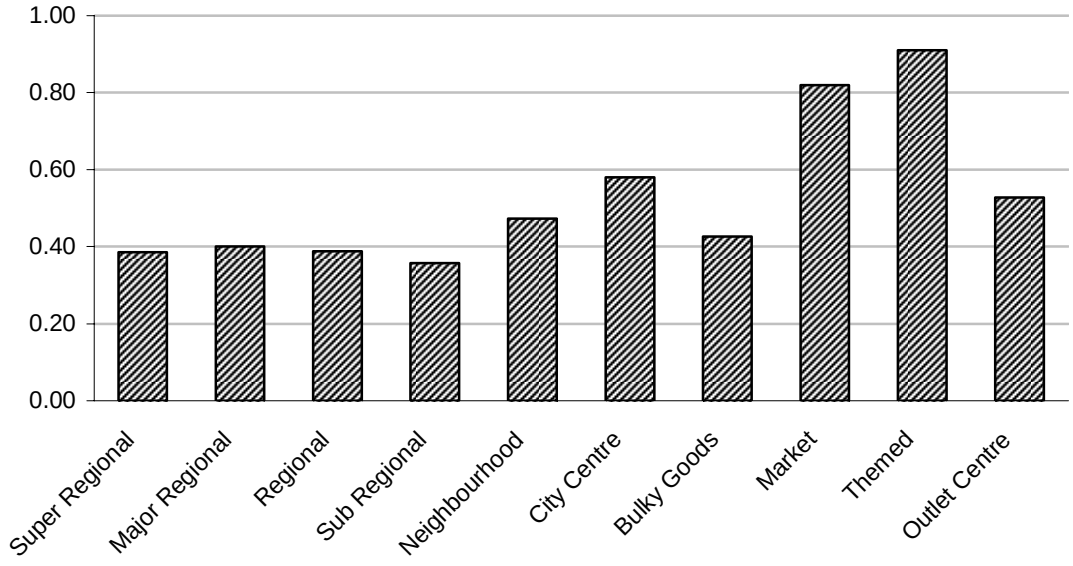
Table 2.3 **Specialty retailers in shopping centres by State, 2006**

	Centres	*Specialty retailers*	*Total retail gross lettable area*	*Proportion of State retail gross lettable area occupied by specialty retailers*
	No	No.	'000 sq metres	%
New South Wales	394	18 591	5 223	42
Victoria	196	11 786	3 090	41
Queensland	298	13 173	3 698	44
South Australia	137	4 389	1 301	41
Western Australia	279	7 289	1 958	44
Tasmania	23	481	162	32
Northern Territory	20	483	170	32
Australian Capital Territory	17	1 122	313	42
Total	**1 364**	**57 314**	**15 915**	**42**

Source: PCA (2006).

Figure 2.6 **Floor space in shopping centres held by specialty retailers in Australia, 2006**

Proportion of total gross lettable area for retail in shopping centres



Data source: PCA (2006).

While many specialty retailers rely on foot traffic (passing trade) for commercial success, some specialty tenants are a destination for customers — either because of a differentiated product, their own marketing efforts, their reputation or that of their franchisor. Examples include bank and post office outlets, pharmacies, some hairdressers, sports stores, high-fashion and specialty book stores. Other factors being equal, the more differentiated the product that a retailer has for sale (compared with other potential retailers in the area), the more choice that the retailer is likely to have in where to locate and in the terms and conditions of their lease.

Ownership of businesses that use retail space

Ownership of major stores is typically confined to companies and organisations that have resources sufficient to maintain and manage a large retail outlet. In contrast, many specialty retail businesses in Australia are owned by 'independent' retailers either as a small company, partnership or sole trader. For example, within shopping centres alone, available estimates suggest some 47 per cent of all specialty stores are owned and operated by independent retailers (Euromonitor International 2006).

Despite separate ownership, many specialty retailers are part of a national chain or larger franchise arrangement. For example, Colonial First State Property Management states that in its portfolio of centres, approximately 80 per cent of leases involve tenants that are part of a national chain (submission no. 78, p. 6). Similarly, Stockland reports that almost 60 per cent of its retail tenants are multi-store 'chain' retail tenants (submission no. 88, p. 4). In fact, the majority of franchising in Australia takes place in the retail non-food industry (Griffith University 2006). For the specialty retail tenant, the existence of a franchise arrangement often influences the landlord-tenant relationship, depending on the nature of the franchise, and the franchisor's relationship and negotiating position with the landlord.

A small proportion of businesses that use retail space are outlets for a local, State or Commonwealth government agency and may be owned by an individual lessee or the larger agency. For example, many licensed post offices are separate small businesses that operate under a franchise arrangement and it is the responsibility of the licensee to negotiate for retail space (submission no. 10).

2.3 Market entry, exit and vacancies

The operation of the retail tenancy market in Australia is influenced by the availability of vacant retail space and the ease with which businesses enter and exit the market.

Market entry and exit

The entry and exit of firms in an industry is a natural outcome of a functioning market and has significant positive effects on efficiency of the market (Bickerdyke, Lattimore and Madge 2000). New businesses can offer innovative products and services, while exiting businesses can free up labour and resources for more productive uses. Nevertheless, this churning of businesses may involve costs, particularly when there are significant fixed cost items, such as store fitouts.

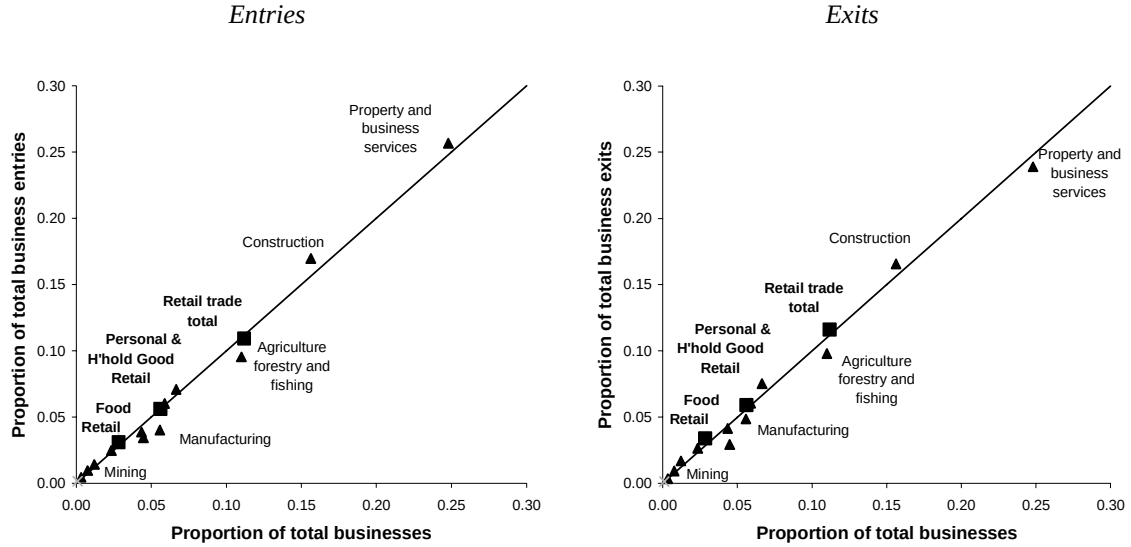
Rates of entry and exit would be expected to vary significantly between activities, with differences in barriers to firm movement and set-up costs. For example, in an activity with relatively low set-up costs — as might be the case for some of the personal and household goods retailers (such as clothing shops) — the number of firms undertaking the activity and the entry and exit rates could be expected to be relatively high compared with those in other activities that have more substantial set-up costs (such as food retailing). That is, entry and exit rates would be expected to be proportional to the stock of businesses, unless there was a systematic problem with the market in which a particular activity operates, or the activity was going through a transition.

Data on the number of businesses and exit and entry rates show that for retail businesses, entry and exit rates are in line with the relative share of retail businesses in the Australian economy (figure 2.7). This is the case for all industry categories examined. This suggests that there is no systematic industry-wide feature of retailing that consistently leads to higher than average business failure.

Entry and exit of businesses in the retail and services sectors have been broadly comparable in recent years (table 2.4). Around 16 per cent of all retail and services businesses leave the industry each year. There is, however, some variation between different retailing activities. For example, there is slightly more movement (or churning) of businesses into and out of food retailing than other forms of retailing, implying slightly lower survival rates than average. The incidence of entries and exits is likely to vary with broad economic conditions, although such variation is not particularly evident in the available data.

Figure 2.7 **Business entry and exit rates, 2005-06**

Proportion of total operating businesses by industry category



a A business entry is recorded for a business which has newly registered for an ABN and which has a GST role allocated. A business exit is recorded for a business for which the ABN has been cancelled and/or which has ceased to remit GST for 5 consecutive quarters or for which the GST role has been cancelled.

Data source: ABS (*Counts of Australian businesses, including entries and exits, June 2003 to June 2006,* Cat. no. 8165.0, Canberra).

Table 2.4 **Entry and exit of all retail businesses, 2003-04 to 2005-06**

Per cent of businesses operating at start of each year

	2003-04		*2004-05*		*2005-06*	
	Entry rate	*Exit rate*	*Entry rate*	*Exit rate*	*Entry rate*	*Exit rate*
Food retailing	22	19	20	20	18	18
Personal & household goods retailing	18	16	18	17	16	16
All retailing[a]	**18**	**16**	**18**	**17**	**16**	**16**
All service industries	17	15	17	15	16	15

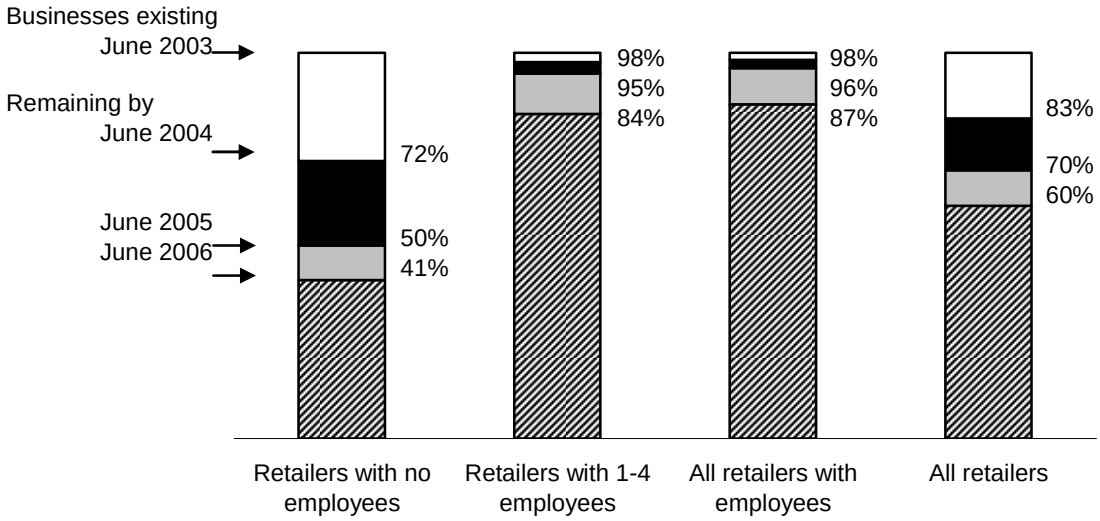
a Includes businesses in food retailing, personal and household goods retailing, and motor vehicle retailing and services.

Sources: ABS (*Counts of Australian businesses, including entries and exits, June 2003 to June 2006,* Cat. no. 8165.0, Canberra); Reserve Bank of Australia (2007).

Across retail trade businesses of differing sizes (as measured by the number of employees), survival varies substantially (figure 2.8). For example, over the period 2003-04 to 2005-06, exit rates were substantially higher for those retailers that had no employees (ABS 2007a). Retailers in this category include small specialty shops operated by the owner.

Figure 2.8 **Survival of retail trade businesses by size, 2003-04 to 2005-06**[ab]

Proportion of businesses in 2003-04 remaining in 2005-06



a A business 'survivor' is a business which was actively trading at the start of 2003-04 and continued to be trading at the end of 2005-06. **b** Includes businesses in food retailing and personal and household goods retailing, but excludes those in motor vehicle retailing and services.

Data sources: ABS 2007a (*Counts of Australian businesses, including entries and exits, June 2003 to June 2006,* Cat. no. 8165.0, Canberra); Reserve Bank of Australia (2007).

Within shopping centres, the SCCA submitted that just over 85 per cent of retailers that were in a sample of centres in 2003 were still located in those centres in 2004 (submission no. 83, p. 57). This suggests an exit rate for those retailers of around 15 per cent — in line with the annual average rate of exit across all retail trade and service establishments (table 2.4). Furthermore, it is likely that only some of these exits represent business *failure*. In a study of small business failure in Australian shopping centres, Watson and Everett (1996) found that annual failure rates varied from less than 1 per cent when 'bankruptcy' was the definition of failure used, up to 9 per cent when failure was defined broadly as a 'discontinuance of ownership' (which may reflect a departure from business due to retirement or ill-health). Failure rates of around 4 per cent were attributed to a failure to 'make a go of it' or 'discontinuance of business'. At a broad level then, it is not apparent that the survival of Australian retailers, and hence churning of retail tenancies, is significantly different in shopping centres compared with elsewhere.[2]

The stability of tenants is generally higher in the larger regional shopping centres (around 90 per cent per year) than in smaller centres (around 82 per cent per year)

[2] In comparison, Cox and Vos (2005) reported that in New Zealand, small business failure rates are lower in managed shopping centres than in unmanaged centres. However, this difference was found to only be significant for a very broad failure category — a failure to 'make a go of it'.

(submission no. 83, p. 57). Reported renewal rates of leases also indicate that there is some variability in the stability of tenancies between different centres. For example, Westfield reported that 75 per cent of its five year leases for specialty shops that fell due in 2006 were renewed (submission no. 85, p. 5), while Centro reported that 81 per cent of specialty leases that fell due in 2006 were renewed (Centro 2006). Colonial First State Property management reported that 70 per cent of leases that expired in 2006 were renewed (submission no. 78, p. 4). These estimates are a broad indicator of the movement of small businesses in shopping centres but may under-estimate the extent of change in business ownership. For example, where leases are held by franchisors rather than the franchisees, a change in the franchisee may not be reflected by a lower lease renewal rate.

FINDING

Entry and exit of retail businesses is not exceptional compared to other service activities. The survival of retail businesses in shopping centres is in line with survival rates of retail businesses elsewhere.

Vacancies in retail space

The ease with which a potential tenant is able to find suitable premises from which to conduct business and lease terms depends on available vacancies, and the location and condition of the vacant space.

Vacancy rates for retail space vary substantially between locations (table 2.5). In general, vacancy rates in retail strips and neighbourhood centres appear to be higher than vacancy rates in the major city CBDs and larger shopping centres — making it potentially harder for a retailer to find space in such a location. In addition, the availability of space can vary significantly between regions, indicating the difficulty in generalising about the market from characteristics of an individual area or region. For example, in 2006, the vacancy rate for prime space in retail strips in the Sydney metropolitan area was over twice that for Melbourne.

Table 2.5 **Vacancy rates by location, 2006 and 2007**[a]
Shopping centres and selected non-shopping centre locations

	Per cent
Shopping centres	
All shopping centres	1.2
Regional centres	0.9
Sub-regional centres	1.0
Neighbourhood centres	3.1
Selected non-centre locations	
Sydney CBD	1.6
Sydney metropolitan prime retail strips	5.9
Melbourne CBD	0.7
Melbourne metropolitan prime retail strips	1.8
Adelaide prime retail strips	2.1
Brisbane CBD (specialty stores)	2.3

a Vacancy rates for shopping centres are averages for 2006. Rates for non-centre locations are the average rates prevailing in the December quarter of 2006 in Sydney and Melbourne, the June quarter of 2007 in Brisbane, and the September quarter of 2007 in Adelaide.

Sources: Submission no. 83, p. 52; CB Richard Ellis (2007a, 2007b, 2007c and 2007d).

While retail space available for rent is an important influence on the functioning of the market, other factors are also significant, including:

- condition of premises and ease of access to potential customers;
- landlord's requirements for tenancy mix or type of service, particularly in shopping centres;
- the demographic characteristics of people living in the areas surrounding vacant retail space and expected changes;
- the relative importance of business reputation and passing trade (foot traffic) to the business model of the retailer; and
- industry-specific factors that may restrict the use of retail space such as geographical-based location arrangements for newsagents (submission no. 51), location requirements for Licensed Post Offices (submission no. 10), and the regulation of pharmacies (submission no. 109).

2.4 Summing up

The retail tenancy market in Australia comprises a range of businesses that vary substantially in terms of the type of goods or services provided, ownership structure and the size, experience and resources that they bring to their operation. While most retailing occurs outside of shopping centres in retail strips and increasingly in stand-

alone bulky goods sites and direct factory outlets, shopping centres as a group are an important and growing share of the retail tenancy market. The vast majority of submissions received in this inquiry related to shopping centre tenancies.

The survival of retailing businesses (and correspondingly, the churning of retail tenancies) varies substantially with business size and type, although there is no significant difference in business survival for those located in shopping centres compared with elsewhere. Vacancies for retail space, however, do appear to vary according to location with more retail space available in shopping strips and the smaller neighbourhood centres than in major city CBDs or larger shopping centres. This makes it more costly for a retailer to find and retain space in such sought-after locations.

3 The regulatory environment governing retail tenancies

The regulatory environment governing retail tenancies is complex. It includes:

- legislation and regulation relating specifically to retail tenancy agreements;
- the interaction of retail tenancy and fair trading legislation;
- common law rights and obligations, with respect to both contract and tort law that apply to all commercial tenancy agreements, including retail tenancies; and
- legislation impacting on the availability of retail space and the conditions under which it is used.

The environment is also affected by government and trade associations' actions to improve education and awareness of tenancy obligations, and by the availability of commercial information and advice services.

This chapter examines the rationale behind the introduction of specific retail tenancy legislation and regulation and the attempted legislative remedies. Section 3.1 looks at the origins of retail tenancy legislation and regulation. Section 3.2 examines the legislative responses to tensions within the retail tenancy market, while section 3.3 looks at zoning and planning regulation.

Dispute resolution in the retail tenancy market is examined in chapter 4.

3.1 Origins of retail tenancy legislation and regulation

Prior to the introduction of specific retail tenancy legislation, all retail tenancy leases in Australia were treated under contract and tort law as standard commercial leases. Retail tenancy legislation evolved in Australia from the mid to late 1980s in response to concerns about bargaining power and information imbalances between shopping centre landlords and small retail tenants. These concerns escalated with the growth in suburban shopping centre complexes during the 1970s and 1980s. The Davies report on Common National Commercial and Retail Tenancy Issues in 1991, commenting on the catalyst for government interest in retail leases in Australia, stated:

> Over the past decade or more, there has been growing pressure on governments to reduce the incidence of disputation associated with commercial tenancy practice. The demise of the corner store in favour of the shopping centre created a different relationship between retail landlords and tenants and gave rise to a new set of concerns for tenants now sharing common facilities and services and associated costs. Lease arrangements became more complex and tenants' activities more restricted. A picture of the powerful, unreasonable landlords and the disadvantaged small business tenant became the perception of governments who were being lobbied to introduce legislation to redress the imbalance in the bargaining positions of commercial tenants and landlords, particularly those in the retail sector. (Davies 1991, p. 3)

As noted in chapter 1, Queensland was the first to introduce retail tenancy legislation (1984), followed by Western Australia in 1985 and Victoria in 1986. New South Wales first attempted a Voluntary Code of Practice (but significant non-compliance with the Code by landlords made it ineffective) before legislating in 1994. South Australia introduced specific retail tenancy legislation in 1995, which replaced provisions in the *Landlord and Tenant Act 1936*, introduced in 1985. The Australian Capital Territory introduced specific legislation in 2001, replacing provisions, including a code of practice, under the *Tenancy Tribunal Act 1994.* The Northern Territory introduced retail tenancy legislation in 2003. Tasmania adopted a regulated code of practice — under its Fair Trading Act — in 1998.

The enactment of Queensland's original retail tenancy legislation followed a report by the 'Cooper Committee' (Committee of Inquiry into Shopping Complex Leasing Practices 1981). Complaints made by shopping centre lessees to the Queensland Small Business Development Corporation prompted the inquiry. As Duncan noted:

> At the foundation of these complaints was the fact that the lessees effectively had no bargaining power in relation to terms and conditions of their leases and were entirely at the mercy of the complex owners. (Duncan 1990, p. 28)

The parliamentary debates and second reading speeches for the original retail tenancy Acts in the other States suggest that their legislation sought to provide a more equitable bargaining position between large landlords and their small retail tenants. For example, the parliamentary debates relating to the introduction of Victoria's 1986 Act stated that 'the intention of the legislation was to protect small tenants, whom it was thought could not match the bargaining strength of large landlords' (Victorian DSRD, 2001, p. 12).

Similarly, in introducing the Retail Tenancy Review Bill, the New South Wales Minister for Small Business said:

> It is all about fostering good leasing practice in the industry; it is about broadening co-operation amongst all parties to ensure that effective leasing relationships are established; it is to regulate only where the market-place has failed. The Government does not seek to intervene in the commercial relationship between lessees and lessors.

> The Government wants to provide for an equitable bargaining position amongst the parties. We believe that this bill will provide cost-effective and timely resolution of the management of retail leasing disputes. (Chappell 1994, pp. 2641-2)

The emergence of the large shopping centres led to the establishment of the original retail tenancy Acts that set up a prescriptive legislative framework for regulating rights and obligations for the formation of leases between landlords and small-medium sized retailers. The Acts had broadly similar provisions covering the scope of the legislation, minimum standards for the leasing of retail space and the establishment of dispute resolution systems.

Stated concerns remained, prompting further reviews

Commonwealth reviews

Despite the introduction of specific retail legislation in five States, in 1997, the Reid Committee report (see box 1.1) highlighted evidence of continuing problems in relationships between retail tenants and shopping centre landlords. In fact, the Reid Committee report described the situation as a 'war' in shopping centres between retail tenants and property owners and managers.

The Reid Committee found that small businesses were often disadvantaged in their dealings with big businesses and recommended a 'Uniform Retail Tenancy Code be submitted to the Council of Australian Governments with a view to the adoption of uniform retail tenancy legislation around Australia' (SCISR 1997, p. xvi.).

The Australian Government's response to the Reid Committee report, in September 1997, indicated that it would amend the *Trade Practices Act 1974* (TPA) to prohibit unconscionable conduct in business transactions and work with jurisdictions to establish stronger retail tenancy regulation around key principles relating to: disclosure; ratchet clauses; relocation costs; rent reviews; outgoings (auditing and reporting); lease assignment; access to turnover figures; and dispute resolution procedures.

The Trade Practices Amendment (Fair Trading) Bill 1997, including the new section 51AC — unconscionable conduct in business transactions — came into force in 1998. The provisions of 51AC have subsequently been drawn down, either directly or in an amended form, into fair trading regulations in all jurisdictions. In December 1997, all State and Territory jurisdictions agreed to introduce key minimum standards into their retail tenancy legislation and regulation (Office of Small Business 2001).

In 1998, a Joint Select Committee on the Retailing Sector was established to inquire into the impact of market concentration in the retail sector. In its report, *Fair Market or Market Failure* presented in 1999, the Committee recommended raising the transactions limitation on access to section 51AC of the TPA from $1 million to $3 million, and revisiting the Reid Committee report recommendation for a uniform retail tenancy code. The Committee also recommended the appointment of a Retail Industry Ombudsman.

In response to this report (in December 1999), the Government raised the transaction limitation to $3 million. However, it did not accept that it should revisit the proposal to establish a uniform retail tenancy code or appoint an ombudsman.

The *Trade Practices Amendment (Operation of State and Territory Laws) Act 2001* provided for the concurrent operation of the TPA and the State and Territory laws. No provision was made for the consequential overlapping in administration and causes of action.

In 2003, a Senate Inquiry into the Effectiveness of the Trade Practices Act in Protecting Small Business was established. This inquiry looked into whether the Act adequately protected small business from anti-competitive or unfair conduct. In its report tabled in 2004, the Committee recommended that the Commonwealth negotiate with the States and Territories with a view to prohibiting retail lease provisions that compel tenants to keep their tenancy terms and conditions secret. But the Australian Government did not accept the recommendation, on the grounds that principles of contract law conferred on the parties freedom to negotiate the terms of a contract, including a lease. However, it agreed to amend section 51AC to allow a court to consider whether unilateral variation clauses in contracts are unconscionable. It also agreed to raise the transactions limitation on access to section 51AC of the TPA from $3 million to $10 million (Australian Government 2004).

State and Territory reviews

There have also been a series of reviews of State and Territory retail tenancy legislation. These have led to a continual series of amendments since the inception of retail tenancy legislation (table 3.1). Broadly, subsequent amendments were premised on the notion that more prescriptive regulation covering how retail businesses should write leases and what the conditions of the leases should be, would address concerns about the imbalances in bargaining power and information between shopping centre landlords and small tenants.

Table 3.1 **Key amendments to retail tenancy legislation by State**

Original Acts and key amendments	*Commencement and key changes*
New South Wales	
Retail Leases Act 1994	• Came into effect on 1 August 1994 • Replaced the 1992 voluntary Retail Leases Code of Practice
Retail Leases Amendment Act 1997	• Commenced on 17 October 1997
Retail Leases Amendment Act 1998	• Commenced on 1 March 1999 • Added unconscionable conduct provisions • Lessee disclosure statement
Retail Leases Amendment Act 2002	• Commenced on 10 January 2003
Retail Leases Amendment Act 2004	• Commenced on 17 December 2004
Retail Leases Amendment Act 2005	• Commenced on 1 January 2006 • Lodgement of security bonds with Director-General
Victoria	
Retail Tenancies Act 1986	• Came into effect on 21 September 1987 • First Victorian legislation
Retail Tenancies (Amendment) Act 1988	• Commenced 27 April 1988
Retail Tenancies (Rent Review) Act 1991	• Commenced 3 December 1991
Retail Tenancies (Amendment) Act 1995	• Commenced from 6 June 1995
Retail tenancies Reform Act 1998	• Commenced from 28 April 1998 • Strengthen disclosure requirements
Retail Tenancies Reform (Amendment) Act 2001	• Commenced 24 October 2001
Retail Leases Act 2003	• Commenced from 16 April 2003 • Inclusion of unconscionable conduct provision • Replacement of 1000m^2 threshold • Notification of lease to Small Business Commissioner
Retail Leases Amendment Act 2005	• Commenced 23 November 2005
Queensland	
Retail Shop Leases Act 1984	• Commenced from 12 May 1984 • Initial legislation
Retail Shop Leases Act Amendment Act 1985	• Commenced 17 April 1985
Retail Shop Leases Act Amendment Act 1988	• Commenced from 3 May 1988
Retail Shop Leases Act Amendment Act 1989	• Commenced 31 October 1989
Retail Shop Leases Act Amendment Act 1990	• Commenced 5 April 1990
Retail Shop Leases Act 1994	• Came into effect on 28 October 1994 • More prescriptive disclosure requirements • Removal of minimum 5 year term provision
Retail Shop Leases Amendment Act 1999	• Came into effect 30 April 1999
Retail Shop Leases Amendment Act 2000	• Came into effect from 23 June 2000 • Introduced unconscionable conduct provisions (commenced from 24 June 2001) • Introduced lessee disclosure statement
Retail Shop Leases Amendment Act 2006	• Came into effect from 22 February 2006 • Changes to definitions including ‘lessee’ and ‘major lessee’ • Changes to disclosure obligations.

(continued next page)

Table 3.1 **(continued)**

Original Acts and key amendments	*Commencement and key changes*
Western Australia	
Commercial Tenancy (Retail Shops) Agreements Act 1985	• Commenced on 1 September 1985
Commercial Tenancy (Retail Shops) Agreements Amendment Act 1990	• Commenced on 30 November 1990
Commercial Tenancy (Retail Shops) Agreements Amendment Act 1998	• Commenced from 15 January 1999
Retail Shops and Fair Trading Legislation Amendment Act 2006	• Commenced on 11 May 2007 • Introduced unconscionable conduct provisions
South Australia	
Statutes Amendment (Commercial Tenancies) Act 1985	• Commenced on 1 January 1986 • Added a part on commercial tenancies to the *Landlord and Tenant Act 1936*
Landlord and Tenant Act Amendment Act 1987	• Commenced 1 January 1988
Landlord and Tenant Act Amendment Act 1990	• Commenced 15 November 1990
Landlord and Tenant Act Amendment Act (No. 2) 1990	• Commenced from 11 March 1991
Retail and Commercial Leases Act 1995	• Entered into force on 30 June 1995 • Originally titled *Retail Shop Leases Act 1995*
Retail Shop Leases Amendment Act 1997	• Commenced 6 October 1997 • Increased disclosure provisions • Introduction of preferential rights provision
Retail and Commercial Leases (Miscellaneous) Amendment Act 2001	• Commenced 4 February 2002
Retail and Commercial Leases (Casual Mall Licences) Amendment Act 2001	• Commenced 1 September 2002 • Added a casual mall licence code of conduct
Tasmania	
Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998	• Commenced 1 September 1998
Fair Trading (Code of Practice for Retail Tenancies) Amendment Regulations 1999	• Commenced 24 April 1999 • Definition of 'small business tenant' changed
Northern Territory	
Business Tenancies (Fair Dealings) Act 2003	• Commenced 1 July 2004
Australian Capital Territory	
Tenancy Tribunal Act 1994	• Commenced 1 January 1995 • Under the Act, a Commercial and Retail Leases Code of Practice was also established • The code prohibited conduct that was unconscionable; coercive; or harsh and oppressive
Leases (Commercial and Retail) Act 2001	• Commenced from 19 April 2001 • Replaced the *Tenancy Tribunal Act 1994* and its code of practice • Incorporated first right of refusal for lease renewal

Reviews of legislation have arisen for a number of reasons. Amongst these have been review clauses in the legislation. Retail tenancy legislation has also been subject to review as a requirement under National Competition Policy.

Typically, reviews have resulted in lengthier and increasingly prescriptive legislation. For example, Queensland's *Retail Shop Leases Act 1994* is now over 100 pages in length, compared with the original 1984 Act that was just 26 pages. Moreover, there are more than twice as many sections — the original Act had 61 sections, while the current Act has 129. Progressive adoption and amendment of retail tenancy legislation across the country has seen the total volume of legislation reach almost 700 pages. As the Shopping Centre Council of Australia (SCCA) said:

> The various State and Territory Acts of Parliament are also reviewed on a regular basis, probably far more regularly than any other legislation. Over the last decade there have been 13 separate reviews (in some States there have been several reviews in that time) and these reviews have either led to new legislation (the Australian Capital Territory in 2002 and the Northern Territory in 2003) or amendments of existing legislation. Each amendment of existing legislation led to increased regulation. (submission no. 83, p. 15)

Despite the recommendation of the Reid Committee for uniform national retail tenancy around Australia, the various reviews across jurisdictions have resulted in differences in the legislation across jurisdictions. Commenting on changes to the retail tenancy legislation at the State and Territory level, Cameron and Blom said:

> At a national level, the outcome of all of this 'reform' is inconsistencies between the respective Acts and, as a consequence, additional costs to both national landlords and national tenants through the need for State and Territory specific leases and legal advice. (Cameron and Blom 2004, p. 1)

FINDING

Specific regulation of retail tenancies has been adopted in all jurisdictions. The regulations have been adopted primarily because of perceived imbalances in negotiating power between small tenants with limited resources and large well resourced landlords. The regulations have been continually reviewed and amended.

3.2 The nature of legislative and other responses

The reviews at State and Territory level have generally led to increasingly complex and prescriptive provisions in each of the key areas covered by the legislation, including: the definition of retail tenancies; security of tenure; terms of the lease; information provisions; and unconscionable conduct (table 3.2).

Table 3.2 **Key matters covered by retail tenancy legislation**

Category	*Matters within category*
Defining retail tenancies	Definitions of premises, tenants and 'who' or 'what' are covered by the legislation
Security of tenure	Minimum lease terms, renewal rights where present
Conditions of the lease	Implied terms, rent review, outgoings, sinking funds, assignment, subletting
Information provisions	Provision of draft leases and other information; disclosure statements by landlords and tenants; termination rights from failures to deliver information and disclosure statements; notification/registration of leases; requirement for tenant to have legal/commercial advice
Unconscionable conduct	Behaviour that might be construed unconscionable
Dispute resolution	Role of courts, mediation systems, role of registrars and small business commissioners; valuations, confidentiality of proceedings and evidence
Other matters	Key money, compensation to tenants, trading hours, security deposits, personal guarantees, land and sales tax provisions, payment of rent during fit out, management fees, advertising and promotion

Source: Based on table presented in Crosby (2006).

Most of these matters are outlined in more detail in this section, highlighting developments over time and differences between the States and Territories. Dispute resolution is discussed in chapter 4.

Defining retail tenancies

As small retail businesses were considered most likely to be at a disadvantage in terms of access to information and negotiating power in lease negotiations, the various jurisdictions sought to define a retail business for the purpose of the legislation and the threshold needed to define a 'small' business.

- In New South Wales, Western Australia, Tasmania and the Northern Territory, retail tenancy legislation applies to premises used for any business in a shopping centre, or to premises used for specified retail businesses in other locations. There is a cap on the size of leased premises that are covered by the legislation of up to 1000 square metres.
- In Queensland, retail tenancy legislation applies to specified retail businesses or any premise in a shopping centre. There is a size cap of 10 000 square metres, or 1000 square metres if the lessee is a listed corporation or their subsidiary.
- In the Australian Capital Territory, the legislation applies to premises located in a shopping centre or retail premises outside a shopping centre that are under 1000 square metres, as well as commercial premises under 300 square metres.

- Victoria and South Australia have a value-based limit. In Victoria, the legislation applies if premises are used wholly or predominantly for the sale or hire of goods by retail or the retail provision of services, but not where the lease occupancy costs exceed $1 million per annum or the premises are leased to a listed company or its subsidiary. In South Australia, the legislation does not apply to premises where the rent exceeds $250 000 per annum (covering retail and commercial) or are leased to a listed company or its subsidiary.

There are also jurisdictional differences in what constitutes a 'shopping centre' and each Act has its own special provisions for shopping centre premises.

The 1000 square metre floor area limit covers most small-medium businesses, while excluding large retail businesses such as supermarkets and department stores. However, a floor limit proxy provides little link to the financial resources of a tenant. As noted in the 2001 Review of Victorian Retail Tenancy Legislation, some large Australian retail businesses have relatively small premises, and so would be covered by legislation with a floor area limit. Following this review, Victoria moved away from the 1000 square metre floor area limit to a limit based on occupancy costs.

Commenting on the jurisdictional differences in the coverage of the retail tenancy legislation in Australia, Crosby observed that:

> … some companies are included in the Act in some States and not in others. In addition the definition of retail is not always consistent. The concentration on indicators that relate to the premises rather than the tenants suggests that in many States the legislation is in fact a smaller retail premises Act rather than a small business tenant Act, with some small commercial premises included in some States. (Crosby 2006, p. 2)

As noted earlier, the stated aim of retail tenancy legislation is to overcome the imbalance in available information and negotiating power between large landlords and small tenants in shopping centres. However, as Duncan noted, the coverage of the legislation appears to be far wider than originally intended:

> … the emphasis is upon the expression 'retail' which requires some element of the provision of goods or services for public consumption. However, in a divergence from the original intention of the Act, the retail shops to which all Acts refer need not be situated in a retail shopping centre. Stand alone retail shops or retail shops in small strips of less than five shops would be caught by the legislation. It is submitted that the ambit of each Act goes far beyond that which was originally proposed, particularly if one takes into account that the clamour for regulation came solely from small traders in large retail shopping complexes. It is also submitted that a stand alone retail shop or a retail shop in a small strip of shops was probably suffering very few of the same perceived disadvantages as the counterpart in a large centre. (Duncan 1990, pp. 29-30)

Similarly, Murdoch, Rowland and Crosby also question why retailers operating outside shopping centres are covered by the legislation and suggest this could be explained by the fact that this group of retailers are a less organised group:

> It is not entirely clear why the legislation covers retailers not in shopping centres as they do not appear to be dissatisfied with their leases. It may be that retail tenants outside shopping centres are less well organised into groups which can represent their grievances. (Murdoch, Rowland and Crosby, 2001, p. 20)

The net cast by the retail tenancy legislation is wide and captures a broad range of tenancy agreements. This imposes an extra regulatory burden on a range of agreements where it is potentially not required, such as where there are large well resourced tenants, who operate relatively small premises; and where landlords are small, for instance, those with retail premises outside of shopping centres.

Security of tenure

There have been various attempts to include provisions in retail tenancy legislation intended to increase small tenants' security of tenure.

Minimum lease terms

Current legislation in all jurisdictions, except Queensland, requires that lease terms be a minimum of five years. This can be a combination of an initial lease period plus options (exercised by the tenant), for instance, a three year lease with a further two year option would meet the minimum term requirement.

There are also some exceptions to the minimum lease period. These vary between jurisdictions, but broadly, include:

- provisions on the extended lease. A lease can be less than five years if it has an exercised option renewing an existing lease where the total term is five years or more. This is further extended in Victoria to include where the lease is a renewal, which includes exercising an option or a renegotiated lease for the same premises with substantially the same terms and conditions, aside from rent. In South Australia, a lease need not be a minimum five years where the tenant has been in possession of the shop for at least five years;
- subleasing. A sublease cannot be inconsistent with the term of a head lease. That is, a party cannot sublet a premise for longer than the lease of the premises; and
- a lease can also be for less than the minimum term if a tenant expressly agrees and obtains certification from the Commissioner/Registrar or a solicitor (depending on jurisdiction).

The origin of the minimum five-year lease period dates back to recommendations of the Cooper Committee in 1981. The Cooper Committee reported a preference amongst lessors in that State for three year terms without options and a preference of lessees for five-year lease terms. However, the Committee considered that, while a five-year term would be reasonable, if the terms of a lease were understood by the tenant then the lease term should be a matter for market judgement.

Nevertheless, following the recommendation in the subsequent Joint Parliamentary report, when the bill was introduced to the Queensland Parliament in 1984, an automatic option to extend the lease to a total of five years (subject to some limitations) was included (Anderson 1992). Similar minimum five-year lease term provisions were subsequently included in the legislation of all other jurisdictions.

A further twist occurred in Queensland when the 1984 legislation was replaced by the *Retail Shop Leases Act 1994*. Under the new Act, the automatic options for a five-year minimum term were removed, reportedly as a result of lobbying by tenant representatives who felt that five-year minimums were potentially too restrictive on tenants. This was acknowledged by the Queensland Government in the second reading speech:

> … the Bill does not provide for guaranteed minimum lease terms for lessees because such a provision would be too prescriptive and would not necessarily advantage all tenants. In fact, many tenants prefer to negotiate shorter lease terms, depending on the circumstances of the retail shopping centre, their own personal situation or their assessment of the market opportunities available to them. (Sullivan 1994, pp. 9546-7)

Security of tenure and minimum lease periods was also raised as an issue in the Reid Committee report. Numerous submissions to that inquiry expressed concern about sitting tenants who were unable to extend lease terms beyond expiry. A number of submissions suggested that five-year minimum terms with no options did not sufficiently meet the security of tenure concerns of retail tenants. Subsequently, in making recommendations for the design of a uniform national tenancy code, the Reid Committee recommended that the code provide for:

- minimum lease terms of five years;
- sitting tenants to have the option of lease renewal for a further five years; and
- sitting tenants to have the first right of refusal of the lease for subsequent five-year periods.

Since these recommendations were made, there have been relatively few changes to retail tenancy legislation in this area. Queensland has not reinstated minimum five-year terms. No jurisdiction has amended legislation to mandate further options for sitting tenants beyond the five-year minimum term.

Minimum lease periods, while introduced as a means of providing some level of security of tenure for lessees, appear to have introduced some rigidity into the retail

tenancy market. In fact, some commentators have suggested that tenants may be worse off under minimum lease periods:

> Prior to the introduction of the minimum five year term, many leases of speciality shops were granted for three years with two 3 year options for the tenant to renew. Since the legislation, many leases in shopping centres are granted for five years without any options to renew. It would therefore appear that the tenants are actually worse off as a result of this statutory intervention. (Murdoch, Rowland and Crosby 2001, p. 25)

Rights of renewal

To increase security of tenure for sitting tenants, South Australia and the Australian Capital Territory have included 'end of lease' provisions including the right of first refusal for tenants located in shopping centres. However, in balancing the rights of the owner, the provisions contain exemptions on providing preferential rights for a number of reasons. Chief among these is if the landlord wishes to change the tenancy mix or if it would be substantially disadvantageous to the landlord to renew the lease with the sitting tenant.

Notification of landlord intentions

Retail tenancy legislation in all jurisdictions also requires that landlords provide adequate notice of lease renewal or termination. In most jurisdictions, the landlord must provide notice between 6 and 12 months prior to the expiry (at least 3 months before expiry in Tasmania) of the lease either offering the tenant a new lease (including the terms of the lease) or stating that the landlord does not intend to renew the lease.

Conditions of the lease

There have been various attempts to include provisions in retail tenancy legislation intended to provide more certainty, particularly for small tenants.

Rent determination and rent reviews

The way in which rents are determined, including the methods used to calculate rents and the fairness of such methods, was one of the initial contentious matters raised by small retailers. The issue of percentage rents, for example, was identified by the Cooper Committee:

> Small retailers felt strongly that they would be penalised for their initiative. They further felt that their increase in turnover would be the basis for lifting the base rent.

> The actual size of the percentage figure was in many cases hotly disputed. (Cooper Committee report, p. 24)

While conceding that in some cases percentage rents would be appropriate (for example, to attract major tenants into shopping centres), the Cooper Committee suggested that the system 'was not really satisfactory in its present form for the position of small tenants in shopping complexes'. The Cooper Committee report noted that an increase in turnover was not necessarily a good measure of an increase in the capacity to pay and that percentage rentals were in some ways akin to a tax on initiative and hard work. It recommended that the practice of percentage rents be dropped when dealing with small traders (Cooper Committee report, pp. 25-6).

In response to these concerns, the original Acts in Queensland and Western Australia contained provisions stating that rent could not be determined by reference to turnover unless the lessee had agreed in writing to this. Further, a lease would be void unless it specified, as part of this provision, the formula by which the rent was to be calculated (Duncan 1990). These provisions, however, were assessed to be of little assistance to small retailers (Anderson 1992) and were subsequently removed from legislation.

The Reid Committee again heard concerns from tenants about methods used to calculate rent and the fairness of such methods. The Committee indicated that it was 'not convinced that specialty retailers were paying fair rents'. Rather, it considered that specialty retailers were being 'charged maximum achievable rents' (SCISR 1997, p. 52).

While the Committee did not consider it appropriate for regulators to determine the appropriate method of calculating retail rent, it suggested that it was appropriate for retail tenancy legislation to 'set down some procedural rules for fair rent negotiations'. Recommendation 2.7 of the Reid Committee report stated that:

> Recognising that rent will always be a matter for negotiation between landlord and tenant, the Committee recommends the Uniform Retail Tenancy Code provide that:
>
> (a) the disclosure statement set out clearly the method by which rent is to be calculated for the term of the lease without provision for review or for unpredictable increases;
>
> (b) market rent review only be permitted on renewal of the lease; and
>
> (c) the level of market rent on lease renewal be determined by an independent accredited valuer, with costs shared between the parties. (SCISR 1997, pp. 56-7)

The current State and Territory retail tenancy legislation requires certain information about rents to be contained in lease disclosure statements and prescribes the scheduling of rent reviews and the basis upon which rent reviews can be conducted.

Many jurisdictions restrict the frequency of rent reviews (although the Reid Committee's recommendation of reviews only on renewal of leases has not been adopted). For instance, in New South Wales and South Australia, a change in base rent may not occur in under 12 months unless the change is by a pre-specified amount or percentage. In Victoria, Tasmania and the Australian Capital Territory base rent changes at less than 12 monthly intervals are prohibited. Most jurisdictions also prohibit discretionary rent review clauses that allow rent to be determined by the highest of two or more different methods. In some States, such as Victoria, legislation is more specific and permits a rent review only on the basis of one of the prescribed methods. All jurisdictions have prohibited upwards-only rent reviews.

The legislation in each of the jurisdictions also defines 'current market rent' and the process to obtain market rent. This typically requires a specialist valuer and, in cases where parties cannot reach agreement, the tenant or the landlord can request an independent valuation.

The legislation in each of the States and Territories now prescribes the items that can be included in the definition of turnover and contains confidentiality provisions restricting disclosure by landlords of turnover data. For instance, landlords may only release information publicly (without tenant consent) as part of aggregate shopping centre figures. Western Australia and Tasmania do not permit landlords to request turnover data unless required for the purposes of calculating turnover based rent. In Victoria, the alleged misuse of turnover data is a factor that the courts consider when determining whether a landlord has engaged in unconscionable conduct. Commenting on the provisions relating to turnover data Webb said:

> Concerns regarding turnover information appear to have been reduced through the imposition of obligations of confidentiality and prohibitions of termination for inadequate sales. Arguably, however, the access to such figures could still enable landlords to calculate maximum rental the tenant could pay, a common allegation before the Reid Committee. The Victorian initiative to include the misuse of turnover figures in the unconscionability provision gives weight to this alleged problem, however proving such misuse may be an arduous task. (Webb 2006, p. 269)

Outgoings

Complaints from tenants in shopping centres about landlords seeking to recover certain expenses led to the original retail tenancy Acts containing requirements that the extent of the recovery of operating expenses be carefully defined. Areas of particular concern were the use of sinking funds and the operation of promotional funds (Murdoch, Rowland and Crosby 2001).

In more recent years, greater clarity has been sought on the items that could be recouped as outgoings. The legislation in each of the States and Territories now requires that leases specify the outgoings that are to be regarded as operating expenses, how they are determined and apportioned to the lessee, and how they are to be recovered by the lessor. While there is some variation across jurisdictions, the legislation generally requires landlords to provide tenants with an estimate of outgoings, an outgoings statement and an audited annual statement. As Webb put it:

> The legislation generally has adopted enhanced documentation regarding the calculation of outgoings and promotions and there are considerable obligations on lessors in relation to audited statements. (Webb 2006, p. 273)

Some jurisdictions have prohibited particular operating expenses. In Victoria, Queensland and South Australia, for example, landlords are prohibited from recovering contributions for land tax. In Western Australia and Victoria, the recovery of management fees paid for collecting rent are prohibited.

Relocation/compensation

The Reid Committee reported that, although retail tenancy legislation recognised tenants' rights to compensation for disturbance and relocation, it had heard 'some horrific stories' about the disturbance to trading suffered by retailers during redevelopment of shopping centres, with inadequate compensation paid to cover trading losses (SCISR 1997, p. 72).

The Committee recommended that retail tenants be compensated for disturbance caused by redevelopment and compulsory relocation according to a pre-determined formula.

Under the current legislation, lessors in all jurisdictions are required to inform tenants of any plans for redevelopment and relocation.

Relocation clauses in a lease agreement are covered in the legislation of all jurisdictions except Western Australia. Generally, relocation during the course of a lease may be initiated by a landlord if there are plans for substantial refurbishment, redevelopment or extensions to the shopping centre that cannot be carried out without vacant possession of the tenant's shop. The landlord must then provide an offer for an alternative shop for the lease period on the same terms as the existing lease. However, rent may be adjusted to account for difference in the commercial values of the two premises. This offer must be made with at least three months notice in most jurisdictions, while there is a six month minimum in Tasmania. Upon receiving the notice, the tenant has the right to terminate the lease. If the tenant agrees to relocation, they are entitled to the reasonable costs of relocation.

Legislation in all jurisdictions provides for the payment of compensation to tenants for certain occurrences, including where a landlord substantially alters or inhibits the flow of customers to the shop. Inclusion of such clauses indicates an acknowledgment by legislators that retail leases, particularly in shopping centres, represent more than the rental of physical space and that shopping centre landlords can affect the foot traffic or number of customers within a centre. These clauses represent an attempt to make landlords accountable for the management of a centre.

Assignment

Retail tenancy legislation in all States and Territories contain provisions governing the assignment of leases, that is, where the lease is transferred from one tenant to another, typically as part of the sale of the retail business located there. Assignment of leases is subject to the approval of the landlord, but there are restrictions on the capacity of the landlord to disallow an assignment. Typically, a landlord may only disallow an assignment if the assignee intends to change the use of the premises, or the assignee's financial resources and/or business skills are inferior to those of the existing tenant.

A key feature of assignment — in all jurisdictions except Tasmania[1] — is that liability is passed to the assignee and the previous tenant absolved of liability (subject to correct procedures being followed, such as provision of an assignor's disclosure statement in some jurisdictions, such as New South Wales). This is a relatively recent addition to retail tenancy legislation. For instance in Victoria, protection from liability was not incorporated until the introduction of the *Retail Leases Act 2003*. In New South Wales, this provision was incorporated in 1998 and revised in 2005, while in Queensland, release from liability provisions was incorporated in 2006 amendments.

Casual mall licensing

Casual mall licensing governs the operation of casual short-term tenants located in the common areas of shopping centres. South Australia is the only State that has regulations governing the operation of these types of lease arrangements. The mandatory casual mall licence code of conduct operates as a schedule under the South Australian Retail and Commercial Leases Act. Under the code, a landlord can not grant a casual mall license unless they have a casual mall licence policy. Landlords must meet a range of disclosure requirements and there are restrictions

[1] In Tasmania, liability is removed only if the terms of the lease, other than rent, are changed after assignment without their agreement.

on the granting of licenses that result in the unreasonable introduction of competition to adjacent tenants.

Concerns over competition with existing tenants appear to have been a primary reason for the introduction of the code:

> The Code will provide a legislated framework in which casual mall licensing can operate. It will clarify the entitlements and expectations of affected parties, ensure that lessees have access to greater information about casual mall licensing in retail shopping centres and significantly reduce the tensions which have occurred from time to time between shopping centre owners/managers and retail lessees over this issue.
>
> The use of common areas of shopping centres by retailers selling goods or services pursuant to licences granted by shopping centre owners (casual mall licensing) is widespread. A number of issues have arisen in relation to the practice. Some tenants are concerned that casual mall licensing can result in the unreasonable introduction of competition. There is also concern that, in some cases, the holders of casual mall licences are subsidised by lessees' payments for outgoings. (Brindal 2001, p. 2831)

While no other jurisdictions have introduced provisions governing casual mall licensing, there has been recent adoption of a casual mall leasing code of practice by industry. This industry code of practice is modelled on the South Australian code. The code is voluntary and it is up to shopping centres to elect to subscribe to the code. This code has been authorised (for an initial five years) by the Australian Competition and Consumer Commission (ACCC), meaning that adherence to the code provides immunity from prosecution under the TPA for actions that would otherwise be of concern. The code took effect from 1 January 2008.

FINDING

In attempting to improve security of tenure and reduce the uncertainties of retail tenancy leases, regulation has become increasingly complex and prescriptive in stipulating the terms of leases — increasing differences between jurisdictions and with commercial tenancies more broadly.

Increasing information and disclosure

Information provisions under the retail tenancy legislation are aimed at ensuring that landlords and tenants have the relevant information available to help them make appropriate decisions before signing a lease. The Review of Victorian Retail Tenancies Legislation 2001, for example, stated that one of the key policy principles for retail tenancy regulation was that:

> Government involvement in retail tenancies matters should aim at ensuring that prospective tenants have sufficient knowledge to make an informed business decision.

> … Government regulation should focus on addressing information imbalances and the misuse of market power. (Victorian Government 2001, p. 5)

Provision of disclosure statements

The original legislation in Queensland did not require the provision of disclosure statements. Amendments to the legislation required landlords to provide prospective tenants with a range of particulars prior to signing a lease, although the form was not specified. The introduction of new legislation in Queensland in 1994, however, prescribed both the content and form of disclosure statements.

In 1997, the Reid Committee report noted that the failure of one party to disclose information remained a problem:

> The Committee received evidence that, even where mandatory disclosure applies, some property managers are failing to provide enough accurate information to allow sensible decisions on the part of prospective tenants. (SCISR 1997, p. 65)

The Victorian Government review of the *Retail Tenancies Act 1986* (which led to its replacement by the *Retail Tenancies Reform Act 1998*), also found that tenants rarely received disclosure statements and that there was no effective remedy to ensure that such statements were provided. As a means of compelling landlords to provide disclosure statements, the Retail Tenancies Reform Act stipulated that tenants were not liable to pay rent until they received the disclosure statement (Office of the Minister for Small Business and Tourism 1997).

The disclosure statement requirements stipulated under the current State and Territory retail tenancy legislation involve the provision of a considerable amount of information, such as rent, estimated outgoings and any plans for development of the centre. Penalties apply if leases are entered into without the provision of the appropriate information in the specified time frame, or if the information contained in the disclosure statement is materially false or misleading. According to Webb:

> Disclosure statements have become more comprehensive over time with more factors being added, it seems, with each amending Act. (Webb 2006, p. 276)

In most States and Territories, the SCCA submitted that the landlord is now required to supply the prospective tenant with:

- a letter of offer;
- a copy of the proposed lease;
- a copy of the legislation, retail tenancy guide or information brochure;
- a copy of the Lessor's Disclosure Statement (completed by the lessors);

- a copy of the Lessee's Disclosure Statement (to be completed by the lessee);
- details of the fitout requirements for speciality shops (in the case of larger shopping centres); and
- other documentation (such as acceptance forms, centre rules, bank periodical payment requests and privacy policy forms (submission no. 83).

The Queensland Retail Shop Leases Act also requires prospective tenants who are not 'major lessees' (that is, those with fewer than five shops nationally) to provide a financial advice report and a legal advice report. These reports are to certify that tenants have been provided with advice about their financial and legal rights and obligations under the lease. The reports also require these professionals to advise tenants to seek further professional advice on a range of specific financial and legal matters if necessary. According to the SCCA, other States have also considered these provisions but, to date, have not imposed these additional obligations on prospective lessees (submission no. 83).

FINDING

All jurisdictions require the provision of disclosure statements. The statements detail important information intended to improve transparency and decision making.

Lease registration

There are provisions for the registration of leases (typically those exceeding three years) in all States and Territories under the various land title Acts. Under these Acts, registration requirements are not specific to retail tenancy leases. However, it was brought to the attention of the Commission that the incidence of lease registration varies across jurisdictions. In New South Wales, registration of retail tenancy leases (under the *Real Property Act 1900*) appears common. Lease registration also appears common in Queensland, the Northern Territory and the Australian Capital Territory. Registration appears to be less common in the other jurisdictions.

The purpose of registration of the lease with land title offices is to register the interest in the property and have indefeasibility of title. However, as part of registration, pertinent particulars, including rent, are recorded on a publicly accessible register. Access to this data provides a source of market information on the retail tenancy market, and is a secondary benefit from registration that is being exploited by some industry participants and information service providers.

Victoria is the only jurisdiction that requires notification of the lease (to the Victorian Small Business Commissioner) under retail tenancy legislation. This was introduced as part of the 2003 legislation. It is notable that lease details notified to the Small Business Commissioner in Victoria are not publicly accessible.

FINDING

Leases can be registered in all States and Territories under property law.

The role of government in the provision of education and advice

Governments also play a role in providing information. At the national level, the Office of Small Business provides general advice to small businesses about operating a business, as well as specific information on retail leasing. It seeks to advise small business and/or retailers of steps they can take to inform themselves of lease obligations and avail themselves of professional advice commensurate with lease commitments and business risk.

The ACCC, through its TPA educational outreach program, also provides a range of educational and training advice to small businesses, including small retailers, about their rights and obligations under the TPA (box 3.1).

Most State and Territory governments also provide educational resources and training on retail leasing matters and operating a small business generally. In New South Wales, for example, the Retail Tenancy Unit distributes a number of documents aimed at improving retailers' knowledge and understanding of leasing matters and dispute settlement. These include the *Retail Tenancy Unit Dispute Resolution Kit*, the *Protect Your Lease Handbook*, along with template disclosure documents (New South Wales Retail Tenancy Unit 2007a). Similar publications are produced by Business Victoria who also conduct a series of regular workshops aimed at potential and existing retail tenants. For example, the 'Signing a Retail Lease Workshop' seeks to provide tenants with '… important information about the *Retail Leases Act 2003* and retail leasing in general' (Business Victoria 2007, p. 1). This workshop is conducted at low cost to participants ($30 per person), takes just over 3 hours and covers topics such as:

- the importance of retail tenancy to your business;
- before entering into a lease;
- unconscionable conduct;
- getting the right advice;
- after the lease is signed;

- dispute resolution; and
- contacts for further assistance.

Box 3.1 **The ACCC's educational outreach program**

The ACCC runs a Educational Outreach Program to attain effective compliance with the TPA by informing stakeholders of their rights and obligations:

The program is delivered through a variety of mechanisms, including:

- regional outreach managers — who interact with, and conduct presentations to, small business groups, local industry and community associations, business enterprise centres, ethnic associations and local government;
  - regional outreach managers also utilise the ACCC's Regional Supporter Network which consists of 400 organisations throughout Australia who act as a contact point for the ACCC.
- the development and production of publications — these are used to inform small business of their rights and obligations under the TPA with over 3 000 publications distributed, on average, each week; and
- the ACCC's Small Business Helpline — which provides an inquiry service for small business and franchising inquiries.

Recent examples of ACCC initiatives related to retail tenancy include:

- *Being smart about your new franchise: checklist before signing a lease agreement* — a checklist developed to assist prospective franchisees in considering issues in relation to retail leases such as contractual obligations, renewal and transfer options, occupancy costs, franchise territory;
- *Franchise Bulletin: Being smart about your new franchise and your retail lease* — guidance for prospective franchisees about leasing arrangements they may enter into and their associated rights under the franchising code of conduct (including a checklist for research and due diligence in relation to a retail leasing arrangement);
- *Small Business Bulletin: Being Smart about your retail lease* — aims to explain the protections afforded by the TPA and the role of the ACCC in the retail tenancy sector (publication currently under development);
- *Being smart about your small business: checklist before signing a lease agreement* — a checklist designed to assist small business owners in considering their retail tenancy issues (publication currently under development); and
- *A Small Business Guide to Unconscionable Conduct* — provides guidance as to what constitutes unconscionable conduct in small business transactions under the TPA and explains the distinction between unfair and unconscionable conduct.

Source: Submission no. 128.

FINDING

Information and educational resources on retail tenancy matters are available from government agencies in all States and Territories and from the ACCC.

Fair trading — unconscionable conduct provisions

The Reid Committee report (p. 171) referred to the 'very real economic and social costs currently involved in the unfair exploitation of small businesses by larger businesses'. The report further states that:

> If stronger parties are allowed to shift the liability for risks onto others, which should arguably be theirs, they may behave more carelessly than they would otherwise do. (SCISR 1997, p. 169)

As stated earlier, in response to recommendations in the Reid Committee report (as well as other considerations), unconscionable conduct provisions were included as section 51AC of the TPA (see section on fair trading legislation) and drawn down into retail tenancy legislation in all States and Territories, except South Australia and Tasmania. This occurred as early as 1998 in New South Wales and as recently as June 2007 in Western Australia. In addition, the unconscionable conduct provisions have been drawn down into fair trading laws of all States and Territories.

South Australian retail tenancy legislation has clauses prohibiting vexatious conduct and threatening behaviour by landlords towards tenants, but does not contain the phrase 'unconscionable'. The provisions in Tasmania state that parties may not engage in conduct that is 'harsh, unjust or unconscionable'. The Australian Capital Territory, while having drawn down the provisions of the TPA, also prohibits conduct that is 'harsh and oppressive'. Box 3.2 provides more details of unconscionable conduct provisions in the retail tenancy legislation of each State and Territory.

FINDING

All States and Territories have unconscionable conduct or similar provisions within retail tenancy legislation. There is some variation between jurisdictions.

Box 3.2 **Unconscionable conduct in retail tenancy**

Unconscionable conduct provisions in retail tenancy law vary across the country.

South Australia's Retail and Commercial Leases Act prohibits 'conduct that is (in all the circumstances) vexatious'. A landlord may not require a premium for a renewal, nor threaten a tenant to prevent them from exercising a right to renewal or a right under the Act.

In **Tasmania,** the Code of Practice for Retail Tenancies prohibits conduct that is 'harsh, unjust or unconscionable'. Unconscionable conduct by a property owner may include a threat to subsidise a competitor to the tenant in nearby premises, or to not renew the lease unless the tenant agrees to a proposal by the property owner to pay a rent in excess of the market value rent.

The **Australian Capital Territory's** Leases (Commercial and Retail) Act prohibits conduct that is 'unconscionable or harsh and oppressive'. The legislation specifies the matters that courts may consider include most of the factors set out in section 51AC except for those relating to industry codes, and the willingness to negotiate lease terms. It requires consideration of the extent to which parties 'acted honestly' rather than 'acted in good faith', as under the TPA.

In **New South Wales,** the Retail Leases Act prohibits 'unconscionable conduct' and requires consideration of all factors listed in section 51AC. The legislation specifically notes that a failure to renew a lease will not constitute unconscionable conduct.

In the **Northern Territory,** the requirements under the Business Tenancies (Fair Dealings) Act are the same as those in New South Wales.

Queensland's Retail Shop Leases Act prohibits conduct that is 'in all the circumstances' unconscionable, with the same considerations as for New South Wales.

In **Victoria,** the Retail Leases Act prohibits conduct that is 'in all the circumstances' unconscionable. It requires consideration of all factors listed in section 51AC, as well as the unreasonable use of tenant's turnover figures and the reasonableness of fit-out costs and preparedness to incur them. The legislation specifies that a failure to renew or a failure to agree to an independent valuation of current market rent will not constitute unconscionable conduct.

Western Australia's Commercial Tenancy (Retail Shops) Agreements Act is similar to legislation in Victoria.

3.3 Zoning and planning

The supply of land for retail activities, which is governed by planning regulations in each State and Territory, can also affect the operation of the retail tenancy market.

The planning context

In terms of retail and commercial activities, State and Territory governments have formed planning policies around the 'centres policy' (New South Wales Department of Planning 2005; Western Australian Planning Commission 2000; and ACT Planning and Land Authority 2002). Centres policy seeks to set in place systems that exploit the benefits of concentrating activities in the one location. This policy is reflected in both metropolitan plans, such as Victoria's *Melbourne 2030*, and regional plans, such as Queensland's *Wide Bay Burnett Regional Plan 2007-2026* (Victorian Department of Sustainability and Environment 2003; Queensland Department of Local Government, Planning, Sport and Recreation 2007a).

Centres policy is based around the notion of combining all major trip-generating activities, such as retail and commercial activities, in the one location with the aim of reducing 'unnecessary' car use and traffic congestion and making better use of (or planning decisions pertaining to) public infrastructure such as public transport and roads (Cockburn 2005). As the SCCA recognised:

> … retail developments that are permitted outside these designated centres inevitably generate their own demand for road and transport infrastructure and, in a constant climate of scarce public resources, this will inevitably be at the expense of continuing public investment in designated urban centres. Such out-of-centre developments are therefore discouraged because of their significant community and environmental cost. (submission no. 83, p. 23)

Other benefits from concentrating activities in central locations are argued to arise from:

- improved access to retail, commercial, health, education, leisure, entertainment and cultural facilities, along with cultural and personal services; and
- increased competition, collaboration and innovation amongst businesses from clustering (New South Wales Department of Planning 2005).

Each State and Territory has separate planning policies and legislation which governs development within cities and regional areas (see box 3.3). In many cases, State legislation provides an overarching guide for implementation that is conducted at the local council level.

Box 3.3 **State regulation governing planning and zoning**

Each State and Territory has its own legislation and regulations that cover planning and the zoning of retail space. Often, zoning is left to individual local councils under the guidance of State planning laws and policies. Retail zoning in States and Territories is governed by:

- The *Environmental Planning and Assessment Act 1979* in New South Wales;
- The *Planning and Environment Act 1987* in Victoria;
- The *Integrated Planning Act 1997* in Queensland;
- The *Town Planning and Development Act 1928* in Western Australia and the *Western Australian Planning Commission Act 1985* which establishes the authority which develops State planning policies;
- The *Development Act 1993* and associated *Development Regulations 1993* in South Australia;
- The *Land Use Planning and Approvals Act 1993* in Tasmania;
- The *Planning Act 2007* in the Northern Territory; and
- The *Planning and Land Act 2002* in the Australian Capital Territory.

Planning policies vary across States and Territories based on the individual characteristics of each jurisdiction. Thus, the extent to which the supply of retail space is regulated, and the degree of centre planning varies. Despite this, all jurisdictions apply centre policy principles to some extent in their planning.

Changes to zoning usually require applications be made to local councils. Before rezoning is allowed, there is generally a period of public consultation, with many rezoning plans also required to be approved by State or Territory planning departments/authorities.

Sources: New South Wales Department of Planning (2007); Western Australian Planning Commission (2006); Victorian Department of Sustainability and Environment (2007); Queensland Department of Local Government, Planning, Sport and Recreation (2007b); Planning SA (2007); Tasmanian Department of Infrastructure, Energy and Resources (2007); Northern Territory Department of Planning and Infrastructure (2007); ACT Planning and Land Authority (2007).

Zoning and the supply of retail space

In terms of retail zoning, the centres policy has concentrated retail activity into specific locations. A key determinant in decisions made about retail (and commercial) zoning has been access to public transport and other infrastructure. As stated by the New South Wales Department of Planning:

> Clear guidance is required as to where retail and commercial office activities should be located with a critical determinant being good public transport and boosting activity and vitality in centres across the spectrum to encourage and sustain investment. (New South Wales Department of Planning 2005, p. 104)

Such polices have aimed to reduce or eliminate the emergence of new retail concentrations in areas outside identified centres. For example, the NSW Metropolitan Strategy suggests that the emergence of retailing in some industrial areas has both displaced some light industry and created excess trip generation. Planning policy thus restricts such activities to those which are 'ancillary to the industrial use or has operating requirements or demonstrable offsite impacts akin to industrial uses (such as building and hardware, plumbing and nurseries)' (New South Wales Department of Planning 2005, p. 105). That is, retail activities should not be permitted in industrial zones unless they are by nature selling bulky goods (for example, a homemakers centre) or supplementary to the industrial activities undertaken on the site.

Instead, planning policies aim to induce new retail investment into under-developed, or poorly maintained existing retailing developments — particularly strip shopping centres in main transport corridors (such as Parramatta Road in Sydney, which has been signalled as an area for redevelopment in the New South Wales *Metropolitan Strategy*). This also provides for uniform regulation for businesses that conduct relatively similar activities — such as factory outlets and more traditional retail stores. For example, the New South Wales *Right Place for Businesses and Services* policy (New South Wales DUAP 2001), which sets out the policy framework that governs zoning for retail, commercial and industrial areas, states that factory outlets, apart from those which are ancillary to industrial activities, 'are simply shops seeking low rents and could be encouraged to agglomerate in existing declining centres where they can play a positive role in their revitalisation' (New South Wales DUAP 2001, p. 12).

Such polices are mirrored in other States and Territories, for example, in Victoria's *Melbourne 2030* policy (Victorian Department of Sustainability and Environment 2003), in Western Australia's *Metropolitan Centres Policy Statement for the Perth Metropolitan Region* (Western Australian Planning Commission 2000) and the *Planning Strategy for Metropolitan Adelaide* (Planning SA 2006).

Limiting such 'non-centre' developments has also been prompted by concerns over congestion and the availability of infrastructure. The creation of trip-generating activities outside of centres, for which infrastructure has been developed (and for which continued development is planned) has the potential to put strain on existing infrastructure, and create externalities such as congestion. Further, it is believed that concentrating retail activities will also promote competition, leading to consumer benefits (New South Wales Department of Planning 2005).

FINDING

Zoning and planning controls affect the location, quantity and use of retail space.

3.4 Summing up

The last two decades or so has seen a transformation in the regulation governing the retail tenancy market. From initial beginnings in Queensland, specific retail legislation has been extended to cover every State and Territory, except for Tasmania where a regulated code of conduct has been applied. Moreover, legislation has been continually amended and expanded, resulting in complex and prescriptive, and to some extent, arbitrary rules.

In general, the legislation across jurisdictions covers the same broad topics, although there are many differences with respect to detailed provisions. Chapter 5 outlines participants' views of the operation of the retail tenancy market in the context of this legislative framework and develops some principles for assessing regulation of the retail tenancy market.

4 Dispute resolution

Processes for dispute resolution for retail tenancy in Australia exist at both the State and Territory level, and at the national level through the Australian Competition and Consumer Commission (ACCC).

This chapter outlines the development of arrangements to resolve retail tenancy disputes in Australia (section 4.1) and the current operation of these arrangements (section 4.2).

4.1 Development of dispute resolution procedures

Prior to the introduction of retail tenancy legislation, disputes between landlords and tenants were handled as commercial tenancy disputes. For small retailers who were unable to settle disputes via direct negotiation, the only other options were either a tribunal or court with its associated formality, expense and delay. The cost of these options had the potential to act as a barrier to efficient dispute resolution. Also, the use of the courts to settle disputes had the potential to jeopardise ongoing commercial relationships between parties.

Queensland, the first State to introduce retail tenancy legislation in 1984, was also the first State to introduce a dispute resolution mechanism specifically for retail tenancy disputes. Prior to this, the 1981 report of the Cooper Committee, the Inquiry that preceded retail tenancy legislation in Queensland commented on the frustration experienced by retail tenants in their disputes with landlords because of the lack of a neutral third party. The Committee observed that:

> … many of the problems brought forward by small tenants could have been resolved by intelligent, flexible, understanding attitudes and response by management. (Cooper Committee report 1981, p. 5)

The Committee also observed that some owners and managers already had arbitration clauses in their leases and that this practice was desirable.

About the time that that Inquiry was initiated, the Building Owners and Managers Association (BOMA) had proposed the establishment of a representative Retail Tenancy Advisory Body to investigate, using a conciliatory approach, legitimate complaints from either tenants or landlords. BOMA considered that such a body could work well given ‘the small magnitude of real disagreement’ in the industry

(Cooper Committee report, p. 40). The Cooper Committee also saw merit in BOMA's proposal and suggested that:

> … such a body could well have a place as part of an overall package of measures which could be adopted to achieve industry self regulation and administration. (Cooper Committee report 1981, p. 40)

The Queensland Government, however, opted to introduce retail tenancy legislation in 1984. At the outset, the legislation had provisions for mediation and a tribunal. The other States broadly adopted Queensland's approach, introducing from the outset a dispute resolution process either in parallel with, or as part of, their retail tenancy legislation (box 4.1).

Reid Report identifies concerns

In 1997, the report of the Reid Committee (SCISR 1997) noted dissatisfaction amongst tenants with the operation of the dispute resolution procedures that were in place at that time:

> … an overarching concern of retail tenants in the inquiry concerned mechanisms for dealing with retail tenancy disputes outside the courts. (SCISR 1997, p. 27)

Dissatisfaction with these procedures was most evident in Victoria and Western Australia. Neither of these States had separate retail tenancy tribunals at the time. In Victoria, concerns related to the high costs for retail tenants of resolving disputes, and the fact that arbitration determinations were not on the public record. In Western Australia, the main complaints made to the Reid Committee concerned delays and the lack of ultimacy of the rulings of the Commercial Tribunal (many verdicts were being immediately challenged in the District Court).

As discussed in chapter 3, the Reid Committee found that small businesses were often disadvantaged in their dealings with larger businesses and recommended a 'Uniform Retail Tenancy Code' that would:

- provide for low cost mediation and conciliation of retail tenancy disputes;
- provide for retail lease tribunals around Australia with jurisdiction to make binding decisions on retail tenancy disputes and afford limited rights of appeal to the courts; and
- explicitly exclude the option of legal representation for parties to a retail tenancy dispute, short of any eventual appeal to the courts. (SCISR 1997, p. 31)

Box 4.1 **Introduction of dispute resolution procedures for retail tenancies**

The States introduced, from the outset, dispute resolution processes either in parallel, or as part of, their retail tenancy legislation:

New South Wales — The Voluntary Code of Conduct for Retail Tenancies (1992) contained a dispute settlement mechanism comprising mediation and determination by an independent expert. The *Retail Shop Leases Act 1994* provided for access to the Registrar of Retail Tenancy Disputes who could negotiate with parties; make arrangements for mediation; facilitate access to either the Commercial Tribunal or to a court (with preference given to the tribunal rather than court to determine an order).

Victoria — The *Retail Tenancies Act 1986* allowed for referral of disputes to commercial arbitration. In 1995, further reform introduced a scheme of compulsory conciliation prior to the referral of disputes to arbitration.

Queensland — *Retail Shop Leases Act 1984* included dispute resolution mechanisms with provisions for mediation and a tribunal.

South Australia — Provisions in the *Landlord and Tenant Act 1936*, introduced in 1985, provided access to the Commercial Tribunal. The *Retail & Commercial Leases Act 1995* established mediation and access to the Magistrates Court.

Western Australia — The *Commercial Tenancy (Retail Shops) Agreements Act 1985* provided for access to the Commercial Tribunal for alternative dispute resolution, with the Registrar required to attempt to resolve disputes through mediation before referral to the Tribunal

Tasmania — The *Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998* requires the Code's Monitoring Committee to conciliate on disputes.

Northern Territory — The Territory's *Business Tenancies (Fair Dealings) Act 2003* established a Commissioner of Business Tenancies and introduced a two-step process of mediation or conciliation for retail leases followed by either access to an inquiry process by the Commissioner or court action.

Australian Capital Territory — The *Leases (Commercial and Retail) Act 2001*, transferred jurisdiction of commercial and retail matters from the Tenancy Tribunal to the Magistrates Court of the Australian Capital Territory. The Act requires the courts to actively manage disputes including, where appropriate, referral to alternative dispute resolution such as mediation.

Sources: BOMA and RTA (1991); Chadwick (1994); Chappell (1994); Australian Capital Territory OFT (2002); Victorian DSRD (2001).

In responding to the Reid Committee report, the Minister for Workplace Relations and Small Business supported the development of low-cost dispute settlement processes, stating:

> The Government particularly believes that effective low cost justice is an essential element of any retail tenancy safety net and should be incorporated in all State and Territory legislation where it does not currently exist. (Reith 1997, p. 9)

In 1998, the Australian Government added its own protection for small business by amending the *Trade Practices Act 1974* (by inserting section 51AC) to prohibit unconscionable conduct in small business transactions. On announcing the changes, the Minister for Workplace Relations and Small Business said:

> … This new provision will be particularly beneficial to retail tenants as it allows a court to have regard to the relative strengths of the bargaining position of the retailer and the landlord in determining whether the conduct complained of was unconscionable. (Reith 1997, p. 10)

At the State level in 1998, immediately following the Reid Committee report:

- Victoria introduced its *Retail Tenancies Reform Bill 1998* which provided access to the newly created Victorian Civil and Administrative Tribunal (VCAT); and
- New South Wales introduced legislative amendments that gave jurisdiction to the Administrative Decisions Tribunal (ADT) to deal with claims under the retail leases legislation, and established a new Retail Leases Division of the tribunal.

Further refinements made to dispute resolution processes

In more recent years, there have also been a number of refinements made to the dispute resolution processes at the State and Territory level. In response to a Review in 2001, Victoria's *Retail Leases Act 2003* established the Small Business Commissioner which has the power to investigate complaints and mediate retail tenancy disputes. The Victorian Government's policy intent in establishing the Small Business Commissioner was to allow parties to resolve their problems and maintain business relationships in a low-cost non-adversarial environment, and to take relatively small disputes out of the formal tribunal and court system. The 2003 reforms also required mediation before parties could access VCAT.

While the Victorian Government took a broad approach in establishing a Commissioner for Small Business, most of the Commissioner's work has been associated with retail tenancy (submission no. 111).

In 2004, the Australian Capital Territory Government also appointed a Small Business Commissioner, whose responsibilities included assisting the mediation of disputes involving small businesses (Quinlan 2004). However, the position was abolished in 2006, which left disputes to be dealt with by the Magistrates Court.

In Western Australia, legislative amendments in 2004 gave the State Administrative Tribunal (SAT) jurisdiction over retail tenancy disputes. In 2007, further legislative amendments made provisions for small businesses to be protected against unconscionable conduct and to have matters heard by the SAT.

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All State and Territories have dispute resolution mechanisms for retail tenancy which have generally focused on the development of alternatives to the courts through arrangements that are low-cost, accessible and timely.

4.2 Current dispute resolution procedures

State and Territory level

The dispute resolution frameworks currently in place are similar across jurisdictions and embody common elements such as access to mediation or conciliation prior to proceeding to a tribunal or the courts. However, there are differences in the operation and cost of dispute resolution processes across jurisdictions, which means that options for tenants and landlords vary depending on where they conduct their business. For example:

- In New South Wales, Victoria, Queensland and the Northern Territory, procedures in place generally mean that only in the case of mediation failing can disputes be referred to a tribunal (in the case of New South Wales, Victoria and Queensland) or the courts (Northern Territory).
- In South Australia, a dispute can be taken to the Commissioner for Consumer Affairs for mediation, or it can be taken to the Magistrates Court.
- In Western Australia, disputes proceed directly to the State Administrative Tribunal, where they may be referred to mediation or compulsory conference.
- In Tasmania, a dispute can be referred to the Office of Consumer Affairs and Fair Trading.
- In the Australian Capital Territory, disputes are dealt with by preliminary hearings, mediation and court hearings in the Magistrates Court (box 4.2).

For disputes not resolved at mediation, the authorities in New South Wales, Victoria, South Australia and Western Australia can intervene in tribunal or court proceedings, though such provisions have been very rarely used. Under retail tenancy legislation, in the first three of these States, the authorities can also institute proceedings.

Box 4.2 **Current dispute resolution procedures**

New South Wales — the Registrar can provide parties with preliminary assistance of an advisory nature. This information and advice is free. The Registrar may refer the matter to mediation and access to the ADT is generally only available if the Registrar certifies that mediation has failed or is unlikely to resolve the matter. The tribunal itself must also attempt to conciliate the dispute. Matters may proceed to the Supreme Court.

Victoria — the Small Business Commissioner can provide preliminary assistance of an advisory nature, for example, on a party's rights or obligations under the lease. The Commissioner can refer matters for alternative dispute resolution, including mediation. A dispute can only be subject to proceedings before the VCAT if the Commissioner certifies that mediation has failed or is unlikely to resolve the matter. Costs can be awarded by VCAT against a party that refuses to participate in prior mediation.

Queensland — the Registrar of the Retail Shop Leases Registry can arrange mediation. If this is unsuccessful or if the dispute is not settled within four months from lodgement, the matter may be referred to the Retail Shop Leases Tribunal for a directions hearing. The dispute may then proceed to a tribunal hearing. The tribunal must also attempt to conciliate.

South Australia — a party may apply to the Commissioner for Consumer Affairs for mediation using an independent mediation scheme administered by the Commissioner, though mediation is not mandatory. A dispute can also be taken to the Civil (Consumer and Business) Division of the Magistrates Court. Claims over $40 000 must be referred to the District Court.

Western Australia — a dispute may be lodged with the SAT. Following a preliminary hearing, the tribunal can refer a matter to mediation or compulsory conference. If the dispute is not resolved by mediation the dispute can be heard by the SAT. Matters not resolved at the SAT can proceed to the Supreme Court.

Tasmania — an attempt must be made to resolve disputes by direct negotiation. If unsuccessful, parties may request the Office of Consumer Affairs and Fair Trading to investigate the dispute and attempt to negotiate a mutually acceptable solution. If unresolved, either party may refer the dispute to the Magistrates Court or Supreme Court as appropriate.

Northern Territory — parties to a dispute may apply to the Commissioner of Business Tenancies who calls a preliminary conference and, if required, a conciliation conference. Procedures at a conciliation conference include informal mediation as well as conciliation and other forms of alternative dispute resolution. If the conciliation conference fails, the Commissioner may hold an inquiry (if the claim is < $10 000) or refer the matter to court (with the Commissioner's certification).

Australian Capital Territory — disputes are dealt with by preliminary hearings, mediation and court hearings in the Magistrates Court. Upon application, the court must hold a management meeting to assess the likelihood of parties resolving the dispute before the proceeding is heard. If resolution is deemed likely, the courts must promote settlement. If resolution is deemed unlikely, the court must give directions as to how proceedings will be conducted. Disputes may be referred to the Supreme Court.

Dispute resolution arrangements cover most but not all disputes. Some jurisdictions — including New South Wales, Victoria and Queensland — exclude coverage of rent determination, or have different arrangements for related disputes. There is also some requirement that matters be meaningful — legislation for the ADT in New South Wales, VCAT in Victoria, the SAT in Western Australia and the Hearing Commissioner in the Northern Territory expressly allow vexatious or frivolous applications to be declined or dismissed. In New South Wales and Queensland the tribunal can make an order on costs if a dispute is assessed as being vexatious or frivolous.

There are also differences across the jurisdictions in the costs to claimants of accessing dispute resolution processes (table 4.1). The fact that parties must meet some costs is intended to guard against frivolous use of dispute resolution, while the overall level of costs to parties is low compared to court action.

Table 4.1 **Statutory cost to parties of dispute resolution by State, 2007**[a]

State/territory	*Mediation*	*Tribunal*
New South Wales	$180 application fee, plus $145 per hour per party	$55 ($110 for unconscionable conduct claim)
Victoria	$95 per party per day	$284 application fee ($568 for claims over $100 000), $114-$284 per day hearing fee (depending on length of hearing).
Queensland	$100 filing fee	Each party must pay own costs.
South Australia	$500 per party for a 3 hour mediation session, and includes a pre-mediation interview for each party (mediation free in Magistrates Court)	For Magistrates Court, $12 filing fee
Western Australia	As per SAT	$60 application fee, plus $120 per hearing day after the first day
Tasmania	Nil	For Magistrates Court, $88 filing fee ($104 for claims over $5 000)
Northern Territory	Conciliation costs shared equally unless otherwise agreed	For Supreme Court, $300 filing fee
Australian Capital Territory	As per Magistrates Court	For Magistrates Court, $108 fee to institute proceedings (or $377 for amounts over $10 000)

a All charges are rounded up to the nearest dollar. Statutory charges do not cover the costs of mediation in all States and Territories, and additional financial contributions may be made by governments. For example, in Victoria an explicit subsidy for mediation of $400 per day is provided (Office of the Victorian Small Business Commissioner 2007, p. 25).

Sources: Australian Capital Territory Magistrates Court 2007; New South Wales ADT (2007); New South Wales Retail Tenancy Unit (2007b); Northern Territory Supreme Court (2007); Office of the Victorian Small Business Commissioner (2007); Queensland Retail Shop Leases Registry and Tribunal (2007a and 2007b); South Australian Commissioner for Consumer Affairs (2007); South Australian Magistrates Court (2007a and 2007b); Tasmanian Magistrates Court (2007); VCAT (2007a); Western Australian SAT (2007a).

In general, cost recovery for alternative dispute resolution in retail tenancy does not cover all costs associated with these arrangements. To illustrate this, box 4.3 sets out the costs of dispute resolution for the Victorian Government.

Box 4.3 **Estimated costs to government of dispute resolution procedures**

In most States, governments carry some of the costs of alternative dispute resolution. For example, in 2006-07 in Victoria:

- the Government expended over $2 million on the Office of the Small Business Commissioner (whose main work relates to retail tenancy disputes); and
- Government expenditure on VCAT's Retail Tenancies List is estimated to be in excess of $300 000.

In New South Wales, government expenditure on the Administrative Decisions Tribunal's Retail Leases Division is estimated by the Commission to be in the order of $550 000 (in 2005-06 by allocating total government expenditure on the tribunal by the share of retail tenancy cases to total cases heard).

Sources: Office of the Victorian Small Business Commissioner (2007); Commission estimates based on VCAT (2007b); New South Wales ADT (2006).

The financial limits on claims also vary across jurisdictions. For example, in the Northern Territory, the inquiry system limits claims to $10 000, with claims above this value referred to a court. On the other hand, the New South Wales tribunal can hear claims up to the value of $400 000.

Information on dispute resolution procedures is available from the State and Territory retail tenancy offices. Information on retail tenancy disputes, together with State contacts, is also provided by the Australian Government Office of Small Business.

Provisions for dispute resolution also under fair trading legislation

Fair trading legislation in a number of the jurisdictions also contain unconscionable conduct provisions and access to tribunals or courts under which claims can be heard (table 4.2).

Table 4.2 **Unconscionable conduct provisions in fair trading law and retail tenancy law by State**[a]

State/territory	*Fair trading law*	*Tribunal/ Court to hear*	*Retail tenancy law*	*Tribunal/ court to hear*
New South Wales	Section 51AB	General Division, ADT	Section 51AC	Retail Leases Division, ADT
Victoria	Section 51AC	Various lists, VCAT	Section 51AC plus additional factors courts may consider; specifies certain behaviour as not unconscionable	Retail Tenancies List, VCAT
Queensland	Section 51AB	Industry tribunal or Supreme Court	Section 51AC	Retail Shop Leases Tribunal
South Australia	Section 51AB	District Court	Prohibition on 'vexatious' behaviour and the making of threats in relation to lease renewal or extension	Magistrates Court if claim <$10 000, or/else District Court
Western Australia	Section 51AC	Supreme Court	Section 51AC plus additional factors courts may consider; specifies certain behaviour as not unconscionable	Commercial and Civil Stream of SAT
Tasmania	Section 51AC	Supreme Court	Prohibition on 'harsh, unjust or unconscionable ' behaviour (specifies certain threats as unconscionable)	Magistrates Court or Supreme Court
Northern Territory	Section 51AB	Supreme Court	Section 51AC	Local or Supreme Court
Australian Capital Territory	Section 51AB	Magistrates Court	Prohibits conduct that is 'unconscionable or harsh and oppressive', and most elements of section 51AC	Magistrates Court

a Reference to Section 51AB relates to the draw down of that section of the TPA prohibiting unconscionable conduct in relation to consumers. Reference to Section 51AC relates to the draw down of that provision of the TPA prohibiting unconscionable conduct in business transactions.

Sources: AUSTLII (2007); Tasmanian Office of Consumer Affairs and Fair Trading, pers. comm., 17 September 2007.

As is evident from table 4.2, in Victoria and Western Australia, there is potential overlap in the unconscionable conduct provisions in fair trading law and retail tenancy law. In New South Wales, Queensland, the Northern Territory and the Australian Capital Territory, fair trading law has only drawn down section 51AB of the TPA. As such, the drawing down of most or all elements of section 51AC in retail tenancy law in these jurisdictions is complementary to rather than duplicative of the unconscionable conduct provisions in fair trading legislation.

The greater detail in retail tenancy legislation's unconscionable conduct provisions — such as additional factors that the courts may consider when determining unconscionability, or specific behaviour that would not be deemed unconscionable — is aimed at providing some certainty about the application of the law in the retail tenancy market. The Victorian provisions specifically included additional factors so as to ensure greater clarity concerning how unconscionable conduct may relate to retail tenancies (Brumby 2003). Similarly in Western Australia, the drawing down of section 51AC into retail tenancy legislation (at the same time it was drawn down into fair trading law), aimed for provisions 'tailored to the circumstances of retail leases' (Kobelke 2003, p 12049).

National level

Provisions for dispute resolution also exist at the national level through the ACCC and its enforcement of the TPA. The provisions include:

- section 51AC which prohibits unconscionable conduct in business transactions (see box 4.4 for factors a court may consider in determining whether conduct is unconscionable);
- section 52 which prohibits conduct that is misleading or deceptive or is likely to mislead or deceive. In retail leasing, this may include, for example, incorrect advertising of site properties or rent levels or other inaccurate information that concerns the premises or its location; and
- section 53 which prohibits false or misleading representations. In the retail tenancy context, this may include representations about future turnover, people traffic and shopping centre advertising and marketing (submission no. 128).

Box 4.4 **Criteria for determining whether conduct is 'unconscionable'**

The term 'unconscionable conduct' is not defined in the TPA. However, for the application of the concept of unconscionable conduct in dispute resolution, section 51AC includes a set of criteria to assist tribunals and courts in determining whether unconscionable conduct is present in a transaction. The factors a court *may* consider include:

- bargaining strength of each party;
  - of this, requiring conditions which were not reasonably necessary to protect the legitimate interests of the stronger party;
- capacity of the small business to understand any document;
- use of undue influence, pressure or unfair tactics;
- whether the small business could obtain an arrangement on better terms elsewhere;
- consistent conduct in similar transactions;
- adequate disclosure;
- willingness to negotiate;
- extent to which each party acted in good faith; and
- requirements of any relevant industry code, including those reasonably seen as relevant by the small business.

In September 2007, the TPA was amended to include an additional factor — whether there is a contractual right to unilaterally vary a term or condition of a contract. According to the ACCC:

> This provision expressly recognises that there may be an inequality in the bargaining position of parties to these types of transactions, and aims to afford small businesses protection from exploitation by a stronger party. (submission no. 128, p. 15)

The amendment also raised the transactions limitation on access to section 51AC from $3 million to $10 million.

Some disputes are notified directly to the ACCC as the administrator of the TPA. Other disputes are referred to the ACCC by State and Territory retail tenancy officials. Referral from the States and Territories generally occurs when the alleged conduct is found to:

- extend beyond the State or Territory boundary;
- be beyond the local regulator's powers to resolve;
- represent a particularly blatant disregard for the law; or
- require a wide ranging educational initiative from a national regulator (submission no. 128).

All disputes are assessed on the basis of whether a breach of the TPA has occurred. If the dispute does not contain an allegation of a breach of the TPA it is either referred to a more relevant government agency, or if it is of a purely contractual nature, the complainant is advised to seek legal assistance and private resolution. The ACCC also regularly refers complaints and inquiries it receives to the relevant States and Territories. The complaints are referred if the issue:

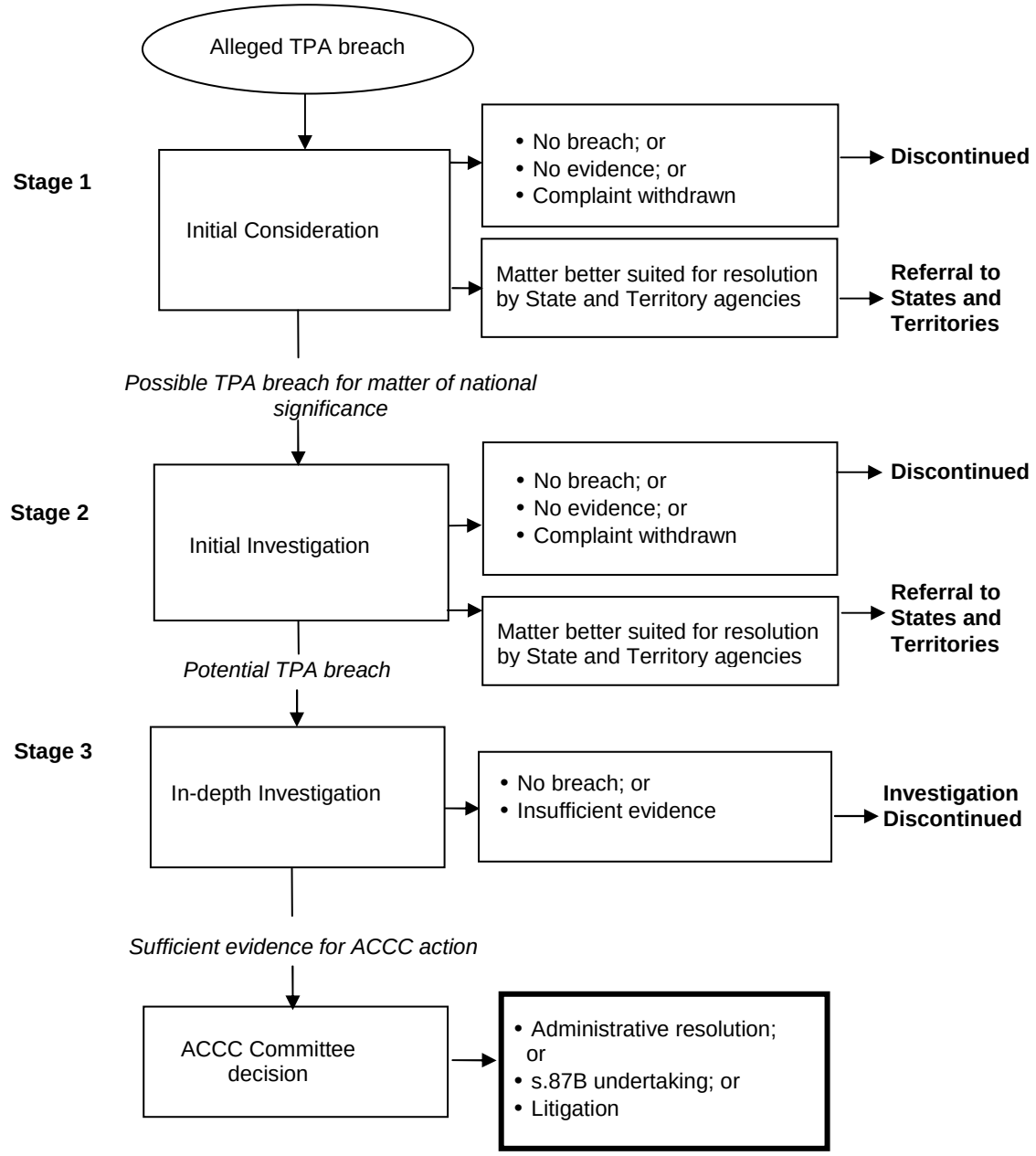
- does not constitute a potential breach of the TPA but may fall within the ambit of State law (such as disclosure obligations); and/or
- is suitable for formal dispute resolution; and/or
- may be more efficiently resolved through the local laws and regulations.

Complaints that contain allegations of breach of the TPA escalate to the attention of the ACCC.

The ACCC's three stage dispute or complaints investigation process involves initial consideration, initial investigation and in-depth investigation (figure 4.1):

- Stage 1 — is a preliminary assessment of general data and initial analysis of the conduct. Valid complaints are progressed to the investigation stage. In some cases a complaint may not be progressed to investigation due to the reluctance of the complainant to have the matter so escalated, the withdrawal of the complaint or the conclusion reached in discussion with the complainant that the matter is best addressed through dispute resolution.
- Stage 2 — investigators seek to find sufficient corroborating evidence to support the claim. If successful, and the complainant has not withdrawn the allegation, the matter is progressed to the in-depth investigation stage. If the evidence is lacking, the investigation is discontinued.
- Stage 3 — involves further collection of information and assessment. If the allegation is substantiated and reliable evidence exists to support it, the matter will generally be referred to an internal Committee. Options at this stage include litigation, administrative resolution (where the company agrees to do certain things or refrain from doing others) or resolution by means of a court enforceable undertaking (where the ACCC accepts formal administrative settlements or undertakings from the business, in addition to or instead of taking legal proceedings) (submission no. 128).

Figure 4.1 **ACCC complaints investigation process**



Source: Adapted from submission no. 128, p. 25.

The ACCC does not investigate or take action in every matter which may involve a breach of the TPA. Rather, it takes a risk/cost assessment based approach to selecting matters or industry-wide issues of concern which are appropriate for intervention. In particular, the ACCC focuses on matters of national significance and/or widespread consumer or business detriment. As such, even when TPA provisions are duplicated in State or Territory law, the operation of such law in the States and Territories does not appear to duplicate the operation of Commonwealth law.

Amendments made in 2001 to the TPA (section 87CA) also gave the ACCC an expanded statutory basis for applying to a court to intervene in private proceedings instituted under the TPA. The principle guiding a decision to intervene is whether the public interest would be served by doing so (submission no. 128). The ACCC can also undertake representative actions under section 87(1B).

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The ACCC's role in dispute resolution is additional to that of State and Territory authorities, with a focus on addressing breaches of the Trade Practices Act that are assessed to be of national significance.

4.3 Summing up

A key objective of retail tenancy dispute resolution is to provide an alternative to tribunals and courts. As a result of developments over the last two decades, retail tenants and landlords now have access to low-cost alternative arrangements for dispute resolution in each jurisdiction. This is intended to be of particular value to small retail tenants and small landlords.

While these arrangements have many common elements, such as access to mediation or conciliation prior to proceeding to a tribunal or the courts, there are differences in the operation and cost of dispute resolution processes across jurisdictions. Moreover, some provisions relevant to dispute resolution in the retail tenancy market in some States duplicate provisions in fair trading law.

The ACCC's role in dispute resolution is complementary to that of State and Territory authorities. Its focus is on addressing breaches of the Trade Practices Act that are of national significance.

5 Principles for regulation of the retail tenancy market

Despite more than two decades of extensive legislative activity affecting retail tenancies (chapter 3) and the development of dispute resolution systems (chapter 4), imbalances in bargaining power between small retailers and large landlords continues to be raised as an issue of concern. What this suggests is that specific retail tenancy legislation, introduced to redress concerns about bargaining power, has not been entirely successful in delivering the results expected by some. Whether this is a result of inadequacies in regulation or unrealistic expectations is an important question.

While good regulation can contribute significantly to preventing or counteracting market deficiencies, unnecessary or poorly designed and implemented regulation can impose excessive costs on business, restrict competition and distort the allocation of resources in the economy — as well as failing to meet its intended objective.

This chapter seeks to identify relevant 'design principles' for the assessment of retail tenancy legislation and for evaluating proposed regulatory changes.

Section 5.1 outlines participants' views on the effectiveness of the legislation. Section 5.2 places the development of design principles for tenancy regulation in the broader context of regulatory improvement while section 5.3 looks at aspects of retail tenancy bearing on design principles focused on that market. The next section sets out design principles for assessing regulation of retail tenancies. Section 5.5 sums up the chapter.

5.1 Views on effectiveness of retail tenancy regulation

State and Territory retail tenancy legislation prescribes many aspects of the retail landlord-tenant relationship. However, many of the issues raised by participants of this inquiry are the same as those that gave rise to the original retail tenancy legislation. They are also the issues that led to the numerous State-based reviews of the legislation and other inquiries relating to retail tenancy — such as the Reid

Committee inquiry (SCISR 1997) and the 2003 Senate Inquiry into the Effectiveness of the *Trade Practices Act 1974* (TPA).

As one participant said:

> Despite the legislative improvements of the past 10 years (Reid Report 1997, Trade Practices Act amendments of 1997 and 2004, etc plus the many amendments made at State level) there remains a massive imbalance of bargaining power between lessor and tenants in retail lease negotiations. (confidential submission)

The Franchise Council of Australia added:

> The problems in retail tenancy have been well documented since the 1990s, however despite numerous calls for action, including the comprehensive 1997 Reid Report, there has been no effective government action or the implementation of a national code for retail tenancy, as recommended. Inconsistent and ineffective prohibitions on unconscionable conduct have had a very limited effect on addressing the failures of the market identified more than a decade ago. (submission no. 117, p. 3)

A number of participants also considered that fundamental concerns continue to affect the retail tenancy market (box 5.1).

Box 5.1 **Some negative comments relating to the operation of the market for retail tenancies**

Council of Small Business of Australia (COSBOA) — 'the market for retail leases is a continual state of failure. As a result of that failure, COSBOA and its members have seen, first hand and at close quarter small business retailers suffer, mainly at the hands of large businesses. COSBOA asserts that the failure of the retail leasing market is geographically widespread and culturally systemic within large businesses operating in the retail leasing market as lessors — mainly large scale shopping centre owners and managers' (submission no. 94, p. 1).

Southern Sydney Retailers Association — 'The long term damage to the Australian economy and the threat to the nation's future prosperity from the distortion of the broken market for retail leases cannot be overemphasized' (submission no. 131, p. 10).

Western Australian Retailers Association — 'Since the Reid Report in 1997, real progress in the retail tenancy arena has been notable by its absence. In essence, it has been a very one-sided bloodbath with great wealth conferred upon a few chosen ones and enormous suffering inflicted on those whose blood, sweat and tears has then seen their Castles and their capital effectively transferred to those chosen few' (submission no. 118, p. 4).

This suggests that the legislation has not 'fixed' many of the 'problems' that it was designed to address. The Reid Committee report described the situation in the late 1990s as a 'war' going on in shopping centres around Australia:

> The idea that there is a 'war' going on in shopping centres around Australia, between retail tenants and property owners and managers, conveys accurately the tenor of evidence given to the Fair Trading inquiry on retail tenancy issues. (SCISR 1997, p. 15)

In the Commission's assessment, the term 'war' is not representative of the balance of evidence provided in this inquiry — a few skirmishes, some lingering resentment, hard bargaining and some disappointments, but not 'war'. This is not to say, however, that the market is working perfectly. Indeed, the Commission heard evidence of difficult commercial negotiations and cases involving significant personal loss. Despite this, it appears that some positive improvements have been made to the overall market since the 1997 Reid Committee report.

The State Governments generally considered that the legislation was effective in forming a basis for sound lease practices, with the New South Wales Government commenting:

> … since its introduction, the NSW *Retail Leases Act 1994*, has been strongly supported by landlords and tenants associations as forming the basis for good leasing practice in the retail sector. (submission no. 136, p. 1)

The Victorian Government also said:

> Overall, the retail tenancy market appears to be functioning relatively well. The existence of enquiries and mediated disputes between landlords and tenants is evidence of a robust regulatory system where parties are able to access the information and advice they need, and can seek low-cost mediation assistance when required. (submission no. 111, p. 10)

It added:

> The retail leasing commercial relationship requires some government intervention to ensure fair, competitive outcomes for market participants.
>
> At this point in time there does not appear to be fundamental problems with the retail tenancy market in Victoria that require a substantial change in the regulation of the market. The Victorian Government considers that its approach helps to balance the retail tenancy relationship by dealing with information imbalances and imperfect competition arising from varying degrees of bargaining power between players. (submission no. 111, p. 11)

A number of participants also commented that the current retail tenancy framework and market have a number of positive features and that the market is working reasonably well (box 5.2).

Other participants commented that retail tenancies have become over regulated adding to costs. Westfield, for example, while believing the Australian retail tenancy market to be the most efficient in the world, commented that duplicated legislation creates compliance costs:

… there is, uniquely within Australia, excessive regulation of the retail tenancy lease market through the operation of State and Territory retail tenancy laws which are, in the main, designed to protect retail tenants as a class. Those laws regulate all aspects of the landlord and tenant relationship. In addition, they are supplemented by Commonwealth law principally in the form of the TPA … State and Territory Retail Tenancy and associated legislation, such as Fair Trading Laws, also provide remedies for unconscionable conduct and misleading and deceptive conduct. It is apparent that the existence of this regulatory framework embeds a significant level of cost within the market for retail tenancies. This cost includes not only the cost of compliance, principally borne by landlords, but also the cost to the taxpayer of the bureaucracy and administrative infrastructure required to oversee and administer these laws. (submission no. 85, p. 16)

Box 5.2 Suggested positive features of the current retail tenancy regulatory framework and market

Law Institute of Victoria (LIV) — 'Generally the LIV is satisfied with the current regulation in respect of disclosure of relevant information to tenants before and during the course of the lease term' (submission no. 27, p. 11).

Subway Systems — 'In view of our considerable footprint on the Australian retail leasing scene over several years we have generally developed a good working relationship with most major lessors' (submission no. 28, p. 1).

The Royal Institution of Chartered Surveyors (RICS) Oceania — 'The general RICS view is that the current structure and function of the Australian retail tenancy market has many POSITIVE aspects'. It referred to the disclosure of information, the dispute resolution/mediation process and the operation of registrars/commissioners (submission no. 39, pp. 2-3).

Shopping Centre Council of Australia (SCCA) — 'The market for retail tenancy leases in Australia is competitive. As a result it works efficiently and there is no evidence of significant market failure that requires correction. … Only a very small number of retail tenancy disputes (both in numerical terms and as a proportion of retail leases) occur each year and these are usually successfully resolved by low-cost, easily-accessible dispute resolution mechanisms' (submission no. 83, p. 2).

Real Estate Institute of Australia (REIA) – 'Notwithstanding localised shortages of retail premises, trends in consumer shopping preferences and regulatory differences between jurisdictions, the retail tenancy market appears to be operating relatively efficiently across Australia. The REIA is not aware of any major fundamental flaw in the market that systematically disadvantages either landlords or tenants (submission no. 112, p. 1).

The GPT Group submitted that:

Certainly additional legislation is not required in what we believe is already an area of business that is over regulated. Rather a simplification and uniformity of legislation will lead to benefits for both retailers and landlords. (submission no. 34, p. 2)

Colonial First State Property Management (CFSPM) considered that some of the regulation was redundant:

> … with the large amount of regulation comes some uncertainty, inconsistency, and significant compliance costs affecting both owners and tenants. CFSPM has been involved in several reviews of retail legislation over the past 5 years and has noticed that in some cases at least, regulation was introduced which served no material benefit to either owners or tenants, yet resulted in additional compliance costs. In other cases, regulation was introduced as a result of only a small number (supported by empirical evidence) of isolated incidents in the retail leasing market, although again, it had a material and significant impact on the vast majority of participants in the retail leasing industry. (submission no. 78, p. 7)

Others commented on the extent of regulation covering the retail tenancy market in Australia compared with that in other countries. For example, the Australian National Retailers Association said that its members:

> … who have a presence in both countries (NZ & Aus) believe the system in Australia is over-regulated and inconsistent with multi-layered legislation. (submission no. 92, p. 6)

The SCCA added:

> It is difficult to think of another area of business-to-business relationships where governments have intervened so substantially in order to protect small businesses or where they spend so much taxpayers' money on providing advice and support.
>
> As a result of this intervention the market for retail tenancy leases in Australia is now heavily regulated. We are unaware of any other country in the world with such a highly regulated retail tenancy market. (submission no. 83, p. 7)

FINDING

Many of the concerns raised in this inquiry are the same as those that gave rise to the original retail tenancy regulation. This suggests that the regulation has not fixed the concerns that it was intended to address. Some participants, however, suggested that regulation has gone too far.

Detailed comments and a range of suggestions for possible changes to the regulatory environment for retail tenancy reflecting these various perspectives were presented to the Commission. Many of the suggestions focus on more heavily regulating the relationship between contracting parties, particularly leases in large shopping centres. Suggestions covered concerns in the areas of:

- security of tenure — including 'end of lease' issues;
- occupancy costs — including rent setting and outgoings, turnover rents and fit-outs;

- market information, transparency and disclosure — including reporting turnover data, lease transparency and understanding, model leases and disclosure statements, and lease registration; and
- business conduct — including clarifying unconscionable conduct provisions and extending these to regulate for greater 'fairness' in the market.

There were also suggestions for a less regulated approach and for greater national consistency.

In order to assess participants' (sometimes conflicting) concerns and possible options for regulatory change (which is taken up in the following chapters), a framework for assessing the regulation of retail tenancy leases is required.

5.2 Designing good regulation

While markets are the most efficient way of allocating resources, there are occasions when markets can work in such a way as to result in perverse economic and social outcomes. Good regulation can contribute significantly to preventing or counteracting such outcomes. But inappropriate or poorly designed and implemented regulation can act as a handicap by imposing excessive costs on businesses, limiting competition, stifling efficient investment and changing business behaviour. It can also add to the administration costs incurred by government. Ultimately, the costs of poor regulation are borne by taxpayers and consumers.

Effective regulation can correct market failures and help achieve economic efficiency, while avoiding the imposition of unnecessary burdens on businesses or the community (see box 5.3 and PC 2006a). In other words, well considered regulations or actions by governments have the potential to generate benefits to society that exceed their costs.

Box 5.3 **Notions of economic efficiency and effectiveness**

Notions of effectiveness and efficiency are often used by economists to evaluate market outcomes and the effects of regulation. An economically efficient outcome is one where no other outcome has a higher net benefit to society as a whole.

Effectiveness relates to how well a stated (or given) objective is achieved. The effectiveness of regulations, for example, is measured by how well the outcomes of the regulation achieve their stated or desired outcomes.

Determining whether regulation meets the dual goals of 'effectiveness' and 'efficiency' requires a structured approach to policy development that

systematically evaluates costs and benefits of policy. According to the Regulation Taskforce (2006), good process for developing and administering regulation requires the application of six key principles:

- Governments should not act to address 'problems' until a case for action has been clearly established.
  - This should include establishing the nature of the problem and why actions additional to existing measures are needed, recognising that not all 'problems' will justify (additional) government action.
- A range of feasible options — including self-regulatory and co-regulatory approaches — need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.
- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.
- Mechanisms are needed to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

The application of this policy development process should ensure that the benefits to the community of any regulation outweigh the costs and provide some assurance that the option chosen yields the greatest net benefits.

5.3 Considerations for intervening in retail tenancies

To assess whether aspects of the retail tenancy market provide a case for government intervention, a set of more detailed principles, consistent with the above broad policy process, are needed. The detailed principles should focus on maintaining the efficient operation of the tenancy market and provide a basis for avoiding regulatory pitfalls. To develop these principles, this section considers:

- aspects of the retail tenancy market that have provided a case for government intervention;
- issues associated with the application of specific retail tenancy regulation; and
- considerations associated with efficient rents and other tenancy conditions for retail space.

Aspects of retail tenancies leading to government intervention

Australia is unique in its regulation of retail tenancies (box 5.4). The case underpinning regulation of this market, as discussed in the two previous chapters, was based on perceived impediments to its efficient operation, including:

- information imbalances between large landlords and small to medium sized tenants;
- the potential for landlords to misuse negotiating power; and
- the need for low-cost resolution of disputes.

Box 5.4 Approaches to retail tenancy governance in other countries

Australia's approach to retail tenancy governance is different to that taken in comparable OECD countries.

Retail tenancies are overseen by a broader commercial tenancy voluntary code of practice in the United Kingdom (applying to England and Wales only) along with the Landlord and Tenants Act which covers both residential and commercial tenancy matters. The code of practice is 'intended to promote best practice in commercial lease negotiations' and provide 'greater choice and flexibility in the market and for businesses to take professional advice on their property issues' (BPF 2007, p. 1). The code covers lease negotiation, conduct during a lease, and landlord and tenant rights and responsibilities. It is a principles based code.

In New Zealand, Canada and the United States, no specific retail tenancy legislation, or codes of conduct exist. These markets operate under broader commercial laws such as the Fair Trading Act 1986 in New Zealand. In Canada, Industry Canada provides a series of information reports, such as *Winning Retail* (Industry Canada 2003), which seek to provide guidance to retail tenants when choosing and negotiating a lease. This document also sets out what are considered affordable occupancy costs as a percentage of sales amongst other things, which Industry Canada suggest (potential) tenants should not exceed when signing a lease (that is, walk away from the deal if the occupancy cost is too high).

FINDING

Australia is unique in its specific regulation of retail tenancies.

Regulations were developed based on the notion that failures arose in the retail tenancy market due to imbalances in negotiating power between landlords and tenants, particularly in shopping centres.

Regulators considered that information asymmetries were one aspect of the market that contributed to differences in negotiating power. Differences in information,

exploited by a party to a negotiation, could lead to inefficient business investment and operating decisions. It was also considered that significant transaction costs existed in accessing traditional dispute resolution processes (such as, through the courts), limiting the available recourse for small, less resourced market participants.

The information required by prospective tenants in the retail market (particularly those operating in a shopping centre) is market specific and extensive (and therefore difficult to obtain). Notwithstanding strong commercial incentives to acquire relevant information, some prospective tenants could be disadvantaged in lease negotiations. As the New South Wales Government put it:

> In some cases, this information asymmetry can be overcome by a prospective tenant engaging professional advisors (eg lawyers). This often involves significant expense, with large tenants more likely than smaller tenants to be able to afford the costs associated with overcoming this information imbalance. (submission no. 136, p. 3)

However, in assessing the need for government regulation to fill information gaps, a balance needs to be struck between the potential benefits of new information and the likely compliance and administrative costs that would be incurred in order to fill known gaps.

It has also been argued that retailers' greater dependence on location, compared with other commercial tenants, has contributed to imbalances in negotiating power. As stated by the New South Wales Government:

> This imbalance arises largely because, unlike businesses which lease office and industrial space, retailers are arguably more dependent on 'location' for the success of their business and are therefore in a weaker bargaining position in lease negotiations.
>
> … Tenants who lease office or industrial space can generally relocate to new premises with minimal impact on their business, if they are offered lease terms for existing premises that they consider unfavourable. (submission no. 136, pp. 5-6)

Negotiations for location-dependent tenants were believed to occur predominately with larger landlords, exacerbating imbalances. However, retailers are not the only business tenants that may negotiate with larger landlords, or be location dependent. The Australian Capital Territory legislation recognises this possibility by including all small commercial tenants in its coverage (those who rent a space of less than 300 square metres).

While legislation has been instituted to reduce negotiating power imbalances, regulating to eliminate differences is not likely to be possible in all cases and could lower incentives to develop negotiating skills commensurate with the market. Also, because such regulations tend to advantage a certain class of business, they are likely to restrict the entry of new businesses in response to technological change and changes in consumer taste.

Regulators also assessed that imbalances in negotiating powers had the potential to lead to leases and business negotiations that were inherently 'unfair'. In response, a range of fairness provisions prohibiting unconscionable conduct were introduced. While there is an economic justification for regulating for fairness or against unconscionable behaviour — such situations are not unique to the market for retail tenancies. Also, clauses to prevent unfairness can be fraught with problems. Not least of these is the distinction between what constitutes unfair or unconscionable behaviour as opposed to a hard bargain. If levels of fairness are overly prescribed, provisions may also create disincentives for parties to enter into contracts that are mutually beneficial and undertake efficient investment. Further, overly defined provisions could become inflexible, becoming unresponsive to changing views on acceptable conduct.

High transaction costs to settle grievances through court-based judicial processes are a further reason put forward for government intervention into the retail tenancy market. To ameliorate these costs, governments have established low cost dispute settlement processes that deal with retailer and landlord issues. For small business, such processes can be particularly important as the cost of legal action through the judicial system can be significant relative to potential gains, and could present a barrier to proceeding with substantive complaints. Access to low cost dispute settlement procedures can, therefore, be important in improving efficient and fair outcomes in the retail tenancy market. While it may be cost effective to establish dispute resolution processes for retail tenancies, it is, nevertheless, likely that the processes established could apply more widely to other business disputes.

Recognising many of these issues, the Victorian Government (2001,) in seeking to regulate to the minimum extent necessary to address impediments to the efficient operation of the market, adopted a set of policy guidelines:

> … 1: Government regulation of retail tenancies should focus on addressing information imbalances and the misuse of market power.
>
> … 2: Retail tenancies legislation should only protect small and medium sized retail businesses.
>
> … 3: Government involvement in retail tenancies matters should aim at ensuring that prospective tenants have sufficient knowledge to make an informed business decision.
>
> … 4: While a landlord has a fundamental right of control over the use of its property, this right does not extend to engaging in unfair business practices.
>
> … 5: Landlords and tenants should be able to access a low-cost informal dispute resolution forum prior to any grievances proceeding to formal litigation. (Victorian Government 2001, p. 5)

Such an approach involves creating incentives/opportunities for efficient decision making and penalties for the misuse of market power and unfair business practices,

rather than through legislated intrusions into contract terms (limiting the right of control over property). Many legislative provisions, however, do target contract terms (such as minimum lease terms) violating the stated principles of intervention.

Issues associated with the application of specific retail tenancy regulation

For various reasons, the judicial and legislative mechanisms that cover standard business contracts (such as common law and the TPA) have been deemed insufficient to deal with retail leases. This has led to State-specific regulations which, in some instances, overlap or are inconsistent with current judicial and legislative mechanisms.

Concerns about imbalances in bargaining power and information asymmetries in the context of shopping centre leases, led regulators to limit the coverage of retail tenancy legislation by definitions of what constitutes a 'retail tenancy' (see chapter 3). Definitions range from business types (listed companies versus partnerships and sole traders), to floor space occupied, to lease value or a combination of all aspects. These somewhat arbitrary definitions add to the complexity of operating retail (and sometimes commercial) businesses, particularly those operating in multiple jurisdictions. Arbitrary lines of distinction can also create market inefficiencies if they alter landlords' choice of tenants — for example, landlords preferring certain types of businesses because they face fewer tenancy regulations in dealing with them, or tenants selecting certain business formats for similar reasons.

Also, because of concerns that retail tenancies differed materially from other commercial tenancies, a range of regulations prescribing deviations from commercial law (for example, minimum lease terms) were enacted. However, attempts to regulate behaviour of market participants through prescriptive limits on what they can and cannot do are often unsuccessful (Lattimore et al. 1998). With such limits, it is often possible to exploit gaps within legislation, reducing its effectiveness. In these instances, prescriptive legislation can result in unwarranted compliance costs on businesses and other mechanisms to influence conduct may work better. Prescriptive regulation can also:

- lead to instances where small tenants come to rely on government to reduce the negative consequences of their own bad decisions, and thus become more likely to make such decisions — known as 'moral hazard'; and
- restrict the ability of two parties to engage in trade and commerce, and thereby inhibit economic activity that is beneficial overall.

What level of government is best to govern retail tenancies?

Currently, matters relating to retail tenancy are the responsibility of State and Territory governments. The Subsidiarity Principle proposes one answer to the question of what level of government is best to govern retail tenancies (PC 2005). Under this principle, responsibility for a particular function should, where practicable, reside with the lowest level of government competent to deliver it (CEPR 1993; Kasper 1995 and 1996). However, even when applying this principle in determining governance arrangements that can most efficiently resolve retail tenancy issues, the relevant benefits and costs of governance at any level need to be considered.

The characteristics of retail tenancies have an impact on the suitability of different levels of government for dealing with retail landlord-tenant relationships. At a local government level, for example, there will be advantages in that regulators will have a greater understanding of the community in which landlords and retailers operate, but they will not necessarily give weight to broader issues of competition or the costs of cross-border commerce. Conversely, at the Commonwealth level, regulators may be too distant from communities to understand the manner in which the markets are functioning when making decisions. Despite this, a national approach to regulation would be beneficial to firms operating across State and Territory boundaries.

One potential benefit that has arisen by each State and Territory maintaining jurisdiction over regulation in the retail tenancy market is that jurisdictions have conducted, in effect, policy experiments in order to devise a better regulatory approach. With numerous legislative revisions increasing prescriptions of the landlord-tenant relationship, however, these gains are likely to have been exhausted and even eroded.

Considerations for efficient rents for retail space

Market interactions between retailers and landlords that occur within retail concentrations, such as shopping centres, have unique characteristics that need to be considered in deriving principles for the efficient regulation of retail tenancy agreements. In particular, regulations should not predetermine pricing behaviour in different retail formats or impinge on the ability of market participants to negotiate.

In shopping centres, individual retailers do not act in isolation from other retailers. Rather, the sales generated by one retailer have an effect on the sales of others. Where there is a single landlord and many retailers in the retail concentration, as in shopping centres, the overall success of the centre is largely the responsibility of the

centre landlord. In less concentrated retail spaces, these interactions are not as significant, with leases between individual landlords and tenants formed via negotiation, as for any business contract, where neither the landlord nor tenant has a controlling influence on the surroundings.

The clustering of retailers is brought about to capitalise on consumers' preference for 'one stop' shopping (Ghosh 1986; Brown 1989; Oppewal and Holyoake 2004; and Smith and Hay 2005). Retailers within these concentrations are able to exploit the passing trade that is created by consumers visiting multiple stores, at very little additional cost per visit. This has been termed the 'inter-store externality', and means that the returns earned by each store are, in part, dependent on how many customers other stores attract and on the foot traffic generated overall.

Leasing retail space within retail concentrations provides the opportunity for individual retailers to capture the benefits of passing trade created within a retail concentration. In the case of shopping centres, the landlord supplies a common space for retailers and an opportunity for different retailers to aggregate in the one location (Miceli and Sirmans 1995). Landlords, through using larger well known 'anchor tenants' as draw cards, attempt to generate customer traffic within their centres (Arakawa 2006). For shopping centre landlords, the success of a centre, in terms of its ability to generate rental returns on the invested capital, is dependent on the centre's ability to attract and establish leases with a sufficiently diverse mix of retailers to generate the maximum amount of passing trade and for the stores therein to take advantage of this.

These two characteristics of retail shopping centres — that each store's turnover depends on other stores and that landlords need to maximise the passing-trade effects to maximise the overall return to the shopping centre — have several implications for the setting of rents in centres.

First, rents should vary by store to be efficient (this does not constitute monopoly power — see box 5.5). For example, to account for the larger volume of customers attracted by anchor tenants, the unit rent of these tenants should be lower. Those smaller tenants who benefit (in terms of customer sales for their own business) from the passing trade created by anchor tenants should pay higher unit rents (Brueckner 1993 and Wheaton 2000). In this sense, price regimes between tenants that allow larger anchor tenants to pay less rent per unit of space occupied, while smaller tenants pay more per unit, are more likely to be efficient (Brueckner 1993 and Arakawa 2006).

Second, centre managers require flexibility to alter the tenant mix and location within centres. By having the flexibility to change the tenant mix, centre managers can remove underperforming tenants or tenants offering services poorly aligned

with a centre's market and replace such tenants with better performing or suited tenants. This, in turn, can benefit all other tenants to the extent that new, better performing tenants attract an increased number of potential customers to the centre. Such flexibility is particularly important in the face of changing consumer preferences and product technology. To do this, landlords require the ability to not renew leases of those stores whose sales performance or range of goods/services are not compatible with the objective of maximising the returns for the shopping centres as a whole, in the judgement of the centre manager (Miceli and Sirmans 1995).

Box 5.5 Price discrimination does not mean monopoly pricing

Landlords, in particular those who own larger shopping centres, do not operate in a perfectly competitive market for the provision of retail space. Due to zoning restrictions, high set-up costs and geographic factors (such as the population size that is required to support large retail concentrations), owners of retail concentrations such as shopping centres compete in an oligopolistic fashion with other landlords. This type of competition suggests that some positive economic rents are extracted from consumers as the overall supply of retail space has been restricted. This restriction leads to a net loss in economic surplus, which can also be viewed as a market failure.

However, this *does not* mean that landlords act as monopolists to retail tenants. A monopolist will restrict the supply of a good or service in order to extract a higher price than what otherwise would be paid if there were competition in the market. In dealing with tenants, landlords have no incentive to restrict access to retail space for potential tenants within existing developments. Indeed, landlords have an incentive to lease all available space to tenants who can, in aggregate, achieve the greatest return. Thus, there is no loss in economic surplus within this more narrowly defined market.

But landlords will actively, and should, price discriminate between tenants (that is, charge different rents to different tenants) to maximise the return on their investment. This price discrimination is evidenced by rents to individual tenants that are based on the number of customers drawn to a centre or turnover achieved. The practice of setting different rents for similar spaces cannot be taken as *prima facie* evidence that the market is inefficient (or inequitable). Indeed, price discrimination can be a feature of well-functioning markets — such as the pricing of aeronautical services at airports (PC 2006b). Price discrimination has also been established as a principle to enhance the efficient operation of the telecommunications market (PC 2001) and it should not be ruled out as a pricing approach in the retail tenancy market.

Third, lease conditions need to be such as to align the incentives of tenants and landlords. Leases should be designed so the rent paid reflects the benefits *created* by differing levels of passing trade, and so that landlords do not under-provide services (such as marketing which helps to draw consumers to a centre) that are

beneficial to all stores or operate in an opportunistic manner (Miceli and Sirmans 1995 and Wheaton 2000). Leases should also be designed to:

- reflect a need for landlords to share some of the retail market risk of tenants so that landlords are responsive to changes in the retail market; and
- provide a disincentive for landlords to act in a predatory fashion, particularly in 'end of lease' situations.

Finally, rents should reflect different demands placed on, and services provided by, landlords (such as security, marketing and utilities).

While these considerations are relevant to establishing regimes for efficient rent setting and lease conditions, there is debate over the implications of how they should be realised in leasing conditions. For example, Miceli and Sirmans (1995) suggest that percentage rents provide retailers with an incentive to under-report their turnover or reduce their selling 'effort' to *reduce* the rent paid. On the other hand, Wheaton (2000), argues that under certain conditions percentage rents provide an incentive for landlords to avoid acting in an predatory fashion or against existing tenants when reletting space.[1] Further, it was argued that percentage rents were an efficient means to ensure the sharing of market risks.

5.4 Proposed principles

The preceding discussion indicated that there are many potential pitfalls in the regulation of the retail tenancy market, as with any market. There are also different views concerning the most efficient leasing conditions in particular circumstances. Accordingly, regulation of landlord-tenant relations needs to proceed with caution and with consideration of the current rules and laws that govern standard business contracts. Principles for regulation in this market need to rest on facilitating commercial transactions and maintaining the efficient operation of markets so that the net gains to society are maximised while maintaining conscionability in business transactions. With this in mind, some general principles for the regulation of retail tenancies are presented in box 5.6.

[1] Wheaton (2000) suggested that landlords were less likely to act in an opportunistic fashion when percentage rents are adopted as the rent receipts from small tenants would expand to comprise a greater share (and importance) of a landlord's earnings. Further, when there are fit-out and other fixed costs or when leasing contracts do not fully account for the tenant-landlord relationship (such as the impact of passing trade), Wheaton also suggested that percentage rents would provide the greatest net benefits compared to other rent setting regimes.

Box 5.6 **Principles for assessing regulation of retail tenancies**

To ensure the efficient and fair operation of the retail tenancy market and facilitate commerce, regulations should:

- not extend or overlap with current laws governing all commercial transactions (including common law and the TPA) unless there is a clear net benefit to the community;
- ensure all lease conditions (rights and responsibilities) are clear and transparent to lessees and lessors and that lease and property rights are clearly defined;
- provide affordable and accessible dispute resolution and judicial processes;
- not unduly restrict the provision or the conditions (and hence availability) or retail tenancy space;
- not restrict commercial decision making including through:
  - arbitrary regulatory distinctions between businesses (whether landlord or tenant) based on the type or level of activity, or geographic location;
  - prescriptive rent setting or mandated rent setting processes; and
  - limitations on the flexibility of landlords and tenants to decide whether or not to re-enter a new lease agreement.
- not provide opportunities for market participants to shift risks associated with letting retail space or undertaking retail business;
- not overly prescribe levels of 'unconscionable' behaviour in a manner that would reduce the efficient operation of the market;
- ensure that those significantly involved in the negotiation and management of a lease are subject to unconscionable conduct provisions and legal proceedings;
- not restrict the commercial provision of market information; and
- be the minimum necessary and not unduly add to administrative and compliance costs.

The first principle relates to the pre-existing body of laws and regulations that are in place outside specific retail tenancy legislation. Simply, it suggests that if provisions exist under common law, or in other legislation and/or regulations that have a wider scope of application, such provisions should not be repeated in specific retail tenancy legislation. This ensures that regulatory overlap or inconsistencies, which have the potential to lead to unnecessary compliance and administration costs for businesses and governments, are minimised. Also, if current laws are to be extended or varied, additional regulation should be beneficial (overall) to the community. Moreover, as set out in the final principle, all regulation introduced should be the minimum necessary, to avoid an excessive compliance and administrative cost burden for businesses and governments respectively.

The second principle states that all lease conditions need to be clear and transparent, and lease and property rights need to be clearly defined. Such information is critical if informed decisions about the market are to be made — participants need to be aware of what they are entitled to, the recourse available to them when their rights are impinged upon, and the penalties that apply for breaches to their responsibilities.

The third principle relates to access to dispute resolution processes when breaches of tenancy rights and responsibilities occur. In this regard, it is essential that market participants have access to dispute resolution processes as this can be important in achieving efficient outcomes in the retail tenancy market.

The remaining principles deal with the incentives created by regulation. These principles provide a basis against which regulations that seek to change the behaviour of market participants can be evaluated. In essence, regulations should avoid altering market incentives that provide for efficient trade, and seek to remove those that create inefficiencies. In order to do this, regulations should not seek to prescribe what can and cannot be contracted (once property rights have been established and assigned), but instead should seek to establish an efficient environment in which negotiations take place.

FINDING

Principles are needed to assess alternative views about regulatory requirements and approaches to ensure that the maximum net benefit from government interventions are realised.

5.5 Summing up

The principles presented in this chapter can guide the Commission's assessment of the current regulatory arrangements and inform recommendations to improve the efficiency and equity of the operation of the retail tenancy market.

The principles are applied in chapters 6 to 9 to assess four broad areas of concern raised by participants:

- security of tenure (chapter 6);
- occupancy costs (chapter 7);
- market information, transparency and disclosure (chapter 8); and
- business conduct and dispute resolution (chapter 9).

They are then used to assess some alternative approaches to regulation in the retail tenancy market (chapter 10) and the Commission's recommendations (chapter 11).

6 Security of tenure

Many of the current regulations in the retail tenancy market have been put in place with the intention of providing retail tenants with greater security of tenure. Despite this, many tenants expressed concerns to this inquiry in relation to tenancy security, with some suggesting that the current provisions 'have not done enough'.

Section 6.1 presents participants' views on the current arrangements. Section 6.2 provides evidence to place these views in a broader market context. Section 6.3 then assesses the various suggestions made for further regulation to influence tenancy security. Section 6.4 summarises the issues raised in the chapter.

6.1 Participants' views

The issues raised by tenants and tenant advocacy groups relating to security of tenure during this inquiry were broadly aligned with those raised in the Reid Committee report a decade earlier. The specific tenure issues raised related to:

- minimum lease terms;
- the 'vulnerability' of tenants at lease renewal; and
- 'loss' of goodwill at the end of lease.

Of the 50 plus initial submissions received from tenants, around half addressed security of tenure issues. Tenure issues were also raised by the majority of tenant advocacy groups making submissions to the inquiry. One retail representative claimed that 'the most common source of despair for retail tenants is how they are treated at renewal or when their lease terminates' (confidential submission). Security of tenure also received considerable attention in the inquiry draft report hearings and submissions commenting on the Commission's draft report.

Minimum lease terms

Many retailers said that they face difficulties in negotiating lease terms longer than five years. Some suggested that the five-year minimum lease term (a provision incorporated in most State and Territory legislation in a bid to improve security of tenure for tenants) has become a maximum lease term. For example, the Pharmacy

Guild stated:

> … when enacted, the five-year minimum term was envisaged to be the *minimum* period over which a lease could be granted. In practice, it has evolved into the *standard* term granted. (submission no. 109, p. 15)

The Australian Retailers Association (ARA) also argued that lease term options in shopping centres ceased with the minimum lease term provision:

> The offering of an option for a lease in regional and sub-regional shopping centres ceased in about 1994 when fixed terms of five years became the minimum term that a landlord was required to offer a tenant for a retail shop. That five-year term has become the term. (submission no. 119, p. 18)

One reason for retailers' concern is that a five-year term is considered to be an insufficient period to amortize capital costs. As Ipswich Leisure Centre put it:

> A business needs tenure to set-up, build up and close-down. Within a 5 year lease term, it is impossible, the business being most vulnerable at lease renewal with fixtures and fittings not yet written off. (submission no. 30, p. 1)

Some attributed this concern to differences between the lease period and the period allowed by the Australian Taxation Office (ATO) to fully depreciate shop fit outs. For example, it was suggested to the Commission:

> … shopping centre fit outs have risen dramatically and it's now impossible to write-off costs of a fit-out over five years. Costs of $150 000 for an average suburban shop fit are not uncommon. The ATO will allow accelerated depreciation on some items, but many retailers take at least seven years to write down the value of their shop fittings. (confidential submission)

The Pharmacy Guild also argued that a five-year lease term:

> … is still a very limited time for a high-cost/low-margin business, such as a pharmacy, in which to operate to recover establishment costs and then make a reasonable rate of return. …
>
> In the context of pharmacy, finance contracts or loans are generally for 10 to 15 years. The current financial operating structure of pharmacies is such that many cannot repay a loan in less than 10 years. (submission no. 109, pp. 15-6)

More generally, the ARA argued that:

> The five years that has become the norm in shopping centres clearly needs to be extended given the investment that they are forced to undertake as a condition of complying with the fit out standards required by the landlords. If the retailer is unable to renew the lease, not only is there the economic loss associated with what is left on the balance sheet but also the cost of removing and disposing of the fit out, most of which is unsalvageable. This cost is of the order of $20-30 000. (submission no. 119, p. 24)

At the draft report hearings, a few participants reiterated the need for longer minimum lease terms. For instance, COSBOA stated:

> In its submission COSBOA asserted that a seven-year lease should be the minimum term. Landlords suggested they need full control over their shopping centres to allow them to control the tenancy mix, and this is true. A tenancy mix of a shopping centre is critical, to allow it to change with the marketplace. What has not been said is that it doesn't change and evolve that fast.
>
> The time of a retail life cycle is shortening. However, seven years gives retailers ample time in which to set up, depreciate and close down, and enough time for landlords to plan properly. (transcript, p. 282)

Similarly, the Queensland Retail Traders and Shopkeepers Association said that five years was too short to recoup the cost of expensive fit-outs, noting:

> What we try to say is eight years for taxation implications. But maybe a suggested range should be five to eight years. What that does is it forces the parties to think. It forces the parties to say, 'Okay. Mate, do you want me to spend $3000 per square metre on a fit-out? Zero based accounting, how can I do it in five years, and you want X rent? It's impossible. The numbers are not going to work.' (transcript, p. 448)

ATO rulings suggest that the effective life of retail assets for amortisation purposes is in excess of five years for many items — five years for certain electrical items and electronic security equipment, but up to 10 years for counters, shelving and flooring and 20 years for billboards/hoardings and some specialised items such as food preparation benches and fixed chairs and tables in cafes (ATO 2007).

A different perspective on lease terms

The perspective on minimum lease terms from one landlord with a small shop, however, was quite different. The landlord claimed that it was her experience that tenants do not want to take on leases as long as five years (recognising that this is a different scenario to that in large shopping centres):

> In my experience, it is the tenant who does not wish to take a 5-year lease. In fact, if I could procure a tenant who wanted to take such a lease term, I would be grabbing them with open arms. (confidential submission)

The small-business landlord also argued that it should not be necessary for a tenant to seek instruction from a solicitor in order to take a lease for a shorter term.

Some tenant organisations also noted that lease terms need to be flexible to accommodate a range of uses. For instance, the National Retail Association (NRA) said:

> We don't advocate minimum lease terms, for the simple reason that a bookshop would have entirely different needs to a highly capitalised coffee shop, for instance.

(transcript, p. 411)

Similarly, the Retail Traders Association of WA noted that small retailers had stressed the importance of maintaining flexibility in lease terms to allow new tenants the ability to test the market without locking into a long-term lease (submission no. 65).

The vulnerability of tenants at lease expiry

Limited negotiating power of retail tenants in shopping centres at the time of renegotiating a lease was raised as a source of difficulty by numerous retailers and retail representative groups. Many participants suggested that landlords exploit their superior bargaining power when a lease expires by either seeking 'excessive' rent increases or 'forcing' tenants to terminate their business (or relocate within a shopping centre). With limited alternatives, particularly where one shopping centre dominates retail sales in an area, tenants consider themselves to be 'sitting ducks' — they take the offer or leave.

A number of retailers indicated that while they were able to drive a hard bargain when negotiating new leases in shopping centres (because shopping centre managers wanted the retailers in the centres), they found the situation quite different when negotiating a subsequent lease. The ARA, for example, described the shopping centre tenant as an 'economic captive' at the end of the lease:

> The difficulty that arises at the end of the lease is the position of the sitting tenant in a shopping centre where he or she is an economic captive having invested heavily in a fit out, stocked the shop for the term of the lease and contributed substantially to the asset of the landlord. If the tenant is to vacate they are confronted with the loss not only of their goodwill and also the value of the business as a going concern and their livelihood for the majority of small businesses. (submission no. 119, pp. 22-3)

Similarly, the Australian Newsagents' Federation argued that:

> … landlords are well aware that it is difficult and expensive for any retailer to relocate once established. When it comes to a lease renewal, the tenant's business is a going concern with much of the business' goodwill tied to its retail location. Under these circumstances the tenant cannot simply walk away from negotiations without facing serious repercussions on their business investment. For landlords to argue that competitive forces remain constant once retail businesses become entrenched is difficult to accept. (submission no. 72, p. 2)

The NRA also suggested that:

> End of lease and lease renewal is a very different market environment. It's like the difference between getting married and getting divorced, as an analogy. That negotiating environment is a pretty reasonable analogy, I think. The end of lease is the

crucial issue in the whole debate. (transcript, p. 413)

Limited bargaining power at lease expiry appears to be less of an issue for larger retail tenants and those operating in retail strip locations. Herro Solicitors, for example, said:

> … larger tenancies do have greater bargaining power and the writer readily sees this in day to day legal practice, where the 'mini major' tenant has considerably greater bargaining power as against the small tenant. (submission no. DR175, p. 1)

In terms of retail strip locations, property ownership is more widely dispersed and there is greater opportunity to secure alternative retail premises than is the case in large shopping centres. For example, the NRA claimed:

> The great majority of retail premises in Australia are in 'main street' locations, with widely dispersed property ownerships, and generally substantially lower sales and rentals. With some exceptions, these are more benign landlord-tenant relationships, due to supply/demand factors, wider availability of alternative premises for existing tenants on lease expiry, with somewhat better negotiating positions relative to shopping centre tenants for whom there are usually no feasible alternatives in any particular case. (submission no. 47, p. 6)

A similar point was made by the Post Office Agents Association. It claimed that licensees who rent retail space in a shopping strip generally have a reasonable chance of driving a hard bargain with the landlord — 'true negotiations can take place, especially where there are vacancies in the shopping strip' (submission no. 10, p. 1). In the case of retail space in shopping centres, however, it claims that 'shopping centre management can choose to exercise a greater degree of control over tenants and hold greater bargaining power'.

'Loss' of goodwill at end of lease for retailers in shopping centres?

Some tenants considered that they had established business value, or 'goodwill', tied to their trading location in a shopping centre, which should be realizable by them at the end of a lease. It was also suggested that shopping centre landlords did not, at the end of the lease or in renegotiations, adequately recognise the contribution of tenants to the success of a shopping centre. As Herro Solicitors put it:

> The tenant has expended capital and energy in building his or her business and establishing goodwill but without a lease this goodwill is almost worthless. This places the shopping centre owners in a strong bargaining position – the value (and sometimes the future existence of the business) depends on the grant of a lease. (submission no. 64, p. 1)

Some participants added that any goodwill that was established by a retailer in the

course of a tenancy accrued to landlords in the form of higher rent for a subsequent lease. As stated by the Southern Sydney Retailers Association:

> Theft of a small retailer's goodwill and confidential information is one of the main factors determining rents in Australian shopping centres. The theft comes at lease end, where as a result of the dishonest misappropriation of a retailers confidential information, (his sales turnover) under the sham Percentage rent clause, a landlord confiscates any goodwill a retailer has created, and forces the retailer to 'buy it back' in the form of a rent increase, or auctions the retailers goodwill to competitors, again by the way of higher rents. (submission no. 137, p. 4)

Other participants, however, suggested that there was no goodwill at the end of a fixed-term lease for retail space. Westfield, for example, put the view that:

> … much of the goodwill that is often claimed by a tenant can just as easily be said to be attributable to the drivers of customer traffic created by the location of the tenant's premises within the shopping centre and the tenancy mix and ambience of the shopping centre as a whole and not to factors attributable to the particular retailer's business. (submission no. 85, p. 21)

Westfield also noted that the nature of the lease arrangements, including the lease period, are set out and tenants should be well aware of this prior to entering a lease:

> When a retail tenant enters into a lease of premises within a shopping centre the terms of the lease arrangement are clear, including the period of tenure which will meet at least the statutory five year minimum period and may be longer depending on what has been negotiated. Before entering into the lease the retail tenant will be aware of the rent that is required to be paid, the terms and conditions of the lease and the fact that at the end of the lease term, the lease may not be renewed or if renewed may be for a higher rent (subject of course to the retail tenant being willing to renew the lease on that basis). (submission no. 85, p. 21)

During the course of the public hearings a number of retailers indicated that they were aware of the nature of lease arrangements in shopping centres, including the finite nature of lease terms and conducted their business within this framework.

6.2 Evidence on lack of security

Minimum lease terms

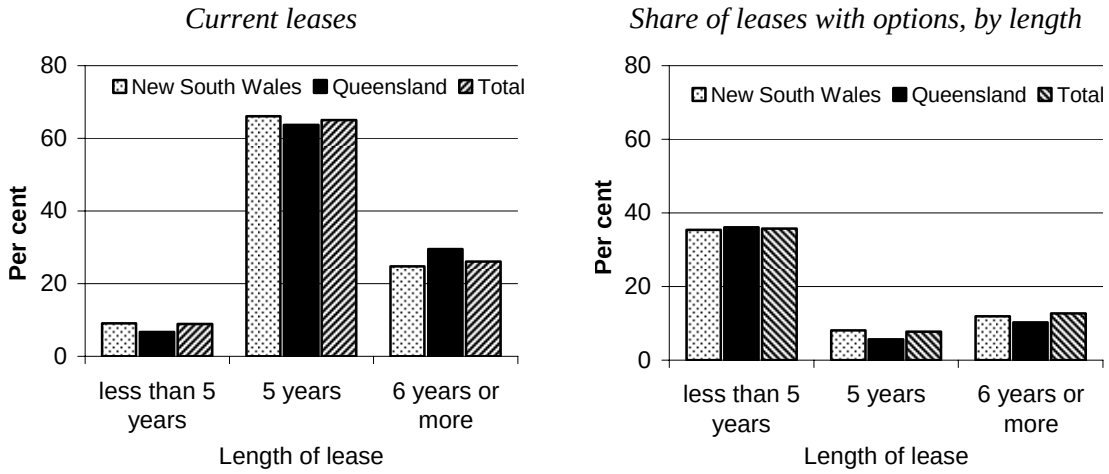
Professor Crosby from the University of Reading submitted that an 'analysis of lease terms in Australia indicated that in shopping centres all but the anchor tenants get the minimum term with no right to renew' (submission no. 84, p. 18). An examination of lease terms in a major regional shopping centre in Victoria found that 7 out of 250 leases in the centre had terms of around 20 years (these leases were

for anchor stores), while speciality shops had leases of five, six or seven years, or leases of less than five years (submission no. 84, p. 18).

Data on lease terms for 11 970 current leases (mainly in New South Wales and Queensland) indicate that, while 65 per cent of these leases are for a five-year term — 66 per cent in New South Wales and 64 per cent in Queensland (where the five-year minimum lease term has been removed) — 35 per cent are either longer or shorter than the 'standard' five-year term (figure 6.1, left panel). In New South Wales, around 9 per cent of these leases were for less than five years and 25 per cent were for more than five years. In Queensland, the corresponding proportions were 7 and 30 per cent.

Figure 6.1 **Lease periods similar between States and over time**[a]

Per cent of leases analysed



[a] Based on leases in the LIS database, which is drawn mainly from registered leases. Data for current leases is based on 9062 leases in New South Wales, 2314 leases in Queensland and 11 970 leases in total across all States and Territories. Leases classed as five years include leases up to five years and eleven months.

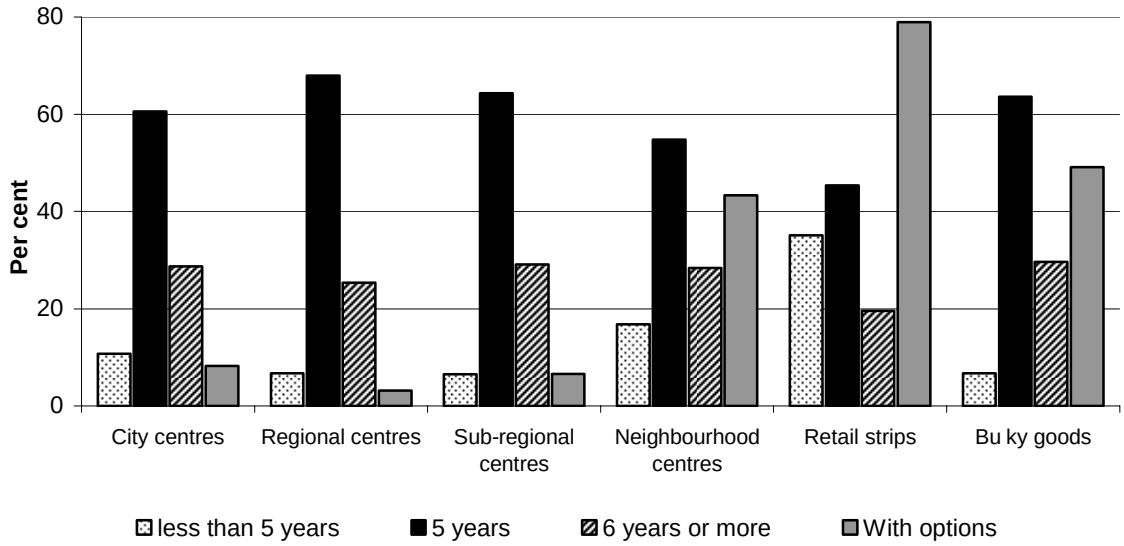
Source: Leasing Information Services (LIS) data.

The use of options also appears to be similar across jurisdictions (figure 6.1, right panel). Overall, about 12 per cent of leases analysed contained options. Options were most common amongst leases of less than five years (36 per cent), followed by longer leases (13 per cent of leases six years or longer). Eight per cent of five-year leases contained an option.

There are, however, considerable differences in lease terms between retail formats (figure 6.2). While five-year terms are the most common lease period in each of the retail formats, they are much more frequent in shopping centres, particularly the larger regional centres. Conversely, options are much more common in retail shopping strips than they are in shopping centres. For instance, 79 per cent of leases

examined in retail strips had options, compared with only 3 per cent of leases examined in regional shopping centres.

Figure 6.2 **Differences in lease terms between retail formats[a]**
Per cent of current leases analysed



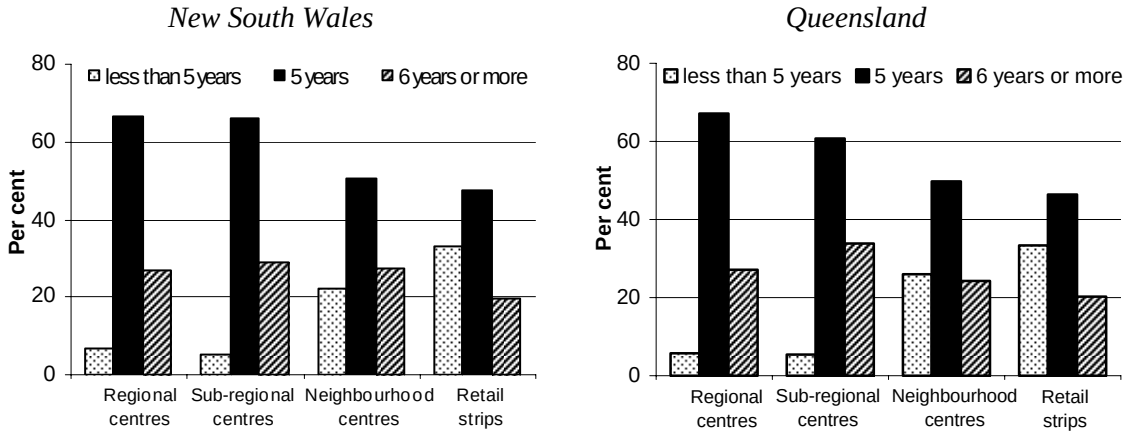
a Based on current leases for all jurisdictions in the LIS database, which is drawn mainly from registered leases. Of 11 215 current leases analysed, 728 leases are in city centres, 7761 leases in regional shopping centres, 1817 leases in sub-regional centres, 626 leases in neighbourhood centres, 664 leases in retail shopping strips and 283 leases in bulky goods sites. Leases classed as five years include leases up to five years and eleven months.

Source: Leasing Information Services data.

The lease data analysed suggest a very similar pattern in both New South Wales and Queensland. In both jurisdictions there is substantial variation in the pattern of lease terms between retail formats, but little difference recorded for each format between the two States (figure 6.3). This suggests that the length of retail leases is less influenced by the legislative framework of the jurisdictions (whether or not there is a minimum lease term) than by the retail format.

Figure 6.3 **Lease periods by retail format, New South Wales and Queensland[a]**

Per cent of leases analysed



a Based on leases in the LIS database, which is drawn mainly from registered leases. Leases classed as five years include leases up to five years and eleven months.

Source: Leasing Information Services data.

Moreover, the regulation of minimum lease terms appears to have had little long-term influence on the length of retail leases. For example, refining the analysis to leases in regional shopping centres in New South Wales indicates that while five years is the most common lease term, the incidence of five-year terms appears to have declined over the last decade. In turn, there has been an increase in the proportion of both longer and shorter leases (figure 6.4). The introduction of the five-year minimum may have initially had the effect of increasing the use of five-year terms, but over time, parties appear to have deviated from the 'standard' term, despite the additional cost in the case of leases shorter than five years, which must be 'signed off' by a solicitor.

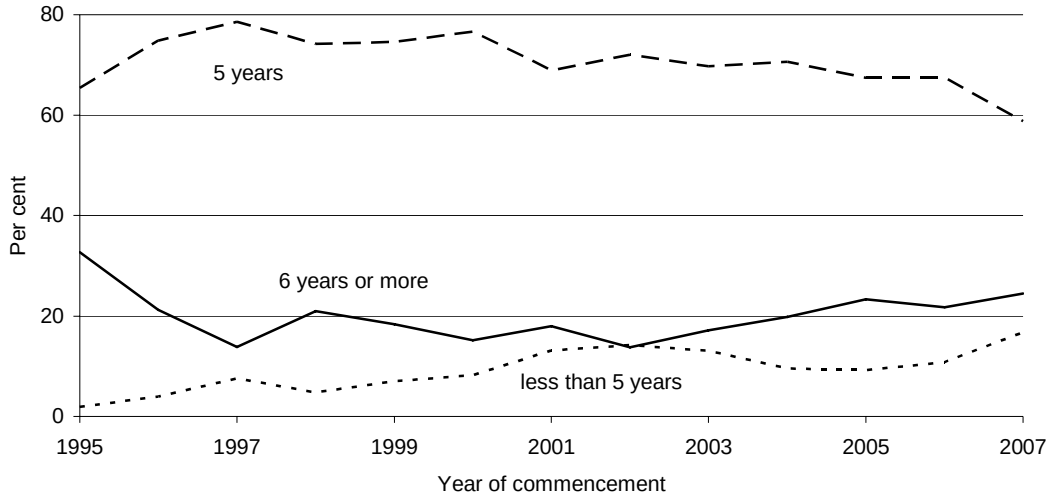
The spread of data across formats and over time, indicates that firms successfully negotiate lease terms both longer and shorter than the legislated minimum. While interstate comparisons need to be qualified because of the small sample, there does not appear to be much difference in the range of negotiated lease periods between jurisdictions that have legislated lease minimum terms, such as New South Wales, and the jurisdiction that does not, namely, Queensland. This suggests that regulations on lease terms are having little or no sustained effects and that lease terms are primarily determined by commercial negotiation.

FINDING

A significant proportion of leases are negotiated for periods other than five years. Legislated minimum lease terms have had little impact.

Figure 6.4 **Lease length by year of commencement, New South Wales regional shopping centres**[a]

Per cent of leases analysed



a Based on a sample of 9613 leases in New South Wales regional shopping centres from the LIS database. The number of registered leases in the database is typically smaller in earlier time periods. For example, data are only available on 370 leases in 1995, but 928 in 2006. In 2007, data are only available for 143 leases. Leases classed as five years include leases up to five years and eleven months.

Source: Leasing Information Services data.

Incidence of lease renegotiation

Negotiations for a subsequent lease are undertaken in the context of the supply and demand for retail space. One indicator of the balance of supply and demand is vacancy rates. Information on vacancy rates presented in chapter 2 indicates that in larger regional shopping centres vacancy rates are typically less than 1 per cent. Such vacancy rates suggest strong demand for retail space in shopping centres relative to supply. In other retail formats, vacancy rates, although varying substantially according to location and format, are higher on average than rates in shopping centres (see table 2.4).

Even in this market setting where shopping centres may have a significant degree of flexibility and choice in selecting tenants, the Shopping Centre Council of Australia

(SCCA) claimed that the overwhelming majority of tenants in centres sign a subsequent lease:

> … the vast majority of tenants (in excess of 80%) who have observed the terms and conditions of their lease and whose retail offer is still relevant to the customer base of that centre, do gain a new lease. (submission no. 83, p. 68)

With respect to individual market participants, Westfield reported that in 2006 roughly 75 per cent of the five-year leases for specialty shops that fell due were renegotiated and 'of the balance that were not renewed, in many instances this occurred at the retailer's instigation. In other instances, the leases were concluded amicably' (submission no. 85, p. 5). Similarly, Colonial First State Property Management indicated that, in its experience, of the leases that expired in the past year, approximately 70 per cent resulted in new leases being signed with the sitting tenant (submission no. 78, p. 4).

Three reviews commissioned or undertaken by the SCCA also found that the majority of leases in shopping centres are renewed:

- A review of lease renewal in 17 Victorian shopping centres in 2000 found that around 74 per cent of leases that expired in that year were renewed. Of the 109 leases that were not renewed, 77 were not renewed at the instigation of the tenant.
- A review undertaken in Western Australia covering 18 shopping centres and leases that had expired in 2001 and 2002, found a renewal rate of 62 per cent of leases and a 9 per cent 'holdover' rate (that is, in lease renewal negotiations). Six per cent of those leases not renewed were because the landlord did not offer a new lease to the sitting tenant.
- A similar study undertaken by the SCCA of lease renewals in the four major shopping centres in Canberra found that 89 per cent of leases that expired in 2004 were renewed. According to the survey, only 1 per cent of leases were not renewed at the instigation of the landlord (submission no. 83 pp. 68-9).

It is apparent that the majority of leases in shopping centres are renewed. However, there are instances in which sitting tenants are either not offered a new lease, or are offered leases that they consider unreasonable and do not elect to accept.

FINDING

Despite tight market conditions in shopping centres, as indicated by relatively low vacancy rates, the majority of retailers in centres are offered subsequent leases.

End of lease negotiations

Speciality retailers within shopping centres argued that they lack the ability to negotiate new lease contracts upon lease expiry — landlords are able to extract excessive rent increases and get tenants to agree to 'unsignable' leases.

Evidence of excessive rent increases for subsequent leases?

While the SCCA asserted that rent increases for follow-on leases are typically moderate, the Franchise Council of Australia claimed that proposed rent increases for new leases in shopping centres averaged between 30 to 50 per cent, and are sometimes over 100 per cent (submission no. 117, p. 3). The Commission was also told of cases where tenants were presented with proposed rent increases of between 30 and 115 per cent. One retailer advised the Commission:

> The new lease was outrageous as it demanded approximately a seventy percent increase on the current rent which included an additional outgoings payment of $8000. (confidential submission)

It is clear that, in renegotiating a lease for a site (or a lease for a new site for that matter), a lot of 'hard bargaining', goes on between parties. The Commission was told (by tenants, landlords and third parties), that initial offers by landlords were often ambit claims. In these circumstances, tenants with relatively poor negotiation skills could end up renewing leases with quite large rental increases, particularly if they were disinclined to walk away. However, evidence presented to the Commission suggests that tenants are often successful in negotiating down the asking rent for their next lease. For example, in a small sample of proposed and final rents, on average rents were negotiated down by 17 per cent on the asking rent. After negotiation, rents were recorded as rising an average of 42 per cent on the rent payable at the end of the previous lease term (table 6.1).

While rents, on average, tend to increase when leases are renewed, this is not always the case. One major landlord group submitted that, of renewals in 2005-06:

> … 82% agreed to a rental increase, 15% agreed to a rental decrease and 4% were renewed on the same rental. The average increase across all deals completed in 2005/2006 was 13%. (confidential submission)

Others commented on the value of engaging independent valuers and lease negotiators to help them in lease negotiations:

> Our business has also been hit hard by a recent rental hike of which we fought utilising an independent valuer. Whilst this exercise was very costly and we still incurred a substantial rent increase, we were able to peg back the initial proposed rent increase by half. (confidential submission)

Table 6.1 **Examples of rent increases negotiated for a subsequent lease**

Annual rent paid at end of lease term	*New lease asking rent in 1st year of term*	*Percentage increase*	*Agreed rent to be paid in 1st year of new lease term*	*Percentage increase*
($)	($)	(%)	($)	(%)
40 360	75 000	86	63 500	57
62 040	124 000	100	94 500	52
46 528	90 000	93	80 000 base	72
53 549	108 000	102	80 000 base	49
28 744	50 000	74	43 000	50
61 692	96 000	54	72 000	16
96 000	140 000	46	Unresolved	
71 196	98 000	38	85 000	19
54 000	96 000	54	74 132	37
78 000	105 000	34	99 500	28

Source: Confidential submission.

There are also situations in which substantial rent increases could be expected. Tenants may have entered leases with relatively low or concessional rents, perhaps because the premises were in an unpopular area or in a new development without an established customer base, or the tenant offered a product or service in high demand. If foot traffic (and sales) increase over the lease term, for instance due to a refurbishment or maturation of a new shopping centre, the novelty of new products or services has worn off or a better use of the space is available, it would be expected that landlords would seek to increase the rent substantially for a subsequent lease. The SCCA submitted that high rent increases for a subsequent lease:

> … are unusual situations and there are generally good reasons why such rent increases have been sought. Most often it is because the tenant had previously been on a very favourable rent, well below prevailing market rents, a situation that the tenant knew was not going to continue. (submission no. 83, p. 57)

This suggests that large rent increases for subsequent leases do not automatically indicate a lack of negotiating power on the tenants' part.

Many tenants and tenant organisations also expressed the view that the requirement to provide data in shopping centres allows landlords to determine rents in new leases according to a retailers' capacity to pay rather than the 'market' rent. For example, at the public hearings on the draft report in Sydney, the ARA, said:

> So they're never going to pay percentage rent, but I put to you that the figures will have — all of the actual declaration of sales figures was left in the list because clearly the landlord wanted to know how well the tenant was trading.
>
> There is in some instances, I believe, misuse of those, and there are other times where

> the perception of misuse clearly sets — especially when some of the rent increases are in the order of 20 or 30 or 40 per cent, and I'm not talking about on top of somebody who has had a very low start-up rent, and the feeling there was the guidance that the sales figures were used to basically take them to the maximum that they could take but still leave the trader in business. (transcript, p. 59)

While there is no doubt that rents charged vary considerably according to the type of retailer (see chapter 7 for a discussion on the use of turnover data to determine occupancy costs), exchanges at the hearings on the draft report failed to substantiate the claim that prohibiting the collection of turnover rent would result in landlords not being able to gauge tenants capacity to pay. The ARA, for example, also said at the Melbourne hearings:

> I agree with the ability of the manager to go around and see the good, the bad and the ugly. Most people can detect whether someone has got a good operation or not, but whether any centre manager could go to one of our stores and guesstimate the sales within 20 per cent, I'd be very surprised. (transcript, p. 564)

While it may be true that without actual turnover data landlords may either over or undershoot the mark, overall the 'guesstimates' could be broadly accurate.

Large rent increases for new leases also reflects strong demand for, and a limited supply of, premium retail space (reflected in low vacancy rates in regional shopping centres). Given the low vacancy rates for retail premises in shopping centres, centre landlords may be able to drive a hard bargain, particularly if the tenant is offering a service heavily reliant on centre foot traffic for viability.

While a 'going rate' or 'market rent' typically applies in retail strips, the business model of large shopping centres is to ask retailers for rent that equates to the maximum they can afford to pay. Many small retailers appear to not understand or accept this basic reality of the rent discovery process. Having each retailer's turnover data makes it easier for centre landlords to do this more consistently and precisely.

Imbalances in negotiating power?

There is no doubt that the major shopping centre landlords have an advantage over the small independent retailer in terms of negotiating skills and bargaining power. As the LeaseWise Group indicated, they tell tenants:

> … you will negotiate a lease once every five years; the landlord will do it daily, so you have to assume that they have an advantage. (transcript, p. 483)

Barry Nilsson Lawyers advised that from their experience:

> … most of the tenants who have failed have been mum and dad tenants who don't have

> the financial resources to know what a fair deal is and possibly don't have the resources to research the market as effectively. (transcript, p. 406)

However, there are things that tenants can do to counter the imbalances in negotiating power. As the Real Estate Institute of Australia (REIA) stated:

> There is however much tenants can do to maximise their own bargaining position including; taking a rational and balanced perspective, accessing up-to-date market information, engaging the services of property professionals (real estate agents and valuers), obtaining legal advice, and obtaining financial advice. (submission no. DR154, p. 2)

Tenants can better equip themselves by employing lease negotiators to negotiate leases for them. The well informed tenant (who has sought both financial and legal advice) will also know at what point a lease becomes 'unsustainable' for their business model and will walk away from the lease negotiations.

The Commission was advised of a variety of negotiating tactics adopted by the major shopping centre landlords at lease renegotiation that could be off-putting for tenants. For example, one negotiating tactic employed by the major shopping centres is to write to tenants six months prior to the end of the lease term indicating that there will not be a new lease. As stated by the LeaseWise group:

> That is something that is trained by leasing executives… they rely on a certain percentage of people to sort of panic, particularly the less highly evolved retailers, and to think that they have so much business and emotional energy invested in this particular enterprise that the sun won't come up unless they renew their lease (transcript, p. 483)

Simply being aware of such tactics can improve a tenant's negotiating position.

It was also clear that retailers adopted their own tactics to achieve more favourable outcomes. The LeaseWise group indicated that they now played the same game back to shopping centre landlords — they write a letter to the landlord indicating that the tenant wants an early exit from the centre. They claimed that:

> … you'd be amazed at the reaction that you get … the leasing executives from the majors say 'No, you can't go, we need you'. It's all about the knowledge and knowing how to negotiate. (transcript, p. 481)

In another case, after 12 months of failing to reach agreement on rent for another lease, a tenant placed advertisements in the major papers indicating that their store would be closing down. The outcome — within 24 hours the tenant and landlord had reached agreement on a lease.

Tenants economic captives at lease renewal?

The Commission was told repeatedly that small specialty retailers are vulnerable when negotiating another lease. For example, the NRA said:

> In lease renewals there is a high degree of anxiety by the sitting tenant, and they may be more concerned to renew the lease even at subeconomic levels rather than face the consequences of loss. (transcript, p. 411)

Another tenant, Manna Confectionary, painted the following picture of the situation at lease renegotiation:

> Let's forget the point that I've just bought a business in a shopping centre. Let's say I'm in there and I'm coming up for my five-year renewal. Let's use your boxing ring analogy. What if I have to get in that boxing ring, because if I don't, my wife and my children don't eat, my house repayments don't get made, everything collapses and I go bankrupt. I have to get in that ring and take on the heavyweight and take my chances with him, and that's where you're at. You've got so much invested in it that if you don't get in there and fight like a dog, you don't meet your commitments. (transcript, p. 790)

In many cases, however, tenants' vulnerability can at least partially be explained by the actions of the tenants. For example, the Commission heard of cases where:

- retailers had taken out business loans exceeding the term of the lease (for example, a 10-year loan and a five-year lease);
- tenants had franchise agreements beyond the length of their lease (and in some cases the terms of the franchise agreement were tied to the leased location);
- tenants were working on the assumption that a new lease would be offered upon lease expiry (having agreed to a lease term knowing that it was not possible to write-off capital costs over the lease term — the 'unsignable' lease).

The ARA, on being questioned at the public hearings in Sydney on whether the word 'renewal' led to a misperception among tenants that if they paid the rent and were good tenants that they would be offered a new lease, said:

> … anyone that I advise, the first point that I make in that advice is, 'Do you realise that this term is for five, six, seven years, and at the end of that period there is no guarantee that you will get it renewed?' That virtually is my opening comment. Now, how many of them have sought advice and how many of them weren't educated to that, I'm not sure, but, you know, as a person involved in the industry it would be remiss of me if I did not highlight that very much when I've been asked for advice on it. (transcript, p. 64)

While it is true that in some cases a sitting tenant may be better off gaining a new lease for the existing premises (compared with relocating to another location), this will not always be the case (box 6.1).

Box 6.1 **Tenants should not bank on a new lease being offered on 'acceptable' terms**

At the end of a lease, a retailer wishing to continue trading will be faced with a choice between seeking a new lease at the same location, or seeking to relocate. In making this decision, a retailer will consider the cost of relocating (assuming an alternate site of equal quality in terms of size and location), the difference between the costs of removing the fit-out from the previous premises and fitting out a new shop compared with the cost of refitting the existing premises.

If a landlord does not require a new fit-out (as a condition of a new lease), or only a partial refit, then the cost of relocating is likely to be significant. Alternatively, if a complete refit of the premises is required then the costs of relocating will be considerably lower (the cost to make-good). The potential to use the fit-out, or part thereof, if a new lease is agreed for the existing premises means that it could be advantageous for a tenant to remain at a location.

A sitting tenant would therefore be willing to pay an additional amount in rent for a new lease for the existing shop, relative to an otherwise identical vacant new premise, up to an amount equivalent to the cost of relocation. Because landlords are aware of the cost to the tenant of moving, it is likely that landlords may be able to negotiate a higher rent for a sitting tenant, capturing some, or all, of the benefit available to a tenant from reusing any part of the existing fit-out. A Landlord's actions that increase a tenant's net cost of relocating would raise the rent that can be achieved in the next lease.

Retailers should not, however, rely on being offered an 'acceptable' new lease for their currently occupied site. Retailers can run their business in such a way that at the end of their lease term they are in a position to walk away (fit-out and set-up costs all written off or covered by reserves accumulated during the period of the lease). A number of successful retailers told the public hearings that this is how they run their businesses.

The ultimate bargaining chip available to tenants is the ability to 'vote with their feet'. But, in order to have this bargaining chip, tenants need to be able to evaluate viable rent levels for their business model and ensure that at lease end there are not outstanding claims on the business that were not funded by returns over the period of the lease (for example, furniture and fitting not fully depreciated, make good provisions). That is, tenants need to be in a position to walk away if they can not negotiate acceptable conditions under a new lease.

The potential effect of rights of renewal

One approach to addressing the security of tenure issue is legislating rights to tenants to renew their leases. This type of approach has been adopted in both South

Australia and the Australian Capital Territory. In these jurisdictions, tenants are granted the first right of refusal. However, there are a number of situations in which the landlord is not required to offer a renewal to the sitting tenant, namely:

- the landlord wishes to change the tenancy mix;
- the tenant has substantially, or persistently, breached the lease;
- the landlord requires vacant possession of the premises and does not propose to relet them within 6 months; or
- it would be substantially more advantageous to lease the premises to another tenant.

The effect of these provisions is difficult to assess. While discretion appears to rest with the property owner, empirical evidence is not available to indicate the effects of the provisions, either on rates of lease renewal or rent adjustments on renewal in these jurisdictions, relative to those where these provisions do not exist.

While some participants (tenants and tenancy advisors) were supportive of the provisions, there were also numerous participants who thought the provisions were ineffective and potentially anticompetitive. For instance, Professors Duncan and Christensen questioned the utility of the provisions:

> We would strongly oppose any automatic right or preferential right to renewal of a retail lease and wonder about the utility of any of these provisions. Ultimately, even with the most complex preferred tenant provisions in South Australia, at the end of the day, a landlord can still object to the renewal of a lease on any grounds. (submission no. DR153, pp. 3-4)

Another participant argued that these provisions have 'serious implications for investment in shopping centres in South Australia and the Australian Capital Territory, with the increase in regulatory risk acting as a significant disincentive to invest in shopping centres in those two States'. (confidential submission)

The NRA also commented on right of renewal provisions:

> I think it may be going a step too far. I think the automatic right of lease — no, I don't support that at all. That perpetuates privilege and perhaps reduces capacity to change. (transcript, p. 417)

It was also suggested that the provisions are likely to mean that landlords will be less prepared to take on riskier tenants:

> The increased risk to shopping centre landlords of a tenant not performing satisfactorily (but being entitled to an automatic renewal of lease) will lead to landlords 'playing it safe' and giving preference to more established state or national retail chains. Faced with a choice in a new leasing situation, between an established retailer and someone seeking to set up in business for the first time, the landlord will be less inclined to take

a risk on a small retailer or would be retailers. (confidential submission)

The Commission was also told that (in the Australian Capital Territory at least) the major landlords will not execute a lease unless the party agrees to contract out of the first right of refusal provisions. As put by the LeaseWise group:

> What's required by the major landlords in Canberra is a letter from the lessee's solicitor or someone acting on their behalf that by consent between the parties they remove that security of tenure clause. (transcript, p. 482)

It is questionable whether first right of refusal provisions are effective in improving security of tenure for sitting tenants. Further, to the extent that these provisions cause discrimination against new or more risky retail businesses, competition in the retail tenancy market is reduced, the efficiency of the market impeded and productivity lowered.

Loss of goodwill?

Participants submitted that different interpretations of goodwill exist. As described by Competitive Foods Australia, there are separate legal, accounting and commercial understandings of what constitutes goodwill:

> Goodwill is, of course, an intangible asset of a business, and business owners count on their goodwill to attract and retain customers on a daily basis. …
>
> The law recognises goodwill as a form of property, although the Courts have found goodwill 'notoriously difficult to define' … A commonly cited legal definition of goodwill is that it includes 'whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers, and agreed absence from competition, or any of these things'. However, from a legal point of view, goodwill is treated as being inseparable from the asset or assets to which it is attached.
>
> … the International Accounting Board has defined 'goodwill' to be 'Future economic benefits arising from assets that are not capable of being individually identified and separately recognised'. However, the only recognition given by the accounting standards to goodwill occurs at the time of sale of a business, where goodwill is recognised as the difference between the value of the business as a whole and the value of its assets. …
>
> From a commercial perspective, goodwill arises from a combination of the elements of location, product, people and management. A good product in a poor location, a poor product in a good location, a good product in a good location with poor staffing and so on will all produce sub-optimal outcomes. It may be possible in some cases to separate out different types of goodwill – goodwill in the business, the location or the product. However, from the point of view of the tenant or franchisee, the goodwill with which it is concerned is the value of the business which it has established at a particular location or locations. (submission no. 122, pp. 9-10)

These definitions demonstrate that goodwill has several components — location, managerial skill/capacity and product/brand (box 6.2). In all three definitions of goodwill given, as retail tenants do not own the location in which they operate, any location-based goodwill associated with a retail space would be the property of the landlord. Further, if the total goodwill of a retail business is conditional on location, its value would only exist while the tenant has the right to operate in that retail location — that is, the life of the lease as negotiated between the parties. Any goodwill would also exist only after all other expenses and lease obligations have been fully accounted for, including the full cost of fittings and make-good provisions under the lease.

Box 6.2 **Components of goodwill**

Goodwill can be viewed as consisting of three components:

- location;
- the human capital of the business' management; and
- its product/brand.

From an economic perspective, goodwill is representative of the future value of returns generated by a business through product differentiation on these attributes. Despite this, only one of these components is fully transferrable on the sale of a business if the location is not owned — the product/brand reputation. If goodwill is dependent on the managerial ability of the owner, it cannot (usually) be bought or sold — it lies with the individual.

Similarly, if the goodwill depends on the business location, it will accrue to the location owner. The value of this location-based goodwill would be expected to become capitalised into asset value, leading to higher rent for the retail space. This occurs through a greater willingness to pay for a particular location by a prospective tenant (the extent would depend on supply and demand for similar retail space). A higher willingness to pay would also increase the value of similarly located retail spaces, increasing rents as landlords seek to maximise the return on their investment (again, the extent would depend on supply and demand for retail space).

There was no evidence received from tenants or landlords during this inquiry to suggest that fixed-term leases for retail space (for example, a five-year lease) should be assumed in advance to be for a longer (or indefinite) period in assessing the value of a business. The commercial reality is that to be viable the retail enterprise must be able to pay for itself, including a satisfactory return on owners' capital and labour, within the term of the lease (including any options) and business plans should be prepared accordingly (see box 6.3). If this is unlikely to be achieved, the tenant should seriously question whether to sign the lease. As Murdoch, Rowland and Crosby said:

There remains an immediate need to better educate those setting up or buying existing retail businesses to the danger of capitalising locational goodwill beyond the expiry of the lease. (Murdoch, Rowland and Crosby 2001, p. 34)

Box 6.3 **Goodwill and discounted cash flow**

A business is only worth the value, in today's terms, of the expected future returns net of expected future costs.

Suppose a business earns a net profit, after rent, wages and other costs, of say, $100 000 a year. As a going concern with an indefinite life, the value of a business to someone will depend on what rate of return they require to invest in the business rather than some other asset. If they expect a 10 per cent rate of return then they may value the business at $1 million. If they are prepared to accept a lower return then they will value the business more highly. For instance if they are happy with a 5 per cent return then they might value the business at $2 million.

However, if the business only has a fixed-term lease and no transferable assets, then the value of the business is dependant on the remaining length of the lease.

For example, for the business with a net return of $100 000 a year, if a full term of say five years is remaining, then the business may be valued at around $380 000, assuming a 10 per cent rate of return. However, if there is only two years remaining, then a purchaser expecting a 10 per cent return (and with identical trading capabilities) may only be willing to purchase the business for around $170 000. That is, the value of the business with a fixed-term lease does not appreciate over time, rather it decreases as the remaining lease term diminishes.

It might be argued that this undervalues the business as it does not consider the value of the business if the lease is renewed or if the business has trading prospects in other locations (such as in a shopping strip). A potential purchaser would need to consider the probability of being offered a new lease, any change to net returns as a result of new conditions, and any additional capital outlays required for refitting the premises. If considerable refitting costs, less favourable terms and conditions and/or higher rent is expected then the net present value of a new lease may be zero. This will depend on the demand for retail space and the negotiating skills of the prospective tenant.

It became apparent to the Commission over the course of the Inquiry that many retailers — and prospective purchasers of retail businesses — apply the valuation method for an ongoing business to businesses operating on a fixed-term lease. This can lead to substantial overvaluation of a business, as demonstrated by the above examples. As a result, some purchasers of retail businesses pay too much and are then unable to fully recoup the purchase price over the remaining life of the lease.

Similarly, one market commentator suggested tenants may need to consider a retail lease as a job, rather than an asset:

> Taking out a lease often means you are buying a job, not an asset. When renewal time comes, expect much of the profitability you have built over the initial term of your

> lease to be eaten up in rent. A landlord may leave you with enough to pay yourself a decent wage — if you're lucky — but usually not much more than that. (Preston 2007, p. 1)

The value of the goodwill in a retail business is often difficult to assess. If the business has trading prospects in another location, its value would be determined commercially on the basis of its expected income stream and the occupancy costs of that location. The absence of any location-based goodwill under tenancy leases is part and parcel of the shopping centre model and is a result of the underlying property rights. It does not indicate an imbalance of negotiating power.

FINDING

The holding of a fixed-term lease in a shopping centre does not confer goodwill to the lessee beyond the period of the lease.

6.3 Assessing the case for change

The variation in lease terms and information received by the Commission suggests that there is no 'single' appropriate lease term. To assess whether government intervention is warranted to ensure lease tenure is secure, evidence on obstacles to firms negotiating lease terms that most suit their business would need to be demonstrated. It would also need to be established that regulatory interventions could cost-effectively remove these obstacles and reduce constraints on the efficient operation of the market. The Commission received a number of submissions from tenants and tenant groups suggesting possible changes to enhance the security of tenure of tenants. The suggestions were focused on lease terms in shopping centres and included:

- extending the legal minimum lease term; and
- placing limits on the actions that a landlord can take at the end of a lease.

Extending minimum lease terms

While a number of participants advocated that minimum lease terms be extended, there were varying views about what would be the most appropriate length of time to extend the minimum term. Suggestions included:

- a five-year term with compulsory five-year option (confidential submission);
- a minimum seven year term (submission nos. 94 and 119); and
- an eight year term with compulsory eight year option (submission no. 30).

The most common argument advanced in support of increasing minimum lease terms is that it would allow retailers more time to adequately write off their fit-out costs across the length of the lease under current taxation laws. This argument was reiterated to the Commission during draft report hearings and in submissions on the draft report. However, tax provisions are known to both tenants and landlords prior to lease negotiation, and as such, to avoid large unanticipated write-offs in the final year of a lease, lease length could be appropriately negotiated or financial models adjusted to reflect commercial realities.

A number of participants also suggested that extending minimum lease terms would reduce the number of lease renegotiations and, therefore, the potential for large rental increases. With the current five-year minimum term, some participants argued that landlords have the potential to enforce 'unsustainable' increases in rent. For example, the Franchise Council of Australia stated:

> The relatively short lease terms are of concern to the franchises due to the significant level of rental increases proposed by the landlord upon lease renewal. (submission no. 117, p. 19)

However, if rent increases are in response to market changes, limiting rent increases on a subsequent lease would reduce the efficient operation of the market by maintaining under-performing tenants longer than would otherwise be the case. Changing legislated minimum lease terms would not be effective in improving efficiency.

Extending legislated or regulated minimum lease terms, to the extent that they bite, could also further reduce flexibility for those tenants who would prefer a shorter term arrangement due to commercial risks or the nature of their business. Indeed, this was recognised by the Queensland Government when it removed minimum lease terms from its legislation (see chapter 3).

In all jurisdictions where legislated minimum lease terms apply, shorter lease terms can be negotiated. However, for the lease term to be legally binding under relevant retail tenancy legislation, the shorter term must be endorsed by the lessee's solicitor. While this requirement does not necessarily add to disclosure or analysis of information pertinent to lease obligations, it can:

- unnecessarily add to complexity and compliance costs of lease negotiation, for example, for a short-term lease in a shopping strip; and
- lead, by example, to a lease term that does not align with the preferences of the lessor and lessee.

One small landlord submitted that their costs for preparing a very simple lease went from $200 (as prepared by a local real estate agent) up to $900 (now prepared by a

solicitor), following legislation changes in New South Wales in 2006.

Because the legislated minimum lease term becomes the default period if the endorsement requirement is not met, the potential exists for the minimum term provision to be exploited by the tenant/landlord to achieve a longer lease term for retail space than initially negotiated.

In addition, for some landlords, extension of minimum lease terms could hamper their ability to find tenants in circumstances where they were only able to offer short-term leases, for instance, in times before renovations or low demand. More importantly, it could substantially reduce the landlord's ability to alter the tenancy mix in response to new products or changes in consumer demand. This could constrain efficient investment in retail space, and disadvantage consumers.

Moreover, data suggest legislated minimum lease terms are ineffective in increasing lease terms for retail tenants. However, they do increase transactions costs in negotiating shorter lease terms, and in such cases impede the efficient operation of the market for retail tenancies. It is the Commission's assessment that lease terms should be a matter for commercial negotiation between landlords and tenants. The Commission notes that legislated minimum lease terms can disadvantage some businesses and raise compliance and administrative costs.

Prescribing greater security of tenure at lease expiry

Suggestions for improving the security of tenure for *incumbent* tenants when their leases expire included:

- legislating for 'fair' treatment during lease renewal or end of lease negotiations (submission no. 65);
- offers for renewal, lease negotiations and dispute processes be mandated to be completed at least six months prior to lease expiry (submission no. 65);
- tenants to be provided with at least eight weeks to decide whether to remain on the lease after dispute settlement during lease renegotiation, in which time the landlord cannot find an alternative tenant (submission no. 9);
- the onus of non-renewal be placed on the landlord — landlords have to demonstrate why a lease is not renewed, and if they cannot, the lease must remain with the current tenant (submission no. 63);
- mandatory first right of refusal for all existing tenants (as in South Australia and the Australian Capital Territory) who have adhered to their lease conditions (submission no. 118);
- mandating that when a landlord offers renewal of a lease and if negotiations fail,

- there is a rent determination that is binding (submission no. 47); and
- when a lease is not renewed, the landlord be liable for lost 'goodwill' and the going concern of the business including fit-out costs not written off over the term of the expired lease (submission nos. 47, 109 and 122).

It was argued by some that renewal of a retail lease should be a 'right' of tenants and there should be greater certainty in their continuing to conduct their business operations in a pre-existing location. This certainty is believed to lead to a number of advantages for retailers. As stated by the Pharmacy Guild of Australia:

> Having a degree of security of tenure is important so that reasonable employment security for employees can be provided. (submission no. 109, p. 15)

For retail tenants, mandated renewal clauses are also perceived to have the potential to place downward pressure on rents. International evidence suggests that such clauses are correlated with lower rental increases. As put by Professor Crosby:

> … research in both the UK and US strongly suggests that renewal rents in shopping centres are higher than new letting rents when no rights to renew exist but are generally lower across all commercial markets when they do. (submission no. 84, p. 5)

However, if lower rents are indicative of landlords having less ability to replace poorly performing tenants, then such an outcome would mean retail space was not being put to its best use.

The main disadvantage of mandating lease renewal is that on average it potentially benefits lower productivity tenants at the expense of more productive potential tenants, that is, tenants willing and able to pay higher rents. As such, mandating lease renewal would discriminate against higher performing businesses or innovative new businesses seeking scarce retail space, particularly in shopping centres. As the REIA put it:

> … it is important to remember that the landlord is also operating a business and, like their tenants, seeks to maximise the return on their investment. For this reason, some landlords may argue that they should have the right to lease their premises to the highest bidder at any given time.
>
> If retail tenants were allowed to remain in a premises indefinitely, more successful retailers would be prevented from entering the shopping complex, to the detriment of consumers, the landlord and the overall tenancy mix (and therefore the other retailers located in the complex). (submission no. 112, p. 5)

While many submissions commenting on lease renewal referred to tenancies in shopping centres, retail tenancy legislation and its provisions extend to a much wider set of commercial transactions between tenants and landlords such as those between small landlords and retailers in shopping strips. Given this, it is likely that lease renewal clauses, as suggested in some submissions, would increase the

complexity and cost (both compliance and unintended) for those tenants and landlords that operate outside shopping centres — some 80 per cent of tenancies (chapter 2).

It is the Commission's assessment that prescribing additional provisions in an attempt to enhance security of tenure provisions for retail tenants creates additional complexity, and if anything, frustrates lease negotiations. Further, during the inquiry the Commission did not receive evidence to support the claim that these would be effective in substantially enhancing security of tenure. Instead, they would introduce inefficiencies to the market that would raise costs for landlords and tenants and lower benefits to consumers.

Would these possibilities constrain efficient market operation?

Legislating for an extension of lease terms or for the provision of greater security of tenure for incumbent tenants, represent calls for government to intervene to determine commercial terms and conditions of retail leases. In most business contracts, such matters are left to commercial negotiations between the parties to a lease. Government intervention would reduce the ability of both parties to negotiate a mutually beneficial outcome. This is no different in the market for retail tenancies. Further, where prescriptions bite, the legislative interventions would constrain the efficient operation of the market through reduced flexibility in allocating retail space to its best possible use.

FINDING

Regulation to improve security of tenure is likely to be largely ineffective. To the extent any effect is felt, it would reduce flexibility, constrain efficiency and raise compliance costs.

6.4 Summing up

Available information is not supportive of the view that measures to improve security of tenure for shopping centre tenants have been effective. Furthermore, successful retailers are well aware of the shopping centre model (including fixed term leases). They structure their business in such a way that they only sign leases if they can expect to cover all establishment costs and earn an appropriate return on capital within the agreed lease period.

Retailers in shopping centres can get into trouble when they do not recognise this model and mistakenly assume that leases will be renewed on favourable terms, and

the value of their business will appreciate — allowing them to sell the business for a substantial capital gain.

To the extent that provisions to improve security of tenure provide any benefits to sitting tenants, they create barriers to entry within the market. This disadvantages some tenants (including potential new tenants), as well as landlords, hampering the efficient operation of the market and lowering productivity.

7 Occupancy costs

The majority of concerns raised by participants to this inquiry related to the leasing arrangements, and the associated occupancy cost, for retail space *within shopping centres*. In some instances, concerns were raised over costs that are unique to the shopping centre model — such as redevelopment and fit-out costs. In other instances, matters raised, while pertaining to the broader tenancy market, appear to come into focus as tenant concerns in the context of shopping centres — such as rent determination.

In section 7.1, participants' views on tenancy matters relating to occupancy costs in shopping centres are provided. Section 7.2 presents evidence on the reported problems, with participants' suggestions for change assessed in section 7.3. Section 7.4 sums up the discussion and the Commission's assessment.

7.1 Participants' views

The direct costs to a tenant of leasing retail space is usually made up of a number of components (box 7.1). These components may be ongoing or regular, may be directly related to the amount of space leased, and may differ substantially in importance depending on the location of the leased space. Other costs are less frequent — for example, 'lumpy' items such as fit-out costs or costs incurred at the end of a lease.

Prior to the release of the draft report there were just over 50 submissions to this inquiry received from tenants. Of these, approximately 90 per cent were received from retailers who operated within shopping centres (despite only accounting for one-fifth of all retail tenancies — see chapter 2). Close to another 50 submissions were received from shopping centre landlords, shopping centre landlord groups and tenant organisations which focused on issues relating to shopping centres. The most common issues raised by participants related to occupancy costs and included:

- rent levels and determination;
- outgoings payable;
- fit-out requirements; and
- shopping centre redevelopments.

Box 7.1 **Components of retail occupancy costs**

Payments to landlords

Base rent: usually expressed as a dollar amount per square metre of retail space occupied by the tenant. Base rent is fixed in the first year, and incremented each year of the lease by some predetermined percentage — such as CPI plus 2 per cent.

Turnover rent: a component of rent that is determined as a percentage of the tenant's turnover during a specified period. Turnover rent therefore varies with the tenant's sales performance and can increase or decrease over the period of the lease.

Variable outgoings: expenses that can be directly or reasonably attributable to the operation, maintenance or repair of the building in which the retailer is located. Such expenses may include insurance, security, electricity, water, cleaning, garbage collection and land tax (in those jurisdictions in which the landlord can pass this expense on to tenants).

For those tenants located in shopping centres, additional variable outgoings such as fees for the centre manager, centre landscaping, and maintenance of carparks and other public amenities and facilities are typically included. These expenses are often allocated to tenants on the basis of their share of the total gross lettable space in the centre.

Marketing expenses: expenses related to attracting customers into the business. These expenses may be higher for those businesses seeking to be a retail destination rather than being dependent on surrounding foot traffic.

For retailers in a shopping centre, a marketing or promotions levy typically covers expenditure by the centre manager on centre promotion, advertising and market research. These expenses are often allocated to centre tenants on the basis of their share of the total gross lettable space in the centre.

Other costs

Fit-out costs: those expenses related to the preparation of the premises for retail operation. The extent of these expenses is likely to vary considerably with the requirements of each tenant and also according to any restrictions which the landlord may place on design or on the use of architects and trades people. For most tenants, there are further costs associated with returning the premises to a bare condition when they vacate ('make good' provisions in the lease).

Other possible financial costs of tenancy: Further costs associated with retail tenancy may be incurred by tenants in securing the information and advice necessary for lease renewal negotiations and in the case of shopping centre tenants, the tenant often pays some or all of such expenses.

Rent levels and determination

A number of retailers expressed concern about the large differentials between rents of anchor tenants and small retailers in shopping centres. For instance, one retailer, Brett Carlton, commented that it is:

> … common knowledge that anchor tenants such as major supermarket chains and department store retailers pay rental amounts any where up to one tenth that of any other retailers on a per square metre basis. … I can see little reason why all tenants can not pay an equal rental rate per square metre. (submission no. 80, p. 2)

The Real Estate Institute of Australia (REIA) indicated that a typical anchor tenant attracts annual rents of around $340 per square metre, while smaller retailers face rents between $400 and $2000 per square metre, depending on the size of the shopping centre and size of the tenancy (submission no. 111, p. 6).

Given the nature of the retail tenancy market and the need to retain a balance of businesses in a centre, others observed that rent differentials would be expected. As stated by the REIA:

> All large shopping complexes rely on the presence of 'destination' anchor tenants which are the primary attraction of the complex and which draw in the bulk of pedestrian foot traffic. Upon the inception of a new shopping complex, centre management will seek to persuade anchor tenants to establish their business at the outset, before it is certain whether or not the overall complex will be a success. In order to entice anchor tenants to take this risk, centre management may offer low rents or special tenancy conditions.
>
> … Once anchor tenants are established, it is possible for smaller speciality stores to benefit from the pedestrian traffic likely to be generated by their presence. It is reasonable for centre management to seek a rental premium from prospective tenants in this situation.
>
> … From the perspective of centre management, smaller retailers are more risky in terms of the likelihood of failure and require a greater effort to manage as a group due to their sheer number and diversity. (submission no. 111, p. 7)

Some participants pointed to observed differences in retail rents in Australia compared with the United States as an indication of a failing in the market (box 7.2). However, international rent comparisons are fraught with difficulties. Such comparisons ignore differences in location, quality and earnings potential, amongst other things. Also, simple rent comparisons do not establish a causal link between perceived problems and outcomes.

Concerns were also expressed over the potential for rent differentials to be 'anti-competitive'. Differences in rent by similar businesses were argued to inhibit competition. As stated by Associate Professor Zumbo:

> … 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 … 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 [of] 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. (transcript, p. 330)

However, it should be noted that the presence of rent differences between stores does not signal market inefficiencies and, in fact, is required to efficiently allocate retail space (chapter 5).

Box 7.2 International comparisons of shopping centre rents

A debate arose in the submissions between tenant groups and the Shopping Centre Council of Australia (SCCA) over the validity of international rent comparisons. Commenting on differences in rents paid by tenants in Westfield shopping centres in Australia and the United States, the Southern Sydney Retailers Association stated:

> For such a discrepancy to exist there must be something manifestly wrong with the operation of the market for retail leasing in Australia. Yes, things are different in America – but other than the fact that water goes down the toilet in a clockwise spiral in the USA – how is it possible that retail rents in equivalent shopping malls are 134% higher in Australia. (submission no. 131, p. 3)

Responding to these claims, the SCCA noted that when 'better' comparisons were made, occupancy cost averages in Australia were approximately 16 per cent in 2006-07, compared with those in the United States of 14 to 16 per cent (submission no. 138). Amongst others, differences in occupancy rates — 90 per cent within Westfield's centres in the United States and 99 per cent in Australia — were cited as reasons for differences.

Despite the arguments on either side, if occupancy costs are found to be different, or the same in Australia and the United States, it does not provide any direct evidence of market failings. For example, the demand for and supply of retail space is likely to differ significantly and a number of external factors influence what returns landlords would expect (such as construction costs, geography, market risks, and the return earned on alternative investments) and as such what level of rent is paid. Also, if rents were found to be different, or the same, it would not provide evidence of a problem in the retail tenancy market in either Australia or the United States.

Given these difficulties, analysis of the market incentives, and those created by regulations, provide a more effective means to assess the presence of market inefficiencies.

Reporting of turnover data

The requirement of many shopping centre landlords for tenants to provide monthly turnover figures was a subject commented on by a numerous retailers operating in shopping centres and retailer organisations. Concerns related to how landlords use the turnover data, with many retailers expressing the view that landlords use turnover data to determine rents — in lease negotiations — according to retailers' capacity to pay, rather than the 'market' rent. This view was consistently repeated during the draft report hearings.

The stated rationale for requiring turnover data is that leases include provisions for tenants to pay additional rent once turnover exceeds a particular threshold, so the landlord needs to know turnover in order that the agreed turnover rent can be assessed and collected. Some participants commented that, in practice, the thresholds for turnover rent are generally so high that they rarely apply, but landlords collect the figures just so they can extract additional rent on lease renewal, and so they can judge whether to change the tenancy mix.

The Australian Retailers Association (ARA) said:

> The figures are used to gouge additional rent out of a sitting tenant at the end of lease term based on the landlord's knowledge of these figures and the vulnerability of an economic captive who has his investment, goodwill and livelihood tied up in the business at the end of the lease term. (submission no. 119, p. 19)

Similarly, one retailer stated:

> We see the reporting of sales as the most significant issue that creates the imbalance and abuse of the landlord's power and creates an unfair advantage in the negotiation. (confidential submission)

The Retail Traders' Association of WA stated in response to the draft report, that access to turnover figures allowed shopping centres to gain an unfair advantage when setting rents:

> … as the calculating of profit margins is very easily extrapolated from these figures, thus fully exposing the marketing and financial position of the tenant. This imbalance can potentially have severe consequences on the viability and future entrepreneurial encouragement/growth opportunities for a small tenant. (submission no. DR171, pp. 1-2)

The Australian Newsagents' Federation (ANF) also commented that, while historically percentage rent clauses were seen as a means of sharing the risks and benefits of a retail site between landlords and tenants, in practice landlords purely access tenants' turnover figures to ensure that rental returns reflect the tenants' ability to pay (submission no. 72). The ANF argued against the requirement to

provide turnover figures, indicating that a newsagency is typically characterised by high turnover and low margins (and the setting of margins for newspapers, magazines, lotteries and telecommunication products is fixed contractually).

On the other hand, shopping centre landlords argue that turnover data are needed (together with foot traffic) to determine the most appropriate tenancy mix in a centre, as well as to assess future development plans for centres. The SCCA submitted that:

> Shopping centres require sales (or turnover) figures from retailers for the same reason that retailers do – to guide major expenditure and investment decisions. (submission no. 83, p. 2)

The Australian Property Institute also said:

> The provision of turnover details to the Lessor of a shopping centre is not only used for the calculation of rent but more importantly, for the sake of monitoring shopping centre performance. It enables the shopping centre manager to optimise the shopping centre mix which is to the benefit of all tenants. It may highlight instances where a particular section of a centre is adversely affected by certain actions of the manager or conversely demonstrate where particular strategies are successful. It is therefore essential that lessors have the option of obtaining retail turnover figures whether or not a lease contains turnover rent provisions. (submission no. 70, p. 12)

Colonial First State Property Management (CFSPM) argued that rents are set by market forces:

> Tenants often express concern that owners use sales information for setting rents. The reality is that rents for a new lease are set by market forces. … it is in the owner's best interest to ensure that vacancies are minimised. (submission no. 78, p. 6)

In response to the draft report, Westfield further argued that limits placed on the collection of turnover data would limit their ability to manage centres and limit available market data:

> Insofar as the submissions made advocate the prohibition of the collection of turnover data, such a measure would strike at one of the unique features of the shopping centre model which has underpinned the success of that model for both retailers and owners. That is the ability of the shopping centre owners to make informed decisions (assisted in a major way by the collection of turnover data) regarding the ongoing performance and market positioning of the shopping centre and its optimal tenancy mix. Further, it would eliminate the data base currently provided, not only to landlords but also available to individual retailers, industry researchers and retail consultants and advisers, which has enabled the appropriate benchmarking of the performance of shopping centres to be undertaken. (submission no. DR191, p. 9)

It was also submitted that reported turnover data do not necessarily provide an indication of what rent is achievable for a particular site. One landlord provided an

example in a confidential submission where, at the expiry of a retail lease, the premises were leased to a new tenant. The new tenant, who offered a different product and paid a higher rent, increased the sales achieved at the site and, as a result of increased customer traffic for that area of the centre, the sales achieved in the surrounding retail premises.

Outgoings payable

On the issue of outgoings, promotional levies and other charges, a number of retail tenants expressed concern about the lack of transparency and accountability in claims for costs by shopping centre landlords. The Pharmacy Guild of Australia said:

> There should be greater transparency in the composition of management fees for a centre, particularly in regard to 'outgoings' and the difference between maintenance costs and capital improvements. (submission no. 109, p. 5)

The Australian National Retailers Association (ANRA) also argued the need to better define the costs attributed to tenants and landlords:

> … there is a need for greater transparency in the dealings between retail tenants and landlords. The direct and indirect costs of leases to tenants are often significant and complex and require further breaking down to understand and verify. Outgoings, category one works, costs of upgrades and management fees are all areas of concern. In addition there is a need to better define what can be attributed to leased premises as opposed to the landlord's corporate overheads. (submission no. 92, p. 7)

The ANRA also said that, while historically outgoings were calculated at between 5-10 per cent of a tenant's total rental costs and were specifically to cover the management costs of the shopping centre, over time they have become equal to the rental price with little or no accountability on the part of landlords. Examples given were:

- Complex managers can let a contract to new cleaners who charge 100 per cent more than the previous cleaners. This increased cost is passed directly onto tenants who have no recourse. Tenants cannot question whether the price they are being charged is based on a competitive process or if it is at a reasonable market value.
- Lack of tenant control over the amount the landlord can charge for management fees can result in one centre charging $200 per square metre and another only $25.
- A tenant can have three properties on one centre and be charged at different rates for the same outgoing. (submission no. 92, p. 7)

The counter claim, made by some landlords, was that retail property owners have a strong incentive to minimise outgoing costs. For example, CFSPM said:

> There is a perception that retail property owners have little incentive to minimise

> outgoing costs. However, the opposite is in fact correct. … From an owner's perspective, the returns required to justify their outgoing investment in a centre is dependent upon ensuring that rents, preferably, increase over time. Consequently, it is in the owners' best interests to also ensure that outgoings are minimised (as they are purely a recovery of actual costs), so that as much of a tenant's total occupancy cost is derived from rent, resulting in real returns to owners. (submission no. 78, p. 5)

In general, while most tenants did not dispute that outgoings were a legitimate cost of tenancy within shopping centres, many felt that landlords were not accountable for their spending decisions made with these monies.

Fit-out requirements

In most shopping centres, tenancy leases require that fit-out, maintenance or repairs on shops be undertaken by designated contractors. A number of retailers expressed concern about the prices charged by designated contractors for these services and the lack of transparency in relation to the determination of such costs. ANRA, for example, said:

> … during refurbishments landlords can use their preferred contractors to erect hoardings, despite the fact these contractors charge between three and four times the going commercial rate for such services.
>
> Current invoicing processes do not detail all expensed items, which makes any attempts at auditing by tenants both costly and time consuming. ANRA would like to see greater clarity in how expenses and charges are categorised, with a consistent national approach. (submission no. 92, p. 8)

An argument put forward by shopping centre landlords is that designated contractors are required to meet safety and other centre standards. As one centre owner/manager advised the Commission:

> It is common for landlords of shopping centres to require tenants to use the landlord's contractors to deal with service alterations. This practice is designed to ensure that the services of the centre are not damaged by an inexperienced contractor. (confidential submission)

Another centre owner/manager pointed out that retail tenancy legislation in New South Wales and Victoria requires landlords to disclose to tenants the cost of alterations to the services prior to signing the lease or alternatively to disclose a formula which sets out how the costs are to be calculated:

> … this requirement achieves that balance between a landlord being able to maintain the integrity of the essential services at the Centre and tenants knowing in advance the likely costs of alterations to services for which they will be responsible. (confidential submission)

The Commission was also informed that offers made by landlords for a new lease are typically conditional on implementing a new fit-out of either the existing shop or one in a new location within the centre (if the tenant is required to move). The requirement of a new fit-out in the event of lease renewal raised concerns from some participants.

One participant cited a case in which a coffee shop operator was offered a new lease conditional on a full refit of the premises, despite having fully refurbished the premises three years earlier, which they claimed still presented extremely well. The retailer stated that the fit-out was expensive and that the landlord would not agree to contribute to the cost of the fit-out or offer a rent-free period (submission no. 89).

CFSPM stated that the reason for the general requirement for a new fit-out on lease renewal is that shopping centre owners need to keep centres fresh and modern to maintain customer numbers in the centre overall.

> As a general rule, CFSPM requires tenants to conduct a complete refit of their tenancy upon the renewal of a lease in order to maximise a centre's customer appeal and market relevance. Given that leases are generally for a period of 6 years, the fit-out of a tenancy can easily become tired and dated. (submission no. 78, p. 5)

They also suggested that investment in replacement fit-outs generally benefit retailers.

> … experience indicates that tenant sales generally increase by 10-30% following a refit - this again is not only a benefit to the tenant, but to the owner and the other tenants in the centre. A centre that does not adopt such a policy will quickly lose appeal with the customer to the detriment of all tenants and the owner. (submission no. 78, p. 5)

It appears that while most tenants believed that fit-out requirements contributed to both the success of the centre and their individual stores, they held concerns over the cost of these works and ability to source competitive quotes for the work undertaken.

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Retailers find it difficult to assess fit out costs and outgoings claims of landlords and to challenge the basis of these costs incurred under their lease.

The cost of shopping centre redevelopments

Shopping centres and other retail formats are subject to regular redevelopment. Landlords indicated that this is a normal part of business, recognised in leases, stating:

> It is common for a landlord to include a demolition and/or relocation clause if the

landlord is contemplating an expansion of the centre. Without this clause, a landlord is not in a position to maintain the competitive edge of the centre.

It is clearly in the interests of the tenants of the centre (as well as the landlord) for the landlord to be able to maintain the competitive edge of the centre. (confidential submission)

Tenants, however, suggested that there were often instances where centre redevelopment adversely affected their business. The Commission was informed that tenants may be required to relocate to accommodate the redevelopment, or they may experience depressed sales as disturbance of the redevelopment temporarily reduces foot traffic. It was also submitted that some tenants experience a decline in trade after a redevelopment, particularly if there has been an expansion in the shopping centre and tenants face additional direct competitors. One participant, Bruce York, argued that:

> … landlords generally do not accept when they refurbish or extend a shopping centre that the impact on existing tenants businesses should be considered as part of the cost of these works. While some state regulations make reference to compensating tenants there is no agreed formula for so doing. My observation has shown that for reasonably significant landlord works the tenants businesses will be impacted up to 5 per cent assuming a well managed change, but some landlords do not properly control their building contracts and a loss of business up to 25 per cent and beyond can be expected. (submission no. 18, p. 6)

In circumstances of redevelopment and relocation, some retailers argued that there should be access to rent review or short-term compensation in circumstances of changed conditions. The Pharmacy Guild of Australia, for example, suggested that the legislation should provide for access to a rent review on a market-value basis, where there is refurbishment of a complex, particularly where it continues over a long period of time and impedes traffic flow into a business (submission no. 109). These provisions already exist in most State retail tenancy regulations.

7.2 Evidence on occupancy costs

Occupancy costs of retailers are explored in this section, together with the case for regulating such costs.

Occupancy costs incurred by tenants

Occupancy costs (per unit of lettable retail space) vary substantially between retailers according to the location of the premises leased and the retail amenity provided. On average, occupancy costs are lower outside of shopping centres, with

only rents in the 'prime' retail strips approaching those in a shopping centre. For example, CB Richard Ellis (2007a and 2007c) reports that in the 'prime' retail strips of Surfers Paradise, Noosa and Sydney, annual occupancy costs can be in the range of $2000 to $3000 per square metre. This is equivalent to the occupancy costs (excluding the marketing levy) of some specialty tenants in the largest regional shopping centres (Urbis JHD 2007b).

Within shopping centres, occupancy costs can vary substantially between small and large retail tenants. Stockland submitted that:

> Anchor tenants enjoy significantly lower rents per square metre upon entry into, and renewal of, leases than specialty stores. (submission no. 88, p. 15)

On explaining the factors that influence retail leasing arrangements between tenants, Westfield pointed out that:

> Anchor tenants are critical to the viability of a shopping centre as they are:
>
> - A major point of distinction between the shopping centre format and other retail formats.
> - The primary drivers of consumer foot traffic in a shopping centre. Speciality retailers in a shopping centre are able to directly leverage their own businesses off that customer foot traffic as this, in turn, directly drives the sales that such specialty businesses are able to generate.
> - Generally commit to a long term lease which often is 20 or more years.
> - Usually occupy substantial areas within a shopping centre of up to 25 000 or more square metres as opposed to specialty retail shops which occupy an average area of 100 square metres.
>
> In addition, anchor tenants may also have the available alternative of locating outside a shopping centre on a stand alone basis. For all those reasons anchor tenants have greater leverage in leasing negotiations with shopping centre landlords than specialty retailers. This is an economic reality of the retail leasing market within shopping centres and it is a clear example of the application of supply and demand dynamics. (submission no. 85, p. 11)

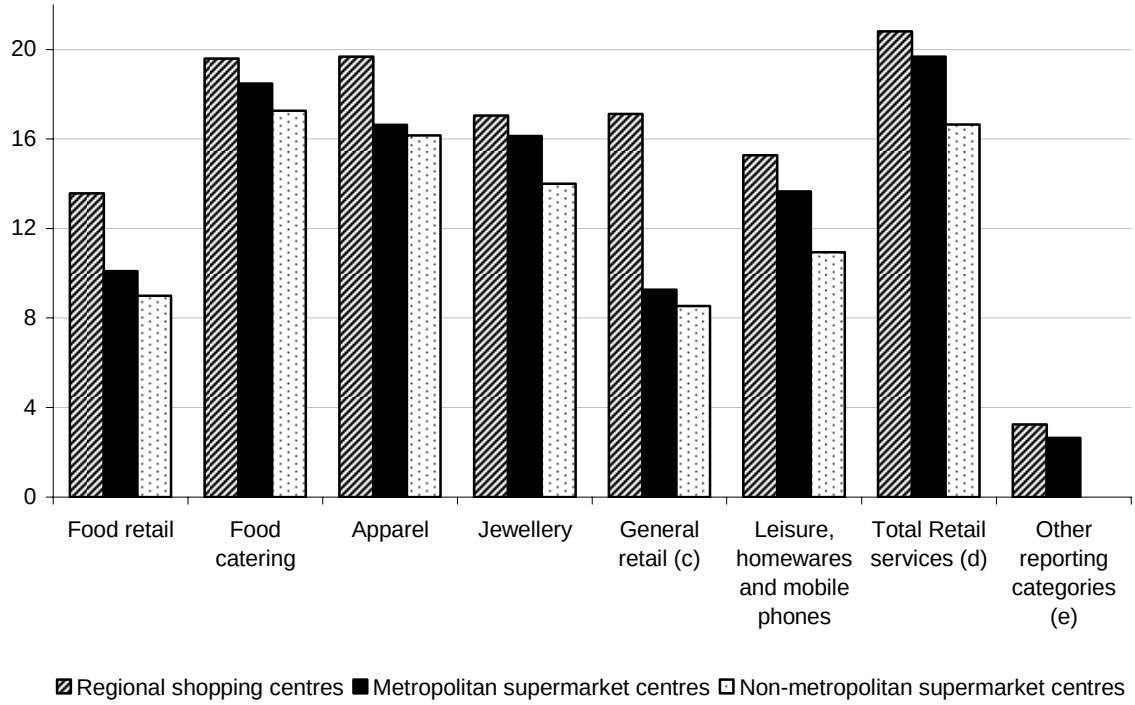
As discussed in chapter 5, rents need to vary by store to be efficient. Because of the larger volume of customers attracted by anchor tenants and the higher average area of space leased, rents paid per square metre by anchor tenants would be expected to be lower than those paid by smaller specialty tenants.

Occupancy costs also vary substantially according to shopping centre type and the category of tenant (figure 7.1). Occupancy costs tend to be highest for specialty tenants (often operating from relatively small retail spaces) in the areas of food catering, apparel and retail services (such as optometrists and hairdressing). The variability reflects the influence of many factors including the demand for retail

space in these centres, the relative trading advantage of centre location for tenants in these sectors and the need for supporting services (such as waste removal for food stores). Prendergast, Marr and Jarratt (1998) found that in New Zealand, clothing retailers inside centres had higher sales turnover than those outside centres, and as a result paid higher rents. Indeed, as indicated by the variability in occupancy costs within centres, the cost of a lease is based on more than access to a particular location (box 7.3).

Figure 7.1 **Specialty retailer occupancy costs by centre and retailer type, 2005-06**[a,b]

Per cent of turnover



a Occupancy costs (rent, outgoings and marketing levy) as a proportion of turnover. Note, the marketing levy is typically around 0.5 per cent of turnover; GST is excluded from both occupancy costs and turnover. **b** Regional shopping centres include the PCA categories of Super Regional, Major Regional and Regional centres. **c** General retail includes giftware, pharmacy and cosmetics, discount variety, florists, pets, toys and miscellaneous. **d** Retail services are key cutting, shoe and watch repairs, optometrists, hairdressing and beauty, other retail services. **e** Other reporting categories are travel agents, lotto, automotive accessories and other.

Source: Urbis JHD (2007b).

Historical data also show similar variations in occupancy costs between centre and store types. In Western Australia, JHD (2002) found in a report for the SCCA, that occupancy costs were higher in regional centres compared to smaller supermarket centres — 17 versus 11 per cent of turnover in 2000-01 (JHD 2002, p. 32). Similarly, data from Victoria over the period from 1995-96 to 1999-00, show that occupancy costs followed a consistent pattern to those in figure 7.1 and those from Western Australia (JHD 2001).

Box 7.3 **Leasing within shopping centres**

The cost of a lease within a shopping centre represents more than access to a particular location. Particularly for larger shopping centre, tenants pay for the overall centre management and promotion — intended to bring customers to the centre. These costs are usually passed on in the form of outgoings.

Speciality tenants also pay for the foot traffic that is created by the larger anchor stores. That is, they pay for the passing trade that is created by the tenancy mix. This cost is not embodied in any particular 'outgoing' but in differences in base rents. Base rents represent both the physical location component and the foot traffic passing that location. Thus, it would be expected that those tenants who rely more heavily on passing trade and discretional purchases would pay a higher base rent along with those in busier corridors, whereas those who are drawcards and attract customers to the centre would pay a lower base rent. Such price discrimination is efficient (chapter 5) and necessary for the shopping centre model to be viable.

However, it has been argued that such price discrimination between tenants inhibits competition. Smaller tenants, because they are paying higher rents, are less able to compete on price with larger tenants. But the ability to compete does not solely depend on the rent paid. Businesses, large and small, compete on a range of factors from the product sold (such as bread bought from a supermarket and that from a bakery next door) to the service provided (purchasing shoes from a discount store versus a small shoe store). Further, to the extent that some anti-competitive pressure is created by rents paid, this should be diminished given sufficient competition between shopping centres, as centres will compete with one another to attract consumers and tenants. These competitive pressures can be diminished by restrictions on the number of centres that can be built (though zoning restrictions), and if so, appropriate attention should be given to reducing such restrictions.

Fit-out costs

The design, requirements and cost of a fit-out are likely to vary considerably according to the type of goods or services retailed by the tenant, the location of the tenant and the requirements of the landlord. For example, while an apparel shop may operate successfully with standard display units, counters, a fitting room and store room, a food retailer may also require refrigeration and additional electrical or plumbing connections while a retailer of electronic equipment could require extensive electrical wiring and connections.

The ARA submitted that fit-out costs are typically in the range of $2500 to $3000 per square metre (submission no. 119, p. 5). These costs are incurred not only at the start of a lease — there may also be changes to fit-out during the lease at either the tenant or landlord's instigation. The actual cost to the tenant depends on any contribution by the landlord as an incentive to attract or retain the tenant.

'Make good' costs on the fit-out may also be incurred at the end of a lease. Retail leases often contain provisions for the tenant to restore the premises to an empty or bare state at the end of the lease if the tenant is vacating. The ARA indicated that removal and disposal of fit-outs typically involves expenditure in the order of $20 000 to $30 000 (submission no. 119, p. 24).

FINDING

As would be expected in a well functioning market, occupancy costs vary substantially between tenants according to the location of the premises, the retail amenity or services provided by landlords and the type of tenant.

Occupancy costs and business failure

An argument put forward by a number of tenants is that high occupancy costs have led to higher than 'normal' levels of business failure, in particular, for those who operate within shopping centres. It is argued that this occurs because landlords seek to create excess investment of capital in retail businesses. In order to capture this capital, it was suggested that landlords act in a predatory fashion, exploiting retail businesses through high occupancy costs. It is claimed that these high occupancy costs lead to business failure, allowing the capital invested in the failed business to be captured by landlords through the use of personal guarantees.

However, there is limited evidence to support this proposition:

- overall retail business exit rates (while not specific to shopping centres) are not significantly different to other service industries (chapter 2);
- the majority (75 to 90 per cent) of retailers operating in shopping centres have their leases renewed (chapter 6); and
- failure rates of small businesses operating within managed shopping centres across Australia are quite low (chapter 2).

Similar results were reported in New Zealand, where a study found that retailers who operated in managed shopping centres had lower failure rates than those who did not, despite higher occupancy costs in shopping centres.

7.3 Assessing the case for change

In assessing the case for government intervention in relation to setting occupancy costs, it needs to be shown that impediments exist in setting rents (or occupancy costs as a whole) that constrain retail space being effectively allocated to those

tenants who value it most. If a case for regulation is found, the benefits of intervention must exceed the compliance and administration costs, or any efficiency losses created. Interventions should also not impinge on the flexibility of rent setting, including the ability of landlords to vary rents between tenants and tenants to negotiate the best deal for their business (chapter 5).

A number of inquiry participants advocated government intervention to regulate occupancy costs. Some suggestions involved greater legislative limits on what a landlord can charge and how rent is determined, while others put forward non-regulatory solutions. The suggested options for change include:

- regulating rent setting and outgoings;
- placing greater reliance on turnover rents;
- regulating fit-outs;
- prohibiting the direct reporting of turnover data; and
- making greater use of collective bargaining arrangements.

Regulating rent setting and outgoings

A number of submissions advocated greater regulation of rents and of what can be charged under outgoings and marketing clauses. A shift away from commercial negotiation toward a rent setting procedure mandated by legislation was the focus of most of the suggestions (box 7.4). Although the issue of 'what is included in rent' potentially exists in all tenancy arrangements, the suggestions were almost exclusively made in the context of shopping centres.

Regulation could be used to limit what can be charged as outgoings and limit the ability of a landlord to transfer risks associated with owning the physical asset to the tenant. For example, charging the landlord's insurance cost (a cost associated with the risk of the asset) to tenants could be viewed as an instance of risk transfer. Indeed, legislative controls on outgoings brought into Queensland's retail tenancy legislation were in response to these concerns (see chapter 3). However, it is not likely that broad regulations could be developed to prescribe the efficient allocation of outgoings for each tenancy agreement.

To the extent that there is 'cost creep' in outgoings, regulations requiring efficiency auditing have the potential to increase the scrutiny of expenses incurred by the landlord. This may, in turn, place downward pressure on the cost of outgoings as landlords respond to the increased scrutiny.

Box 7.4 **Tenants' suggestions about regulating rent setting in shopping centres**

A number of retail tenants suggested that limits should be placed on what can be charged in terms of outgoings or the level of rent that could be charged. Suggested options include:

- regulations to ensure all tenants within a particular shopping centre pay (near) uniform rents (submission no. 63);
- mandatory external rent setting at 'market rent' (submission nos. 8 and 94) including at renewal time (confidential submission);
- extensive limits on what can be charged as outgoings (such as prohibiting landlords from passing on land tax and insurances) (confidential submission);
- limits on what can be charged to the tenant at the time of lease renewal or establishment (such as the landlord's legal fees) (submission no. 118); and
- mandating that outgoings be independently audited and a breakdown provided to all tenants (similar to a provision that exists under the franchising code of conduct) (submission no. 76).

Despite this, regulating rent setting, or occupancy costs more broadly, has a number of shortcomings. Adding prescriptive regulations to rent setting or occupancy cost determination has the potential to create barriers or disincentives for parties to contract. For example, mandating uniform rents within a centre could severely limit the ability of shopping centre managers to alter the tenant mix by altering rents in response to consumer demand (for example, lower rents for a retailer that sold a particularly desired product in order to induce them into a centre). Such regulation would ignore differences between tenants in the use of management services and any spillovers in terms of foot traffic created by larger anchor tenants and would represent a significant loss in efficiency in the market. Regulation would also increase compliance and administration costs as business and authorities attempt to monitor business arrangements and make judgements on individual costs paid as part of leasing contracts.

Overall, regulating rents and other outgoings making up occupancy costs, and how they are determined would not be feasible or appropriate as such measures are likely to:

- reduce the incentive for businesses to enter into negotiations;
- reduce market flexibility in setting rents; and
- inhibit the allocation of retail space to those tenants who value it the most.

The Commission's assessment is that all forms of occupancy costs should be the

focus of commercial negotiation. For efficiency audits, as they have the potential to improve the transparency of outgoings, and potentially place downward pressure on these costs, such measures could be the focus of collective negotiation (exemptions permissible under the TPA) between centre tenants and their landlord or comprise part of an industry negotiated code of conduct.

Adopting a single charge or 'effective rent'

Given that occupancy costs comprise a number of components within shopping centres, some participants argued that there may be scope to move towards a concept of effective rent (box 7.5), inclusive of occupancy costs. Further to this, some participants suggested that an effective rent should be set at the beginning of the lease and only varied in response to agreed reviews (for example, with the consumer price index) (submission nos. 118 and 119).

The concept of effective rent would potentially provide a stronger incentive for landlords to minimise the costs of their outgoings over time. In the case that landlords were required to fix the level of outgoings at the beginning of the lease, they would be required to make commercial judgements of possible outgoings and costs at the beginning of a lease, fixing the monies raised to cover these charges over the life of the lease. As stated by the ARA:

> A gross lease would not only lead to a more efficient and cost effective system but also would place upon the landlord an obligation to manage his outgoings rather than just passing on the costs. (submission no. 119, p. 22)

However, requiring landlords to 'set' outgoings would require landlords to estimate foreseeable costs (and the method of escalation). This would transfer additional risk to landlords, who would have an incentive to increase initial rents to cover this risk.

Instead, the disclosure of an effective rent at the beginning of a lease (but not including the requirement for outgoings to remain fixed) could increase the transparency of the cost of a lease and make it more comparable to other leases outside centres and between centres. Retailers would have the potential to make more informed decisions about their own commercial prospects when entering a lease and comparing different retail locations.

During the hearings it was suggested that the use of an effective rent for the base year of a lease was becoming more common. These leases were termed 'semi-gross' leases and were advocated as they made the total occupancy cost more transparent and allowed tenants to negotiate annual increases in outgoings paid. As stated by Bruce York:

> One of the things that people do nowadays is — often the common practice amongst

the majors — is to have what they call semi-gross leases where you actually have all your first year's outgoings lumped in and you pay increases over the base year. You're never exactly sure what the base year is going to be [cost] until the base year has gone, but it tends to … mitigate that [uncertainty] because a lot of your outgoings are included in a known lump gross lease amount and you're just paying increases. You'll also quite often cap those leases at CPI or CPI plus 1 or 2 per cent, to try and control the outgoings. (transcript, p. 230)

Box 7.5 **The concept of 'effective rent'**

Effective rent can be seen as analogous to the comparison rate used to improve transparency and comparability of home loans. The introduction of a comparison rate for home loans was designed to take into account both the interest rate and all other fees and charges that related to a loan. The mandatory comparison rate was introduced as part of the *Consumer Credit Code* and commenced in 2003. The comparison rate includes costs known at present but excludes:

- government charges such as stamp duty or mortgage registration fees;
- fees and charges which may or may not be charged because they depend on some event which may or may not occur (for example, fees for early repayment or redraw fees); and
- fees and charges that are not ascertainable at the time the comparison rate is provided (The Consumer Credit Code 2007).

Extending the comparison rate analogy to effective rents for retail tenancy agreements in shopping centres, would mean effective rents would include (expressed as a weekly, fortnightly or monthly amount):

- the rental charge taking into account any rent free period or fit-out contribution; and
- the cost of all outgoings payable taking into account any payment free period negotiated.

The effective rent figure would not include government charges or the cost of fit-out as such costs would not accrue to the landlord. Also, costs associated with redevelopment of the centre (such as the cost of relocation or a new fit-out) including changes to shopping centre colour schemes, make good clauses and any costs associated with changes in services based on changes in service providers as these charges would be unknown and be dependent on events which may or may not occur during the life of a lease. But, for the retail tenant, these contingent costs would still need to be considered when entering into a retail lease.

For effective rent to be accurate, all side deals would need to be included. However, this may not occur in practice. For example, landlords and tenants could enter into side deals which are not tied to the use of retail space and thus limit the accuracy of effective rent disclosure.

The Commission's assessment is that while outgoings, their levels and changes over time must remain a matter for commercial negotiation, lease transparency could be improved through the disclosure of an effective rent. Improvements to lease transparency such as these could be negotiated as part of an industry developed code of conduct for shopping centre leasing.

Greater reliance on turnover rents

Within the submissions to this inquiry there was considerable debate over the desirability of landlords charging turnover or percentage rents. Some participants argued that turnover rents (payable when turnover reaches a threshold amount) be prohibited. As stated by Kingsley's Chicken:

> The payment of turnover rent should be banned as the lessor is usually not in partnership with the lessee, and turnover rent is payable by tenants for successfully increasing their turnover, although this may be done without increasing gross profit. (submission no. 9, p. 5)

Others, however, suggested that a system of turnover rents (where all rent is based on turnover) be compulsory for all shopping centre tenants. Soothill & Associates recommended:

> … a system of Turnover Rent be mandated in all shopping centre leases. That is that rent may only be levied on a percentage of turnover basis. (submission no. 121, p. 8)

Turnover rents are purportedly aimed at sharing market risks between tenants and landlords — when sales drop, so does rent (and thus overall business costs) transferring some of the trading risk to the landlord. The opposite is true when sales increase. As the Newsagents Association of NSW and ACT and Newsagents Australia argued:

> Whilst it is realised that property owners deserve a return on their investment, there needs to be a greater share of allocation of risk to reflect external changes which impact on landlords and their tenants. (submission no. 75, p. 2)

Soothill and Associates explained that:

> Turnover Rent has the benefit for the lessee that if turnover falls for some reasons beyond the lessee's control, such as economic downturn or failure of the shopping centre to properly promote, then the rent also falls as a dollar amount, but in such a way that the proportion of turnover paid on rent remains the same. That will not assure a business' viability, but it does add a layer of protection. (submission no. 121, p. 6)

Turnover-based rent can also provide incentives to shopping centre managers to improve management practices to increase sales across the centre. The REIA observed that:

> One of the main benefits of a turnover rent arrangement is that it provides a powerful and enduring incentive for the landlord to work towards the success of all tenant businesses. (submission no. 112, p. 12)

The use of turnover rents provides a potential mechanism to align tenant and landlord incentives, with the added attraction of potentially reducing opportunistic or predatory behaviour of landlords.

However, the use of turnover rent transfers risks to a landlord which are related to factors outside the landlord's control, such as a tenant's retail trading and managerial ability. With the potential to shift some of the costs of poor business performance during a given lease period to the landlord, the selection of 'less risky' tenants at lease renewal is likely to be encouraged. Tenure could also become less secure as landlords are likely to become more reactive to poor performance than under fixed rents.

Greater use of turnover rents would also provide tenants with a clear incentive to under report turnover figures to minimise rent payments. Such under reporting could erode the return to centre owners and the incentive to invest in services such as marketing and maintenance (although this would be offset by measures taken by landlords to minimise the prospect of this type of rent 'erosion').

The mix of pre-determined and turnover rent should, in the Commission's assessment, be a matter for commercial negotiation between tenants and landlords. Government intervention in this area would reduce the flexibility of retail tenants and landlords to negotiate a mutually beneficial lease under prevailing commercial conditions.

Prohibiting the direct reporting of turnover data

To address concerns that the reporting of turnover data in shopping centres is used to set rents at 'non-market' levels, some tenants suggested that landlords be prohibited from collecting turnover figures, or alternatively, that turnover figures be reported through a third party and aggregated at the store category level. For example, the ARA stated:

> … an independent body should be responsible for the collection of such information [turnover figures] if it is to be collected. It should be collated in a format that does not identify any individual retailer and available to all at cost. The cost of such collection would be borne by the industry. This would make the information freely available to all and would be in a form that did not give one party to the contract a decided advantage in the negotiations. It would also remove the number one issue of dispute between the landlord and the retail tenant. (submission no. 119, p. 21)

Prohibiting the collection of turnover data, or mandating that it be reported in an aggregate fashion, would limit the ability of landlords to take past performance into account in determining site rent for the future, including where the outgoing tenant is seeking a new lease. Such provisions would also preserve the commercial confidentiality of retailers, potentially leading to a perception that lease negotiations were 'fairer'. However, it should be recognised that this ability is already limited as landlords do not have access to an individual retailer's cost figures. In addition, the performance of a tenant over a lease may not be the best indicator of the market rent potential of a site; indeed it could be a poor indicator if alternative tenants could make better use of the space and pay higher rents. While it is widely known that landlords use turnover data in the rent discovery process (through assessments of incumbent tenants 'capacity to pay'), such a practice does not, of itself, generate market inefficiencies.

If turnover data were being used by shopping centre landlords to set occupancy costs at unsustainable levels, vacancies rates in these centre would be high. Evidence of vacancy rates, however, does not support this. Indeed, vacancy rates are lower in larger regional shopping centres than in other retail formats, indicating strong demand for this type of retail space (which suggests that retailers benefit from operating within shopping centres, including from their management). This strong demand for space is also likely to be a significant determinant of occupancy costs.

It should also be noted that within shopping centres, landlords seek to increase overall centre performance (to obtain the highest rental return possible) to maximise both centre income and the value of their asset. The Commission was advised that one way this is done is by altering the tenant mix at the individual store level and intervening in a store's operation where assessed as appropriate. Altering the tenant mix may not only involve changing the number of stores in a given category, but also include non-renewal of leases of poorly performing tenants and replacing them with tenants that generate greater turnover. To date, the close management of shopping centres, including through the use of turnover information for within-and between-centre 'benchmarking', has proved a successful business model.

Prohibiting the collection of turnover data, or mandating that it be provided at a store category level, could limit shopping centre owners' managing their assets optimally. This could limit the performance of centres, ultimately disadvantaging centre tenants and consumers. Also, while the reporting of turnover data was one of the most contentious issues raised during this inquiry, it is very unlikely that any means to prohibit the collection of turnover figures would materially ameliorate the expressed concerns (chapter 6). Given information on vacancy rates, and that it is likely shopping centre managers could gauge a tenant's performance and turnover

through other means, it is not clear that prohibiting the provision of turnover data (or legislating the fashion in which it is provided) would materially affect occupancy costs. The Commission's assessment is that the provision of turnover data, and its use by landlords should be the subject of commercial negotiation between the parties to a lease.

FINDING

Prohibiting the reporting of turnover data would be unlikely to lower average occupancy costs.

Regulating shopping centre fit-outs

A number of participants suggested that regulations governing shopping centre fit-outs be established. Suggestions included controls on what landlords can request and caps on fit-out costs. One frequently suggested option was to mandate competitive bidding for fit-outs by prohibiting landlords requiring that tenants use a particular group of builders, architects and suppliers (sometimes in-house). What landlords can request of tenants in terms of fit-outs was also perceived as a particular issue for franchisees as it was felt that brand recognition was limited by some fit-out requirements.

Prohibiting landlords from stipulating who can provide a fit-out for a retailer, and under what conditions, is likely to introduce greater competition into fit-out contracts. As long as fit-outs are consistent with a shopping centre's design and relevant building and labour market regulations, it is reasonable to contend that the use of alternative builders, architects and suppliers to those recommended by the landlord may lower the costs faced by retailers. The achievement of lower fit-out costs could lead to a number of advantages, including:

- a greater ability for tenants to amortise the cost of the fit-out over their fixed lease period;
- lower set-up costs and thus the potential for lower debts or levels of personal guarantees for individual retailers; and
- due to lower costs, a potential for lower prices to consumers and/or higher rental returns to landlords.

But fit-out activity, as with any other construction, can be highly disruptive. Thus, landlords may legitimately seek to minimise these disruptions through mandating that tenants use preferred suppliers with, in their judgement, proven qualities and familiarity with the centre. Also, for those shopping centre-wide systems, such as security alarm systems, maintenance/installation by the nominated contractor may

be required to obtain consistency and effective functioning. Landlords may also require particular fit-out styles in order to develop a theme for a shopping centre with the aim of maximising overall sales, which in their judgement, is best achieved through the use of selected suppliers. This aim, if achieved, is designed to benefit all tenants within a centre. Also, excessive fit-out costs are likely to reduce retail tenants' profitability and capacity to pay a given market rent. As such, landlords should have a strong incentive to avoid such cost imposts being paid to third parties.

Fit-out requirements of tenants in shopping centres represent a conditional aspect of trading in this type of retail concentration. Requirements are unique and vary by both store type and shopping centre, making a 'one-size-fits-all' regulatory solution either unworkable or needing a range of exceptions which would make interventions largely ineffective or even counter productive. Such interventions would introduce a range of rigidities into contract negotiations, frustrating negotiations and imposing compliance costs, hampering the negotiation of efficient outcomes.

The Commission's assessment is that these matters should be determined by negotiations between tenants and landlords. However, there would be scope for opening up competition for fit-out contracts, particularly for non-centre wide systems to place downward pressure on fit-out costs. Such matters could be individually or collectively negotiated by centre tenants with relevant landlords.

Greater use of collective bargaining arrangements

Collective bargaining by retail tenants was suggested as an alternative to calls for more prescriptive regulation of rents and other occupancy costs. The Australian Competition and Consumer Commission (ACCC) has encouraged retail tenants to make greater use of collective bargaining provisions under the *Trade Practices Act 1974* (TPA) (submission no. 128). This has been supported by recent changes to collective bargaining applications, reducing the cost of application and the time taken for approval.

The ANF suggested that landlords should be compelled under legislation to undertake collective bargaining, stating that:

> … collective bargaining provisions be further amended to compel participation from both parties and to provide for independent arbitration in the event that negotiations fail. (submission no. 72, p. 6)

The perceived advantage of collective bargaining by retail tenants in shopping centres is to redress the imbalance in negotiating power between the large landlords and small retail tenants. Negotiating collectively has been promoted as potentially

providing a means for tenants to moderate rental increases on renewal, or high rents on initial leases. Further, as stated by the ACCC, collective bargaining could:

> … lead to a number of potential benefits, such as allowing greater input by small businesses into their contract terms leading to more efficient outcomes. It may also address the information asymmetry that may exist, by improving the information available and increasing access to additional data. These are issues that may be relevant to small business tenants. (submission no. 128, p. 16)

Also, collective negotiations have the potential to lower the individual costs of lease negotiation. Instead of a series of individual negotiations, retail tenants and landlords may save time and legal expenses through a single negotiation process that covers multiple tenants.

More generally, collective bargaining may provide tenants with an avenue to influence centre management and the trading environment faced by retailers.

Despite this, characteristics of the retail tenancy market suggest that collective bargaining is not likely to be a widely adopted negotiating tool for retail tenants. Indeed, a number of significant impediments exist to the use of collective bargaining within the market for retail tenancies. For example, as stated by the ANF:

> … the failure of small business tenants to participate in collective negotiations results from the limitations of the collective bargaining arrangements as follows:
>
> - The authorisation process remains cost prohibitive for most small business retailers;
> - There is no compulsion for the other party to participate in negotiations rendering authorisation potentially meaningless;
> - There is no independent arbitration if negotiations fail; and
> - There is no protection from retribution by landlords. (submission no. 72, p. 6)

Even if participation of landlords were compulsory, it is likely that in the highly competitive retail environment, retail tenants would not have a sufficient shared interest to make meaningful collective bargaining feasible. Also, there may only be a small number of leases falling due at the same time in any given centre limiting the number of firms that are likely to engage in the bargaining process. While, in principle, there might be scope for similar shops within a centre to negotiate collectively, in practice, due to competing interest over lease occupancy conditions including rents and store location (all would be vying for the best position in the centre at the lowest cost to themselves), collective negotiations are unlikely to be successful.

The Commission's assessment is that while there is potential for tenants to use this process to negotiate common costs, such as management charges and the efficiency

auditing of those costs, it is less likely to be a useful tool in negotiating rents due to divergent interests. The formation of tenant groups to undertake collective bargaining under the provisions of the TPA would be a matter for tenants or their representative organisations.

FINDING

Collective bargaining over individual rent is unlikely to be widely pursued due to competing interests of retail tenants. Nevertheless, such bargaining may be practicable for centre-wide costs and conditions.

Would these possibilities constrain efficient market operation?

The possibilities for change suggested by tenants and their representative organisations primarily focused on occupancy costs within shopping centres and, in some cases, involved more regulation of what was allowed to be included within retail tenancy leases and how charges would be set. Such regulatory change would have little relevance to the broader retail tenancy market. In particular, if applied, many of the options to regulate occupancy cost setting would significantly constrain the ability of the market to price retail space efficiently through commercial negotiations. Regulatory limits on what shopping centre landlords can and cannot do, in relation to the setting of occupancy costs, have the potential to limit overall centre performance to the detriment of all stakeholders.

Overall, it is the Commission's assessment that the suggestions for change that involve greater regulation of what can be included in leases, such as those that dictate rent setting, would constrain the efficient operation of the market. Moreover, some options, if applied more broadly to all retail tenancies, could limit and frustrate the majority of the commercial negotiations in this market that take place outside shopping centres.

FINDING

Creating legislative limits or controls on occupancy costs in retail leases would impede the efficient operation of the market.

7.4 Summing up

Most of the issues and reform possibilities raised in the context of occupancy costs related to tenancies in shopping centres — a segment that accounts for only 20 per cent of leases in the retail tenancy market. There appears to be little evidence that the current process of negotiating occupancy costs is constraining the efficient

operation of the market for retail tenancies. It is unlikely that there would be net community benefits from attempts to further regulate occupancy costs. The conditions that govern business operations, in particular the cost of tenancy within shopping centres and other retail formats, should remain a matter negotiated between tenants and landlords.

8 Market information, transparency and disclosure

The Commission was repeatedly told that there is an information imbalance in the relationship between shopping centre landlords and retail tenants. One retailer association stated that retailers often find themselves in an information 'vacuum' when negotiating or assessing their leases. While such claims are not new (similar concerns were expressed to the Reid Inquiry), they are made in the context of extensive information disclosure requirements under current regulations, considerable public information available from tenancy authorities and the development of a lease information and advisory sector. This chapter reports on and assesses the availability of market information, market transparency and disclosure in the retail tenancy market, before considering participants' suggested options for change.

Section 8.1 presents participants' views on information availability and market transparency while section 8.2 evaluates available evidence of information failure in the retail tenancy market. In section 8.3, options for improving information available to landlords and tenants are assessed, taking into account the current availability of market information and the actions available to business to improve the information base and its utilisation. Section 8.4 sums up the Commission's assessment of key information gaps and possibilities for closing them.

8.1 Participants' views

During the course of this inquiry, the Commission received a number of requests from tenants for advice on how and where they could obtain assistance and further information for particular tenancy problems. It was also suggested that the complexity of leases and disclosure statements creates a barrier to good decision making even though these documents increase the amount of available information.

Disclosure of information

A number of participants commented favourably on the disclosure requirements under the current retail tenancy legislation. Indeed, some suggested that the

provisions in Australia could be taken up in other countries, with Professor Neil Crosby stating:

> The means by which tenants are informed at the commencement of lease negotiations by the provision of information including draft leases and information guides does appear to be extremely efficient and useful, either informing tenants or persuading them that they need professional help early in the process. This aspect of the Australian system has already informed the lease reform debate in the UK which is currently focusing on the dissemination of the new third voluntary lease code to small business tenants. The information and subsequent disclosure provisions of the legislation should be retained and may well become part of the UK process in the future. (submission no. 84, p. 3)

Tribe Conway & Co, however, stated that the rules in place for the provision of disclosure statements placed unnecessary constraints on landlords and tenants, because disclosure provisions:

> … entitles a lessee to terminate the lease where the disclosure statement was not given 'at least 7 days before a retail shop lease is entered into' [in NSW], it is commercially impossible for a lessor and lessee to enter into a lease within 7 days after the provision of a disclosure statement.
>
> Often a lessee may wish to enter into a lease, and take possession of retail shop premises quickly, and within less than 7 days after receiving a disclosure statement. Bizarrely this is prohibited. (submission no. DR144, p. 1)

Not enough information?

Some considered disclosure provisions had not done enough and that retailers continue to operate in an environment of considerable uncertainty due to lack of information. The Australian National Retailers Association argued that there is scope to achieve greater certainty for retail tenants:

> When a tenant enters into a five year rental lease they should reasonably expect that major terms of that lease — such as location, rent formulas, number of competitors, will not change during this time.
>
> Unfortunately, the reverse is often true. Retailers can sign up to a long-term lease with the understanding that there are only 15 other competitors, only to have this change overnight with a complex deciding to introduce 30 more stores. Under the current system, no consultation is required with tenants and compensation for tenants' decreased sales is not a consideration for landlords. (submission no. 92, p. 8)

A number of other participants claimed that they had entered into a lease without being aware of critical information, such as imminent changes to the tenancy mix and traffic access changes (elevators being moved, changes to access doors amongst others), that subsequently had a significant adverse effect on their business. For example, a small retailer informed the Commission:

> I wished I had been a little bit more knowledgeable about dealing with leasing executives and know that I should have had a lot more written into the leasing contract and not accepted their verbal untruths. (confidential submission)

Other participants, however, suggested that often it is a lack of business acumen rather than a lack of disclosure of information that results in problems. The National Retail Association (NRA) commented:

> There are fairly extensive disclosure requirements for landlords under some State legislation, particularly for new leases. However, individual landlords and prospective tenants have difficulty in accurately assessing business potential for a particular lease. (submission no. 47, p. 13)

Many of these considerations were echoed in response to the draft report. For example, the Small Business Development Corporation believed that the disclosure requirements in place had a positive effect on the market, stating:

> … disclosure and dispute resolution are key areas that assist to address imbalances between market players. (submission no. DR194, p. 9)

Conversely, participants repeated concerns that disclosure had not gone far enough, with key information needed to assess locations absent from the disclosure statement. As expressed by TCM Consulting:

> Currently the level of Disclosure required by Shopping Centre Landlords is grossly insufficient. … When the level of investment on rent, employment, stock purchases and other expenses are tallied even small Retail Tenants are making 'million dollar' decisions, with very little real understanding of how the Shopping Centre, and the immediate precinct within the centre, are performing. (submission no. DR183, pp. 5-6)

While many participants repeated concerns over the extent and nature of information delivery in response to the draft report, others held a different view. Todd Trevaks, retail consultant, stated:

> My own experience is that the more detail there has been in disclosure statements, the more helpful that has been to me as a consultant to retailers. In fact one of the problems that I find is that there may be not enough information in the disclosure statement. (transcript, p. 527)

Such sentiments suggest that while the disclosure of information is important to enable efficient decision making, improvements could be made to the method in which this information is delivered.

Too much information?

While information is essential to good business decision making, some participants expressed concern at the substantial increase in the size of disclosure statements and

the burden of 'red tape' placed on both lessors and lessees. As the Shopping Centre Council of Australia (SCCA) stated:

> … prescribed disclosure statements in each State and Territory have been exhaustively examined during each review of retail tenancy legislation and have grown in length with each review. The pro forma NSW Lessor's Disclosure Statement, for example, is now 6 pages in length but when populated by the lessor can be twice that length. This statement contains (in the case of shopping centres) 40 separate items of information that must be supplied. Seventeen of these questions are specific to shopping centre tenancies. (submission no. 83, p. 26)

Some participants expressed concern that the increasing length and complexity of the documentation has had its own adverse effects. The Australian Retailers Association (ARA), for example suggested that the length of the documentation may result in less informed prospective tenants rather than the reverse:

> In most shopping centres retail leases with the major landlords can run up to sixty pages. ... The majority of small businesses do not seek professional advice before entering into the lease and sign it not knowing the full ramifications of the contract. (submission no. 119, pp. 4-5)

RICS Oceania noted that disclosure statements had become so complex that legal advice is required:

> … the current disclosure statement required has become unduly complicated, necessitating the need for legal intervention, and therefore incurring significant costs on behalf of both landlords and tenants. It has been stated that 'Agents' will no longer deal with the disclosure statement, landlords generally use inhouse legal resources and tenants are directed to seek legal advice on this matter. (submission no. 39, p. 4)

The SCCA made the further point that disclosure statements cannot predict every business eventuality that may occur and, while designed to help tenants make informed decisions, they cannot 'guarantee that a tenant's business plan will succeed' (submission no. 83, p. 26).

The Victorian Government indicated that it is committed to reducing the regulatory burden on business through its *Reducing the Regulatory Burden* initiative and, in this context, retail lease disclosure provisions have been identified as an area of priority review:

> Current disclosure requirements and forms will be examined to identify opportunities to reduce administrative and compliance burdens on business. This will include clarifying and streamlining information disclosure requirements, particularly in cases where businesses must also comply with additional disclosure requirements (such as under the Franchising Code of Conduct or the Sale of a Small Business vendor's statement under section 52 of the *Estate Agents Act* 1980). (submission no. 111, p. 8)

In response to the draft report it was also suggested that information contained in

the disclosure statement be confined to factual matters. As stated by Professors Duncan and Christensen:

> Disclosure Statements should be retained in the contracting process but only the answers to factual information of relevance should be sought from the recipient not information which could not be reasonably known at the time of the request. (submission no. DR153, p. 4)

However, requirements to disclose potential changes to the tenancy mix and centre developments, for which details may not be known at the time of negotiation, convey important signals about risk. For example, the fact that a landlord will not state that the tenancy mix will not change provides important information to a prospective tenant — that is, there is a risk that the tenancy mix *will* change over the period of the lease. The challenge in designing an effective disclosure statement is to balance the need for information with the cost of provision and the ability of a tenant to make sense of what is provided.

FINDING

Attempts to increase information through disclosure provisions have led to longer and more complex documents. Such documents do not necessarily improve a tenant's understanding of the lease and may even have the opposite effect.

Information imbalances

Many retailers claimed that there is an imbalance in the information available to landlords and retail tenants. The Franchise Council of Australia (FCA) said:

> Shopping centre landlords have access to turnover information of all tenants in centres operated by the same owner. However, tenants have no reliable, timely sources of information on net effective market rent levels. …
>
> The information asymmetry leads to a risk of abuse of market power by the shopping centre landlords, as tenants find it hard to compare rent levels between shopping centres, and the landlord has an unfair advantage in rent negotiations as they know the tenant's ability to pay. (submission no. 117, p. 5)

The NRA said that:

> Shopping centre tenants are required to disclose sales, for legitimate reasons, and this information, in processed form, should be reciprocated in cases where it is relevant to a better informed negotiation and business decision. (submission no. 47, p. 13)

The Retail Traders Association of WA (RTAWA) indicated that greater transparency of a shopping centre's performance would enable tenants to 'understand the market, benchmark a centre's performance with other centres and to enter a lease with their eyes open'. They suggested that:

It would be beneficial for tenants if a landlord were required to release aggregate information about:

- the annual turnover of tenants;
- the number of leases terminated prior to the expiry of the lease term; and
- the number of tenants whose businesses failed. (submission no. 65, p. 5)

Also, the Southern Sydney Retailers Association (SSRA) claimed that the lack of information on rents paid by shopping centre tenants led to uneconomic and unsustainable rent levels:

> What is 'unfair and obnoxious' is a situation where a rent which is inflated, unsustainable and uneconomic, that if any small business is actually paying it, they will certainly face ruin and bankruptcy — can be represented by the landlords as the 'market rent', through a system of undisclosed secret rebates and secret kickbacks. (submission no. 113, p. 6)

Landlords, however, presented a different view. Westfield, for example, argued that retailers already have access to their own representative organisations and retail consultants who have a solid data base of information, including information concerning the trading performance of centres, centre sales and growth in sales as well as the sales performance of particular retailer categories (submission no. 85).

In a similar vein, Colonial First State Property Management submitted:

> As far as the non-national retailer is concerned, there has been a massive proliferation of tenancy advocates who provide advice and negotiate on behalf of such tenants; there has been a massive increase in the amount of information provided to tenants, not only by landlords (as a requirement of the law or otherwise), but by relevant government bodies and private seminars; there are tenant associations that continually support and educate tenants; and tenants regularly talk to each other. (submission no. 78, p. 6)

The SCCA also noted that the majority of tenants in the larger shopping centres are national or State chain retailers or major franchisors and these retailers are very well informed on prevailing market rents. Many of these retailers also have their own property departments with responsibility for lease negotiations (submission no. 83).

The Real Estate Institute of Australia (REIA) indicated that:

> For a nominal fee (around $18 in the ACT) a tenant may access the lease agreement for any particular retail premises and ascertain the agreed level of rent as well as any associated lease conditions. In addition, tenants may purchase detailed reports from publishers which contain information on the average turnover and rent levels for a whole range of retail sectors (for example, food, fashion, liquor). (submission no. 112, p. 13)

While acknowledging the information available from lease registers, some

participants noted that such registers do not operate as well as they might because of the age and cost of the information and the fact that the information fails to disclose detail about 'sweeteners' and 'side-deals'. The FCA, for example, said:

> Although lease registration information exists in NSW and Queensland, they are not up to date and are costly to access. As a result, tenants have no means of determining what is the net effective rent paid by other tenants, and hence the fair market rental value. Confidential deals and rebates also further restrict the free flow of information. (submission no. 117, p 6)

Many concerns expressed over the information imbalances identified above were repeated during the hearings in response to the draft report. In particular, many participants repeated concerns over the lack of available verifiable information on shopping centre rents (including incentives). For example, as commonly put to the Commission, the RTAWA submitted:

> … that Western Australia needs compulsory lease registration regulations to be enacted to give more transparent information, particularly with rental reviews/market rents. (submission no. DR171, p. 4)

Others believed that the usefulness of lease data to retail tenants is not as great as what may have been first thought. As the NRA put it:

> … from the individual tenant's point of view, he shouldn't be too concerned with the passing rent of some other use or space or lease conditions elsewhere. In my opinion, there are very remote connections between rental value compared directly on that basis when you get into very highly specific uses and lease conditions and business opportunities. (transcript, p. 410)

However, the RTAWA believed that data on rents paid for other locations is useful as such information may provide:

> … both parties equal information about what the playing field is. If I then choose, because I know my business, to pay 6 X, that's either my stupidity or my knowledge of my business and they're right, and if I feel that I can do that. But at the moment I go in there and I might be paying 6 X because I've gone in there with the best of intentions but no knowledge. Then once I'm in there, having a quiet chat to Anthony two tenancies up, and he says, 'You paid what?'. (transcript, pp. 693-4)

Rent information for similar locations, notwithstanding that each lease and location in unique, would allow tenants and potential tenants to recognise ambit claims made by the landlord and to have greater confidence in their assessment of the market. However, it should be recognised that ultimately, the negotiation between a landlord and tenant occurs on a one to one basis and that the rent agreed will represent what an individual tenant is willing to pay for a particular location at that time given the nature of their business.

8.2 Evidence on information failure

Information disclosure

Concerns about information imbalances in the retail tenancy market have led to an array of legislative measures. These measures aim to level the information available to both tenants and landlords and facilitate informed decision making (chapter 3). Importantly, such measures do not seek to prescribe what can be negotiated within a lease contract. Instead, government intervention of this kind attempts to better inform market participants. The Victorian Government, commenting on the legislation in that state, said:

> Disclosure of information is a significant feature of the Act. Appropriate availability of information helps to ensure both parties are aware of their rights and obligations under the tenancy agreement and allows small business tenants in particular to make informed business decisions about their lease. The Act requires the landlord to provide a tenant with a Disclosure Statement …. The contents of the Disclosure Statement are prescribed by regulation and include information about the term of the lease, permitted use of the premises, occupancy costs, rent payable, outgoings and, if applicable, information on the shopping centre in which the premises is located. (submission no. 111, p. 5)

Despite these measures, many of the perceived problems in the market for retail tenancies are believed to come about because small tenants (and some landlords) lack information and understanding about their obligations and rights, and the forms of recourse available to them.

The information required in disclosure statements covers most areas of concern raised by participants to this inquiry. Examples of disclosure statements presented to the Commission suggest that a lack of information and reliance on verbal agreements should not be an issue if disclosure statements are diligently executed (box 8.1). Shopping centre landlords, for example, are required to provide details on planned developments, centre foot traffic and tenant mix, including any proposed changes. Despite these requirements, it is clearly not possible for landlords to foresee all changes in the tenancy mix five or more years out as these will be influenced by changing market conditions.

In relation to verbal agreements, the disclosure statements examined by the Commission included a section requesting information on any representations made to prospective tenants — ‘Please provide detail about all statements and representations made to you by the lessor or the lessor’s agent that you are relying on in entering into this lease’.

Box 8.1 **Information provided in retail tenancy disclosure statements**

Retail tenancy legislation in most jurisdictions sets out extensive requirements for disclosure statements. The information in disclosure statements covers most areas of concern raised by participants to this inquiry. Sample disclosure statements provided to this inquiry by two major landlords set out provisions for:

- any/all verbal representations made by landlords or their agents which were relied on by the lessee when agreeing to the lease;
- whether or not options to renew were available;
- (non) exclusivity;
- trading hours;
- planned redevelopments during the lease term — both council approved and those awaiting approval — and relocation provisions;
- rent increases and reviews (including the nature of these) and whether turnover rent is payable;
- the collection of turnover information;
- outgoings payable (and in some instances increases over the lease term);
- fit-out requirements;
- details of tenant mix — stating whether or not it will change — including anchor tenants (their lease length);
- centre foot traffic;
- centre turnover per square metre by broad category; and
- details of ongoing issues with a lease assignor if applicable.

Further, the disclosure statements suggest tenants seek legal and financial advice before signing, even in jurisdictions where sign-off conditions were not required. In general, disclosure statements closely follow sample statements published by State Registrars (such as Lessor's Disclosure Statement published by the New South Wales Department of State and Regional Development).

The disclosure statements also suggest tenants seek legal and financial advice before signing, even in jurisdictions where sign-off conditions are not required.

FINDING

A lack of information and reliance on verbal agreements should not be an issue if disclosure statements are diligently executed.

Public information available from tenancy authorities

State, Territory and Australian governments also provide a range of information on retail tenancy matters. Information aimed at improving retailers' knowledge and understanding of leasing matters is freely available on the web and in printed brochures. A number of the tenancy authorities also run workshops on retail leasing (chapter 3).

The agencies that administer retail tenancy legislation collectively receive over 20 000 enquiries a year on retail tenancy matters (see chapter 9 for more details). In the context of a market consisting of an estimated 290 000 leases, with 58 000 new leases negotiated annually, the number of enquiries is considerable — equivalent to about 40 per cent of the number of leases signed each year or 7 per cent of current leases. Enquiries are broadly distributed across jurisdictions in proportion to the estimated number of retail tenancy leases.

The enquiries are broad ranging including requests for information and tenancy advice (including for potential new retail lessees), as well as complaints. Western Australia's Small Business Development Corporation, which received 2600 enquiries in 2006-07, noted that a significant number of these were from potential tenants requesting advice about entering into a business premises lease (submission no. 81, p. 2).

Market responses to information differences

During this inquiry, the Commission was informed of an active leasing advisory service industry that advises landlords and prospective tenants on business plans and leasing conditions, and provides negotiation services. Many firms in this industry operate across State boundaries. This advisory industry is in addition to the realty sector that provides leasing and property management services to landlords. There are also a number of training courses that have evolved in recent years. For example, the 'Seed' program, a joint initiative between Westfield and the ARA, conducts a range of training initiatives including a diploma of retail management run through The University of Western Sydney.

Centre landlords stated that they often encourage prospective tenants to seek leasing advice prior to commitment. Nevertheless, comments such as, 'it is a pity more retailers are not prepared to seek and be willing to pay for such advisory services and be attentive to the advice' were frequently made to the Commission in industry visits.

Overall, there appears to be a substantial range of information and services about

retail tenancy leases and costs (including rents) available on a fee-for-service basis. This information covers shopping centres and other retail property (for example, shopping centre benchmarking reports which include information on occupancy costs are available from market providers such as Urbis for approximately $3500). Because some of the data are primarily derived from public registers of leases, more information is available in jurisdictions where most leases are registered. Accordingly, the most comprehensive market information appears to be available in jurisdictions such as New South Wales and Queensland where lease registration by market participants is more prevalent.

FINDING

Leasing advisory and market information services have evolved in recent years to provide information to landlords and tenants.

Remaining information gaps

Despite the presence of market-based information providers/advisors, and the mandatory disclosure requirements, a number of information gaps remain. For example, there is little market provision of shopping centre rents and disclosure of disaggregated foot traffic within centres.

Rentals

Information on rentals in shopping centres is scarce in many States — with the exception of New South Wales, Queensland and the Australian Capital Territory where lease registration is more common place. Further, the Commission was not informed of any landlord that routinely provides potential tenants or those renegotiating their leases with rental data for a given centre. While the lack of such information does not necessarily create market inefficiencies, it does lessen market transparency and the negotiating position of centre tenants. The lack of this information can limit a tenant's ability to recognise ambit claims, in some cases making a tenant more likely to accept a rent on terms favourable to the landlord. Such information also aids valuers when they are requested to settle disputes over market rent reviews.

Allied to the lack of information on shopping centre rents, there is an absence of information on incentives provided to some tenants. Incentives are a normal part of negotiating contracts and are common in many transactions (from commercial leasing to purchasing a car). There is also some debate about the value of lease registration as a means of providing rent information given that incentives are common place. Some considered that the presence of incentives distorts market

information and as such information on 'face rents' (that is, not accounting for incentives) could be misleading and/or meaningless. For example, as stated by Senator Andrew Murray:

> … many of the terms which actually impact on the rent that is paid, are contained in the Agreement to Lease, and this document cannot be registered. The Agreement to Lease is a much more extensive document, covering a much wider range of issues than the Lease, and therefore the assumption … that registration of leases would somehow improve information in the marketplace, appears to be naïve. (submission no. DR 178, p. 5)

Others, however, considered that corrections for the level of incentives could easily be made, with Leasing Information Services stating:

> Valuers adjust for this [incentives] all the time, where they look at the face rent; they make an allowance for a market level of incentive and they arrive at the effective rent. … It's much more prevalent in actual fact in other markets, being office; incentives can represent up to 20 to 25 per cent of the actual deal. In large office deals the incentive may be 20 to 25 per cent of the deal. In retail we're talking about a much smaller proportion. In shopping centres the level of incentives are generally somewhat higher than on strips. Strips tend to be more in the form of a rent-free [period]. To make another point, approximately 20 per cent of those incentives are already reported on the lease.
>
> … there are industry groups that report market level of incentives for retail, for any sector. If you just log into any major valuation company … they will show you what the level of market incentive is by centre type, by state, so you can see in New South Wales for regional centres the market level incentive is 10 per cent. So it's quite easy to effectively adjust to get the effective rent without having to simply change the whole system. (transcript, p. 204)

Further, most incentives are negotiated in confidential deals as neither party — landlord nor tenant — want such details to be provided to the broader market. Thus, even where there was strong competition between landlords for tenants (as occurs in shopping strips and other commercial tenancy markets) incentives would not be voluntarily disclosed and do not appear to diminish the value of 'face rent' information in these circumstances.

Disaggregated centre foot traffic

While retail tenancy regulations require landlords to disclose overall centre foot traffic, the foot traffic that passes through individual entrances is usually not provided (either to a new tenant or on an ongoing basis). For the individual trader, centre traffic past a particular location is most relevant to help forecast potential sales when deciding to establish a business in a centre. For the established retailer, centre foot traffic past their location is also important as it allows the retailer to

gauge how sales are related to centre traffic. As for data on rents, the lack of this information will not necessarily create market inefficiencies as, for instance, potential tenants can gauge foot traffic in any particular location prior to signing a lease (through observation). However, the lack of verified information (and other information on centre performance) can diminish the negotiating position of tenants as it reduces the transparency of the effect that centre management has on the returns of individual retailers.

Incentives for the market provision of rental information and additional information on foot traffic do not always exist. Given the strong demand for retail space within larger shopping centres (as evidenced by low vacancy rates — chapter 2), landlords typically do not need to advertise to attract tenants. Similarly, for disaggregated foot traffic data, centre managers are not required to release information on their performance in order to justify claims when negotiating leases as in many cases tenants can be replaced if they do not like the terms that are offered (although this comes at some cost). Thus, the strong demand for retail space in centres relative to its supply creates its own constraint to the market provision of this information that might otherwise occur.

Constraints on sector performance

Information asymmetries exist in the market for retail tenancies — centre landlords are likely to have greater knowledge about centre performance than potential tenants, and tenants are likely to know more about their own trading ability than their landlord — and some constraints exist to the market provision of information. Nevertheless, such information differences, to the extent that they remain, may not actually affect the efficient operation of the market. In most cases, it is not in the interests of either landlords or tenants to take advantage of the other party to the point that their business fails (box 8.2) — businesses have a strong commercial incentive to guard against such an eventuality.

Some participants suggested that the lack of information held by retail tenants, has led to a higher number of business failures that otherwise would be the case (for example, in submission no. 113 amongst others). Such an ‘information failure’ would only occur if, from a landlord’s perspective, it were perceived that the gain from exploiting one tenant to the point of business failure was greater than the costs of doing so. Alternatively, from a tenant’s perspective, if they were making decisions regarding their ability to pay rental amounts based on insufficient information — such as on the incorrect probability of tenancy mix changing and of a redevelopment — then the possibility that their business would fail increases. In part, both of these would be represented by higher business exits than that observed in comparable industries.

Box 8.2 **Compatibility of landlord and tenant incentives**

The interests of retail landlords and tenants are not incompatible, limiting the potential for information asymmetries to constrain the efficient operation of the retail tenancy market. That is, the success of one party is reliant on the success of the other. For tenants and landlords, lease agreements represent an ongoing contract (for a set period) over which a commercial relationship exists between both parties. As such, if a landlord attempts to exploit a tenant to the point where the business fails, some costs will also be imposed on the landlord — either through a vacancy period, the cost of finding a new tenant, and/or the cost of legal action to recover the money owed under the lease.

Ultimately, a practice of exploiting tenants by using information differences would also reduce the number of potential tenants available to a landlord and depress the landlord's long-term rental return. Landlords usually have a long-term interest in the value of their asset (as a going concern at market value) and it would be against their longer-term interests to pursue such a strategy.

Ideally, to assess the evidence of information failure, and its significance, characteristics of the 'fully informed' market would need to be known — that is, the 'counter factual'. As such evidence is not available, other indicators of the operation of the market are required. For this purpose, the Commission has drawn on evidence from:

- business exit rates;
- vacancy rates in various retail formats; and
- information on business profitability.

These indicators provide no *prima facie* evidence of overall market failings, albeit at an aggregate level.

Business exit rates for retail businesses are not significantly different to economy wide averages (those in retail trade and personal and other services — chapter 2). Further, data on exit and entry rates show that for retail businesses, these rates are in line with the relative share of retail businesses in the Australia economy. This suggests that, there is no systematic industry-wide failure in the retail market that consistently leads to higher rates of business failure than what would be expected on the basis of broad industry comparisons. It should be noted, however, that there are many factors that influence business entry and exit rates. Also, if the information asymmetry is permanent and has led to a new market balance, both the stock and flow of businesses would have adjusted accordingly.

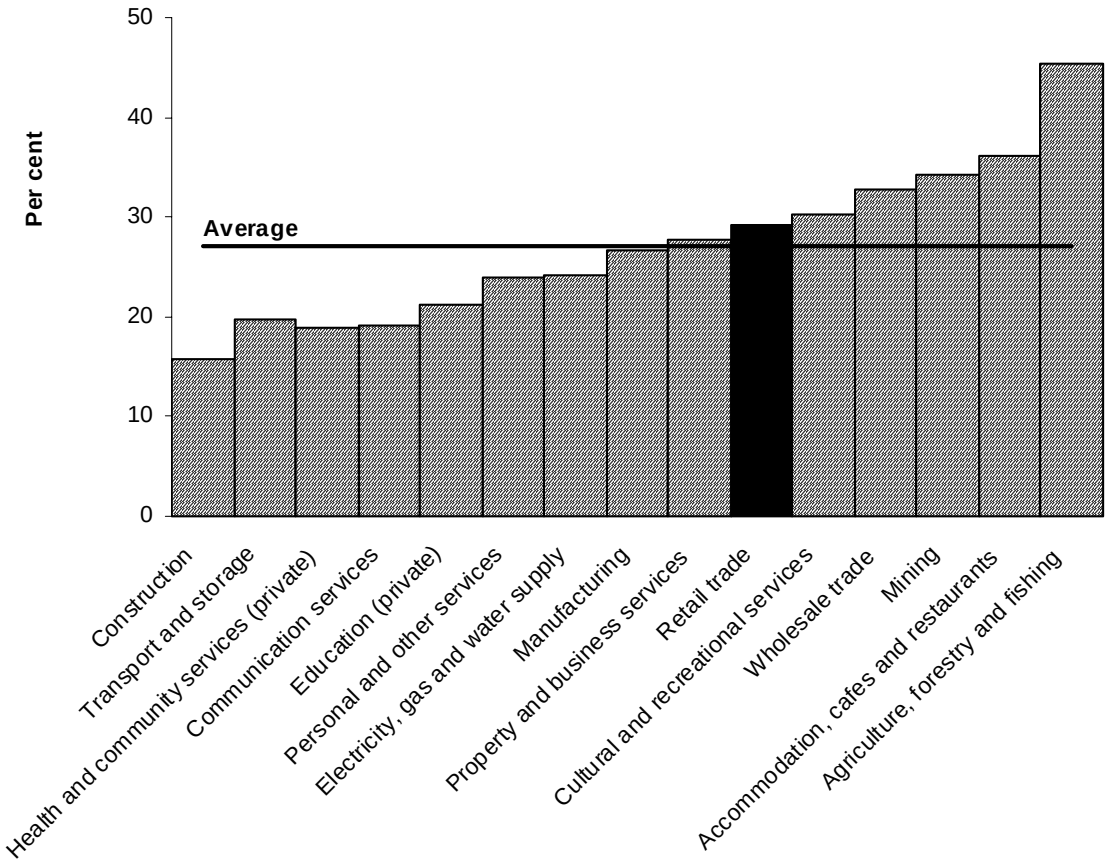
In relation to shopping centres, if there were particular information-related problems it would be expected that renewal rates would be low and vacancy rates high —

prospective tenants would see business in these retail concentrations as too risky, reducing the overall performance of this type of retail format. However, the low vacancy rates that exist (chapter 2), expansion relative to other retail formats (chapter 2) and high renewal rates (chapter 6), suggest that many retailers believe that shopping centres offer attractive opportunities.

Also, if conducting a retail business within a shopping centre (or elsewhere) were constrained by available information, negatively affecting performance, it could be expected that retail profitability levels would be low relative to other activities. While information on retail business performance within shopping centres is not available, aggregate information on profitability in the retail sector does not reveal substantial profit gaps. Indeed, the proportion of retail businesses operating at a loss is close to the industry-wide average over the period 2001-02 to 2005-06 (figure 8.1).

Figure 8.1 **Businesses operating at a loss, 2001-02 to 2005-06**[a]

Average per cent of businesses operating at a loss



a A wider set of businesses operate under a retail tenancy lease to those in retail trade. Despite this, the retail trade sector provides a proxy for these businesses.

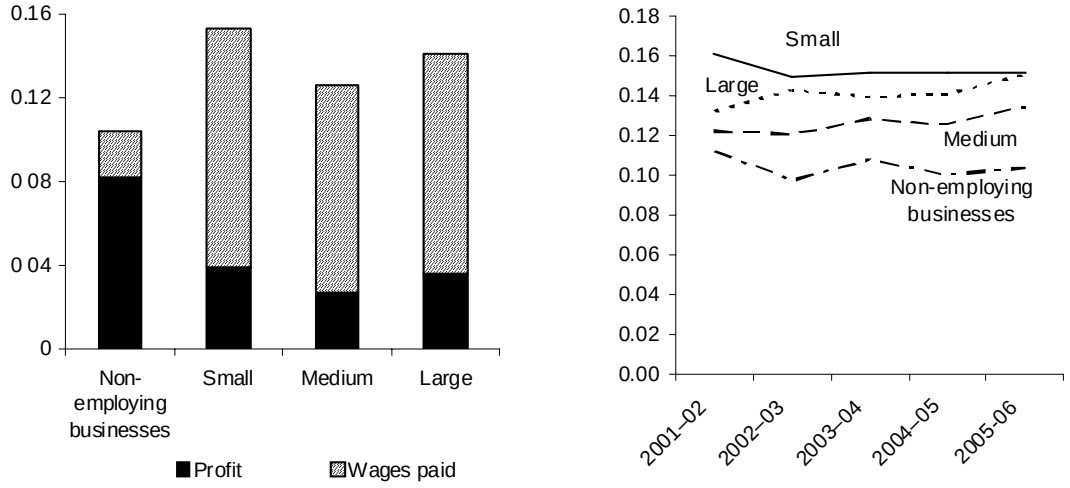
Source: ABS (*Australian Industry 2005-06,* Cat. no. 8155.0, Canberra).

While this broad relationship is maintained in each individual year reported, the proportion of retail businesses operating at a loss increased from 27 per cent (around the average) to 31 per cent from 2001-02 to 2005-06.[1]

Further, the average profitability and business returns excluding wages and salaries paid to retailers show that returns to 'small' retailers (those most likely to be affected by information imbalances, chapter 2), are on par with medium to large businesses (figure 8.2). Wages and salaries were excluded (as for many small businesses) as owners do not draw a wage from their business, inflating profit levels relative to other kinds of businesses. Thus, whilst this measure does not directly conform with standard profit calculations, it provides a less biased means for comparison. For example, actual profit figures — the dark shaded areas on the left panel of figure 8.2 — show profit levels for non-employing retail businesses are greater than those reported for other business categories prior to adjustment, but below when wages and salaries are excluded.

Figure 8.2 **Operating profits of retail businesses, 2001-02 to 2005-06**[a]

Average operating profit (excluding wages and salaries paid) as a proportion of average total income



a Business size defined by number of employees. Small businesses are those which employ less than 20 employees, medium 20 to 200 persons and large above 200.

Data source: ABS (*Australian Industry 2005-06,* Cat. no. 8155.0, Canberra).

[1] During the draft report hearings, the SSRA claimed that the number of retail businesses operating at a loss had increased three-fold over the period from 1997 to 2006 (transcript, p. 119). However, as of 2002, the ABS used different industry classification codes which more than doubled the number of retail businesses from 2000-01 to 2001-02 and accounted for the majority of the increase in businesses operating at a loss reported over the period from 1997 to 2006. Due to the changes in classification codes, comparisons in this report are only made between data which was collected under the same codes.

For the other categories of retail businesses, profit levels with and without wages and salaries indicate a similar pattern of returns. On average, small retail businesses (those employing less than 20 employees) have performed as well as medium to large retail businesses, as measured by profits expressed as a percentage of total income, over the period 2001-02 to 2005-06. Again, it needs to be recognised that many other factors influence business profitability. Despite this, the average and trend results do not provide *prima facie* evidence of information asymmetries which adversely impinge on the operation of retail businesses for those most likely to be affected — small businesses.

It should be noted that data on business entry and exits and aggregate profitability can only be used to evaluate any systematic failure in the market — that is, the extreme outcome. However, it is more likely that the effects that any information asymmetries have on the operation of the market would be at the margin, and thus not evident in aggregate average measures.

The impact of information differences on the operation of this market are more likely to be in the form of altered relative negotiating positions for the parties to a lease. As it is not in both parties' interests to take advantage of the other to the point of failure, any effect of differences in negotiating power would be through the distribution of returns in favour of the party which can achieve a commercial advantage. For retail tenancies, shopping centres would hold a commercial advantage through repeated negotiation and the opportunity to establish effective tenant screening processes. These landlords would negotiate with a wide range of tenants. A tenant (or prospective tenant), despite possible knowledge of their potential trading prospects in a particular location, who negotiates leases infrequently and/or who does not effectively utilise the services of professional advisors, is less likely to hold a commercial advantage. These tenants also face a less transparent market when entering centres as rents are not usually advertised (as is the case for tenancy markets generally). Other tenants would not lack information or be at a commercial disadvantage due to their own information resources and/or repeated negotiations — such as retailers and franchisors controlling multiple stores. Also, if a retailer's product is in high demand, this will afford the retailer a commercial advantage. In contrast, in shopping strips, as there is a more diverse set of landlords and tenants, it is likely that any commercial advantages created by information differences would be more varied between market participants.

The distribution of returns from retailing created from information differences, however, spread between market participants, does not represent an efficiency loss. Rather, it represents a return to superior information gathering and negotiating skills. The presence of this return provides a strong incentive for market solutions to develop to counteract any information differences that remain — a situation that has

been witnessed in the retail tenancy market.

Thus, while there exists some potential for information differences to affect the trading performance of individual retailers, these gaps are likely to be filled through the development of market solutions and the current disclosure requirements. However, to the extent that impediments exist to the market provision of information, additional government action may be warranted to improve the information available to market participants and aid in efficient business decision making.

8.3 Assessing the case for change

To warrant further measures to improve information and understanding in the market for retail tenancies, it needs to be shown that extra interventions will further improve commercial decision making without creating excessive compliance and administrative costs or otherwise erode market efficiency.

In response to the concerns outlined above relating to the remaining information differences and the complexity of information disclosure, a number of participants suggested options for change which focused on further increasing the information available to market participants to support decision making. These included:

- measures to improve lease transparency and understanding;
- the development of template leases and disclosure statements; and
- mandating lease registration.

Improve lease transparency and understanding

A number of suggestions aimed at further improving lease transparency, education and understanding were made to the Commission. Broadly, the suggestions were about making leases more understandable to landlords and tenants (box 8.3). Compulsory sign-off requirements were also suggested (submission no. 121), recognising that despite the current provision of education services and disclosure requirements, tenants and landlords should seek professional advice before committing to a lease.

Improving the understanding and knowledge of individuals entering into small business about their obligations and rights under tenancy leases should improve self reliance and decision making. If parties to a lease are more aware and better understand their contractual obligations, the available recourse if breaches arise, and the limits of those forms of recourse, then they are more likely to enter into

commercially sound contracts. But it appears that the longer and more complex disclosure statements become, the less likely prospective tenants are to read them and understand the implications for their business. Legislation prescribing provisions within disclosure statements needs to be sensitive to the costs of preparing such documents and the likelihood that provisions will be read and the implications understood. Given this, highlighting key lease provisions — such as occupancy cost, planned rental increases, lease length, existence of options, shop size, and total outgoings payable on the first page of a lease and/or disclosure statement — also know as an 'epitome' of a lease — is likely to be beneficial, as such measures create a layered approach to information provision, potentially making disclosure statements easier to understand.

Box 8.3 **Suggestions to make leases and leasing more understandable**

Participants to the inquiry suggested a range of options, including:

- greater use of simple language;
- simplification of lease charges (such as a provision that landlords can only charge rent, inclusive of outgoings and marketing — or estimate thereof — to reduce the complexity of charges within lease) (submission no. 119);
- stronger education and awareness programs of retail tenant responsibilities and rights by State Registrars (or applicable department), including of dispute settlement procedures;
- one page disclosure of key 'controversial' clauses (such as fit-out requirements, end of lease provisions and effective rent) at the beginning of the disclosure statement;
- educational programs for potential tenants about how rents are determined and why they would be expected to be different for different tenants (such as an anchor store versus a speciality clothing store) (submission no. 112); and
- greater awareness programs about available information (such as lease databases in some States) and the merits of engaging consultants when negotiating leases (submission no. 112).

Improved disclosure and transparency of lease terms should also reduce the perception that landlords, in some instances, deceive or mislead tenants when entering into negotiations. As stated by the REIA:

> … the implementation of [educational] measures … will improve the efficiency of the retail tenancy market in Australia for the benefit of landlords, tenants, real estate agents and consumers. These measures will act to improve understanding of the market, lower transaction costs, decrease the risks associated with business failure and prevent many disputes from arising in the first place. If these suggestions are not seriously considered, it is likely that the perception that small retail tenants are at a systemic disadvantage will persist into the future. (submission no. 112, p. 14)

Nevertheless, the provision of more information or educational resources is costly to both the small trader (in terms of time) and the service provider. For those services publicly funded, costs are generally passed on to taxpayers. Also, empirical evidence is not currently available to support the case that the provision of additional information has improved decision making. It is therefore a matter of judgement, at this stage, whether the net benefits of programs to date are positive.

Further, current provisions for disclosure statements are significant and possibly, as some have suggested, excessive. These requirements have led to lengthy disclosure statements that set out tenant and landlord rights and responsibilities. Despite this, as expressed by some submissions, the longer and more complex these documents are, the less likely prospective tenants are to read them and understand the implications for their business. Given this, some tenants felt they were unaware of conditions stipulated in their leases until well after the contract had been agreed (such as no automatic right for a new lease).

The Commission's assessment is that while extensive disclosure provisions exist, gains from additional requirements are likely to be made through improving the delivery of the information disclosed, such as through simple language and a one page summary of key terms where this is not already done and harmonising requirements across States, rather than through increasing disclosure requirements.

FINDING

Improving lease transparency and disclosure through the use of simple language and a one page disclosure of key provisions, is likely to improve understanding of lease terms and conditions.

Use of reference leases and disclosure statements

While retail tenancy legislation sets out the legal framework under which leasing transactions may be undertaken, it does not set out best practice guidelines. The use of 'best practice' or 'reference' leases and disclosure statements could replace the current prescriptive requirements set out in the legislation. Further, as there is an issue of what content is sufficient for prospective tenants to evaluate the opportunities for their business, a distinction could be made between what might be appropriate for retail premises in shopping centres and those in shopping strips and other retail formats.

Reference leases and disclosure statements could set out what the industry (both retailers and landlords) and government consider as best practice, and provide guidelines for all retail tenants. Such templates could cover current contentious areas (and be updated as new ones arise) and might include provisions for:

- lease renewal and end-of-lease conditions;
- lease terms;
- information disclosure; and,
- outgoings payable.

Requirements particular to shopping centres could be detailed in annexures to the reference leases and disclosure statements. These would potentially provide an opportunity for tenants, their leasing agents and advisors unfamiliar with retail leasing to better understand what is generally required and what is likely to be included in a lease before entering negotiations. This would potentially improve transparency and the effectiveness of decision making and complement the education and information role adopted by government. This point was echoed by the RTAWA in response to the draft report:

> The RTAWA supports creating a national retail lease model with jurisdictional amendments noted. The RTAWA believes that this along with nationally consistent disclosure statements would facilitate the removal of a great deal of misunderstanding and associated costs between jurisdictions. (submission no. DR171, p. 3)

Despite this, reference leases and disclosure statements would be voluntary. Given their voluntary nature, landlords and/or tenants could retain or add clauses which are to their own benefit and delete those which are not. Businesses could also develop their own lease models.

Given the vast array of differences that exist between landlords, tenants and locations, some concerns were raised over the usefulness of templates. For example, the Law Society of South Australia stated:

> We suggest a standard model lease would be both unwieldy and inefficient as it would ultimately be a lease with numerous annexures, covering not only differing State legislative requirements but the peculiar requirements of certain landlords, tenants and properties. We consider that the end product in most cases will be a lease which is very difficult to read and understand. (submission no. DR197, p. 1)

An alternate to the use of model (or template) lease and disclosure statements was suggested by the REIA. Instead of developing model documentation, a standard set of items for disclosure and mandatory inclusion in lease documentation could be formulated, leaving the make up of the document to industry:

> The REIA proposes that a more practical alternative model would be for governments to simply prescribe the elements that must be contained in any lease agreement or disclosure statement and then leave it to the market place to prepare the best lease document for any given situation. The REIA considers that it is not the purview of governments to be prescribing actual lease documents in a healthy, competitive market. This should be influenced in part by factors of supply, demand and legislative interpretation. (submission no. DR154, p. 5)

Overall, reference lease documents and disclosure statements could be used as an aid to improve market transparency and make retail leasing simpler. The Commission's assessment is that such a development could be of some benefit if complemented by the development of a standard set of items for disclosure and mandatory inclusions in lease documentation. Further, while incentives exist for industry to develop these measures (to lower the transaction costs of doing business), due to the atomistic nature of the market, it is not likely that a uniform template lease would be developed. Given this, a role could be played by governments to facilitate the development of such template leases and disclosure statements.

Mandate lease registration to improve market information

Landlords, tenants and tenant organisations have advocated mandatory lease registration (box 8.4) in order to overcome a lack of information relating to shopping centre rents. This possibility received strong support from many participants throughout the draft report hearings and subsequent submissions. Leasing in shopping centres is typically undertaken through direct negotiation between the landlord's agent and the prospective tenant. Although prospective tenants may lodge expressions of interest, vacancies are typically not advertised widely. This differs significantly from the wider retail tenancy environment where retail space is advertised. The approach adopted by shopping centres has led to suggestions that there is a lack of information about going rents, which is believed to hamper efficient decision making by prospective tenants.

In view of this, a number of submissions suggested a nationally consistent register of leases be established. Ideally, such a register would:

- detail the effective rent paid by tenants (inclusive of all costs and landlord contributions that relate to the lease but not necessarily the details of these costs and contributions); and
- require prompt lodgement of leases (longer than three years in length) after agreement has been reached.

Box 8.4 **Views on mandatory lease registration**

The Council of Small Businesses of Australia advocated the development of a national register of retail tenancy leases:

> … all Australian leases must be registered with the National Retail Leases Register. (submission no. 94, p. 12)

Similar sentiments were expressed by the Australian Property Institute (API):

> The API supports the establishment of a National Data Base which would add transparency to the leasing process … (submission no. 70, p. 15)

RICS Oceania developed the idea further, advocating not only lease registration, but also for a government agency to analyse the data and provide reports to industry participants:

> If there is a common lease registration process established in all States, then there also needs to be a format for analysis. RICS supports the establishment of this process nationally so as to improve the transparency and efficiency of the market. In addition to a national process of lease registration there must be an appropriate administrative framework, suitably resourced, for providing lease information to those in the market who wish to obtain it. (submission no. 39, p. 5)

Also, Westfield did not oppose the registration of leases at the State and Territory government level:

> Westfield would not, however, be opposed to the States and Territories concerned adopting lease registration requirements similar to those applicable in New South Wales, Queensland or the Australian Capital Territory and views this as a measure that would address any perceived shortcoming arising from the lack of general availability of rental information. (submission no. 85, p. 18)

The SCCA said:

> To improve the transparency of the retail tenancy market there should be mandatory registration of leases in those States which presently do not require registration (Victoria, South Australia, Tasmania and Western Australia) to ensure details of rents or other lease conditions are publicly available to inform retailers during lease negotiations. (submission no. 83, p. 3)

Lease registration already occurs in a number of tenancy markets (for example, residential) and is optional in *all* States and Territories for retail tenancies (generally, for tenancies longer than three years) (table 8.1). Lease registration confers indefeasibility of title under property legislation in most states, except for Victoria where indefeasibility is conferred to the tenant in possession (chapter 3). The cost of doing so, and title search costs are low (additional costs, ranging between $7 to $20 across the jurisdictions, are imposed if a copy of the actual lease document is requested). Because registered leases are available to the public, registration also provides, as a by-product, public information about the market and lease conditions.

Table 8.1 **Retail tenancy lease registration by State**

Jurisdiction	*Requirement*	*Purposes or apparent intention/access*
New South Wales	Voluntary under the *Real Property Act 1900 (NSW)* for leases longer than 3 years.	Registers claim in law on real property. Registration cost: $90 Title search cost: $29
	If registered, the *Retail Leases Act (1994)* requires it be done within 1 month.	Requirement for timely registration.
Victoria	Voluntary under the *Transfer of Lands Act 1958 (Vic)* for lease longer than 3 years.	Registers claim in law on real property. Registration cost: $97 Title search cost: $20
	The Small Business Commissioner must be notified under the *Retail Leases Act 2003 (Vic)*.	Notification is required for information purposes.
Queensland	Voluntary under the *Land Titles Act 1980 (QLD)* for lease longer than 3 years.	Registers claim in law on real property. Also, for mortgages over a lease to be valid, the lease must be registered. Registration cost: $115-$170 Title search cost: $12-$19
Western Australia	Voluntary under the *Transfer of Land Act 1893 (WA)* for leases longer than 3 years.	Registers claim in law on real property. Registration cost: $85 Title search cost: $14
South Australia	Voluntary under the *Real Property Act 1886 (SA)* for leases longer than 1 year.	Registers claim in law on real property. Registration cost: $108 Title search cost: $18
Tasmania	Voluntary under the *Land Titles Act 1980 (Tas)* for leases over 3 years.	Registers claim in law on real property. If unregistered, parties forgo potential common law legal action over the lease and rely on equity. Registration cost: $86 Title search cost: $20
Northern Territory	Voluntary under the *Land Title Act (NT)* enacted in 2000 for all leases.	Registers claim in law on real property. Registration cost: $135 Title search cost: $15
Australia Capital Territory	Voluntary registration under the *Land Titles Act 1925 (ACT)* for all leases.	Registers claim in law on real property. Registration cost: $90 Title search cost: $14

However, to register a lease there are often a number of additional requirements that must be met. For example, in Queensland Barry Nilsson Lawyers suggested that the cost of registration was significantly greater than just the amount paid to the titles office:

> … when you want to register a lease, let's say it's a lease for a shop in a shopping centre, which is the typical situation that I'm involved with, you must attach a survey plan of the shop to the lease, and which identifies the shop. That survey plan must be prepared by a surveyor, and there is a whole range of requirements about the particulars of that survey plan. … in my experience, the cost of that is about $300 to $500, to get a survey plan done, and that is invariably passed on to the tenant. (transcript, p. 403)

The arguments in favour of compulsory lease registration rest on the potential net benefit that may accrue from additional information about the lease market. Because vacancies in shopping centres are not widely advertised, the main benefit would accrue to tenants and potential tenants in centres. Outside of centres (where a large proportion of retail tenants operate) rental charges are commonly advertised, thus limiting the overall information value of lease registration.

If all leases were registered in a timely fashion, existing tenants and potential tenants would be able to compare rents paid within shopping centres, and between centres and location types (for example, strips versus centres). This information would clearly place them in a more informed negotiating position. For example, as stated by the Western Australian Retailers Association:

> Australia and Australians need a fully national lease register so they can be fully informed about exactly who is being charged and what they are receiving. (submission no. 118, p. 42)

A nationally consistent register of leases would also enable landlords to compare rents and may promote greater competition for tenants.

The fact that not all leases are registered, however, suggests that the value that some parties place on increased legal security is outweighed by other factors such as the cost of registration and commercial confidentiality. Indeed, the information benefits created to an individual tenant from registering their lease are likely to be well below the collective benefit to all tenants (as they already know the terms and conditions of their own lease). Thus, compulsory registration could only be justified if the overall information benefit from doing so exceeded the cost, and was determined to outweigh considerations of commercial confidentiality.

Additional requirements for mandatory lease registration would increase both compliance costs and the cost to government of regulation. For example, in all States and Territories, lessors and lessees can register leases to legally validate claims on real property. Thus, introducing legislative requirements for this to occur is likely to be unwarranted (indeed, the provisions currently available to protect legal rights can already be viewed as the minimum necessary). Also, the mandatory registration of retail tenancy leases would invalidate any confidentiality provisions that have been included in contracts, limiting businesses' freedom to contract.

In some States, where the incidence of registration is higher, many retail tenants seemingly do not make use of the available information, or of specialists who analyse and report on this information. Also, it is unclear whether tenants in these States are in a significantly improved negotiating position and consequently are making better business decision than their counterparts in those jurisdictions where lease registration is less common. Nevertheless, it was suggested that one reason

why many tenants do not make use of available information was that such services have only recently developed (in the last three years). However, patronage of these services has increased substantially, indicating that many tenants value the information provided (submission no. DR156). Also the FCA suggested that retailers in States where information was not available, such as Victoria, make use of data from other jurisdictions as a second best option in order to improve decision making:

> New South Wales has become the benchmark for rentals and that's where a lot of franchisors get their information from and make decisions about in Victoria. … if the information is available in New South Wales we will use that information and extrapolate it all over Australia. (transcript, pp. 587-8)

In a survey of users of lease information, many felt that access to such information was useful to their business and improved their lease negotiation outcomes (box 8.5). Importantly, the most significant improvements to their business were reported to be in the form of improvements in rents paid, negotiating rental increases and dispute settlement.

The regulatory structure for lease registration is already in place in all jurisdictions. While there is scope for market participants to use these provisions more fully, the Commission's assessment is that there appears to be little justification for further government intervention as there are currently no legal impediments to the registration of retail tenancy leases. The current provisions also do not place restrictions on the commercial provision of information (by allowing confidential lease agreements not possible with mandatory registration). Nevertheless, the Commission considers that there would be merit in alternatives that seek to enhance available lease information.

Alternatives to lease registration

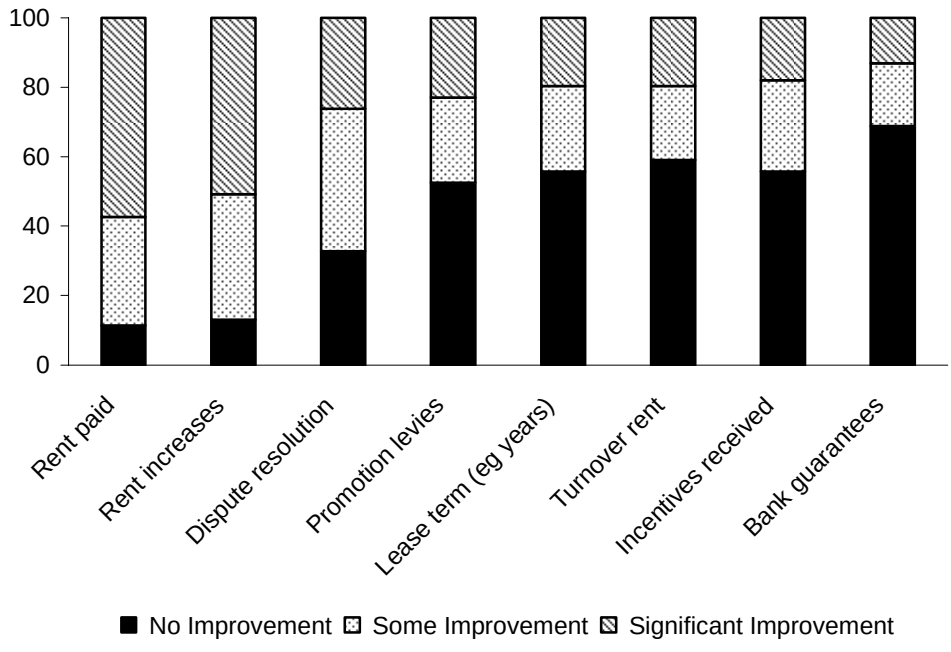
The purpose of lease registration is to provide indefeasibility of title for parties to a lease — that is, it registers a 'legal interest' in a property. But calls for mandatory lease registration are based on improving market information (a by-product of registration). In most States, it appears that the legal benefit of registering a lease to the parties of a lease is less than the cost of registration, the result being a limited number of leases registered. As the cost of registration is borne by the individual who registers the lease, to which no direct private information benefit accrues (they are already aware of the information contained in the lease), there is no incentive to register a lease for information purposes only. This suggests that mandating lease registration is not the most efficient means to improve market information. Nevertheless, making use of the established lease registration system would result in an administration cost saving compared with the establishment of an independent system.

Box 8.5 **Benefits of information on lease terms and conditions**

In March 2008 a short survey was conducted by Leasing Information Services of its clients on the usefulness of information on lease terms and conditions. A total of 60 responses were received from businesses and their representatives (in some cases lease consultants) who reported involvement with over 12 000 retail stores Australia wide. Over half of the stores were reported to be operating in New South Wales, Queensland and the Australian Capital Territory where lease information is currently publically available. Of the remainder, the majority operated in Victoria. Most were operating within shopping centres. However, a significant proportion also had some stores on retail strips.

Over 85 per cent of the respondents rated the information obtained from lease registers as very useful to their business during end of lease negotiations, in assessing new locations or opportunities and during market reviews. Further, over 65 per cent of respondents stated that access to this type of information had improved negotiation outcomes in these areas. The gains made from access to information were concentrated on improvements in outcomes relating to rents paid, rental increases and dispute settlement.

Circumstances where lease information has improved negotiation outcomes
Per cent of respondents



Source: Based on survey data provided by Leasing Information Services.

A number of alternatives to mandatory lease registration were put forward in response to the draft report. These included an expansion in the data collected under

the Victorian lease notification requirements (submission no. DR156), the use of the Valuer General in each State to collect and publish information on retail rents (submission no. DR156) and the lodgement with a nominated agency (possibly a government authority) of a one page disclosure of key lease terms (transcript, p. 404).

The lodgement of this information would not only improve market transparency, allowing retailers to compare the cost of operating in different locations, but potentially also aid in the settlement of rental disputes. For leases which include mid-term 'market' rent reviews (most prevalent in shopping strips), access to rental information, it has been argued, has improved dispute settlement. Leasing Information Services submitted:

> In NSW … of the last 379 mediation reports between July 2006 and December 2007, 208 had 'rent' listed as an issue for mediation. Of these 208, an average of 80% had been resolved within five weeks of applying for a hearing. (submission no. DR156, p. 7)

In contrast, it was argued that in Western Australia where lease registration is less common, and thus data is scarce, disputes over 'market' rent reviews are more common and difficult to resolve (submission no. DR 156). However, in the context of the number of leases in operation the number of disputes over 'market' rent clauses appears to be very small.

It should also be noted that information on incentives provided to tenants, if not contained within the lease, would not be collected through this process. However, the extent to which this would diminish the usefulness of the information created is likely to be limited. Leasing Information Services suggested:

> In fact, retail leasing incentives represent a much lower proportion of total rents [in] the commercial office market when compared to retail. Research undertaken by Leasing Information Services in 2006 indicated that incentives typically represent a very small proportion of rents over the term of the lease. Across the board of retail strips and shopping centres, incentives represent less than 5 per cent of the total net rent of a five-year lease. (transcript, p. 193)

Further, the lodgement of a one page summary of key terms would avoid any need to amend State Torrens legislation — which in some jurisdictions also has limits on what length of leases can be registered — or significantly alter current legal practice in jurisdictions such as Victoria nor impose significant additional compliance costs on business. As put by Barry Nilsson Lawyers:

> … the cost to the parties to prepare that epitome of the lease would be minimal, especially given that most institutional landlords require their lawyers to prepare a sign-off letter which has the commercial terms, and many tenants, larger, more sophisticated tenants who engage lawyers, again require an epitome or summary of the lease to go

> through a relevant sign-off process before the lease is actually signed. … It could be lodged electronically and it could potentially be quite a minimal imposition on the parties, rather than going through the whole, in the case of Victoria, fundamental change to their practice. (transcript, p. 405)

In the Commission's assessment, the lodgement of a one-page document with a nominated agency that outlines key lease terms, including rent, outgoings and other key statistics, could provide a more effective and efficient means to improve market information than mandatory lease registration. Any such scheme, if introduced, should recover the administration costs from the users of the information (that is, the beneficiaries) and not those who register the information.

Would these possibilities reduce constraints on the efficient operation of the market?

Options to improve the information available to market participants, and to make that information more understandable, have the potential to reduce information gaps between landlords and tenants, and potentially improve decision making. If parties to a lease understand their contractual obligations and are aware of market conditions they are more likely to enter into more commercially sound contracts, improving the efficient operation of the market.

The provision of information comes at an additional cost to industry and government, and any additional measures need to be considered in the context of the already significant disclosure requirements, information available and options for lease registration. Despite this, changes that create consistent and simpler documentation, including through simple language and the use of a one page summary of key lease terms, and that increase market information through the subsequent lodgement of this document would improve lease understanding, transparency and market information. This would improve the operation of the market and potentially and enhance the negotiating position of small retail tenants.

8.4 Summing up

Current information disclosure requirements are substantial, particularly for lease terms and conditions. Provisions for the registration of retail tenancy leases exist in all States and Territories, but are only common in some jurisdictions. Where lease information is available, there is scope for its wider use by market participants.

It does not appear that the lack of information has placed significant efficiency constraints on the market. Hence, the case for further government intervention in

the provision of information can only be justified on the ground that the provision of extra information would enable small retail tenants to make more informed business decisions without creating constraints on the efficient operation of the market. To the extent that there are information gaps, there would be a role for industry participants and advocacy groups. This role would be enhanced though the lodgement at a publicly accessible site of key lease terms.

The Commission has also identified a number of areas where information delivery may be improved. There would appear to be scope to improve the information on retail tenancies through the greater use of simple language and the use of a one page summary of key lease terms and conditions. There may also be scope to improve coordination between relevant information-providing government agencies.

9 Business conduct and dispute resolution

Extensive procedures exist in all States and Territories to facilitate the resolution of disputes between landlords and tenants (chapter 4). This chapter canvasses the views of both tenants and landlords on the operation of dispute resolution mechanisms and the operation of unconscionable conduct provisions (section 9.1). It then examines the number and nature of retail tenancy disputes (section 9.2), business conduct issues (section 9.3) and the scope to improve dispute resolution and business conduct (section 9.4). Section 9.5 provides a summary of the issues raised in the chapter.

9.1 Participants' views

Dispute resolution mechanisms

A number of participants to this inquiry considered that the retail tenancy dispute resolution mechanisms were operating well. The benefits of early intervention were acknowledged by many. Herro Solicitors, commenting on the system in New South Wales, said:

> The requirement of the parties to attempt mediation is a very positive and beneficial requirement. It enables the party with less financial resources to have a venue for dispute resolution, without the needs to incur the significant and sometimes prohibitive cost of litigation. Further it enables the parties to restore and to build on, their relationship as landlord and tenant. (submission no. 64, p. 2)

The Australian Retailers Association observed:

> The dispute resolution process based upon early intervention, the use of formal and informal mediation and [in] cases that cannot be resolved by mediation the use of the tribunal system has seen the majority of disputes resolved quickly and efficiently. (submission no. 119, p. 26)

A similar comment was made by Westfield:

> … [the regulatory] framework within which the retail tenancy market operates … incorporates a low cost and generally efficient dispute resolution process which is able to be accessed by retailers to obtain appropriate redress where genuine instances of

landlord malpractice occur. (submission no. 85, p. 11)

While the Shopping Centre Council of Australia (SCCA) noted that:

> In most States disputes can fairly speedily be referred for mediation and the success rate of mediation tends to be quite high (around 80 per cent). While the quality of mediation can vary, it is generally of good quality. (submission no. 83, p. 42)

Others suggested that there was scope for improvement. Commenting on the dispute resolution process in South Australia, the State Retailers Association of SA said:

> There is an urgent need for an effective system to deal with disputes — not court action, not mediation, but a return to the tribunal system which was effective. SA had a Tribunal which worked well, but it was abolished for cost reasons and now few retailers can afford to contemplate expensive court action, especially when the Act itself provides little protection.
>
> Mediation, which isn't enforceable, is a blunt remedy and is useless in most cases. (submission no. 43, p. 5)

Similarly, the Small Business Development Corporation (SBDC) in Western Australia indicated that in that State it would be:

> … supportive of the creation of an informal mediation service, specialising in the commercial tenancy area, which could be accessed by landlords and tenants prior to pursuing matters through the SAT or the courts.
>
> Further, increasing tenants' awareness of their rights and responsibilities through education programs would assist to minimise the number of disputes that arise. (submission no. 81, p. 6)

Some participants also suggested that mediation could be ineffective where a party was unwilling to participate. One tenant group stated that, in their experience, the landlord:

> … made a mockery of the proceedings. From the outset, they delayed the Mediation by refusing to agree to a date, on the basis that they needed time in which to prepare for the Mediation.
>
> … After two months and the threat of the Tribunal setting the date, they finally agreed to a date for Mediation. … [at the mediation, the landlord] clearly had no intention of resolving anything … The Mediation was concluded within one hour without resolution. We subsequently applied for a Certificate of Failed Mediation. (confidential submission)

According to the participant, in this case the landlord agreed to a resolution one day prior to the scheduled tribunal hearing.

Other participants, while acknowledging the accessibility of the dispute resolution process, expressed some frustration with the speed of the processes. For example,

Newsxpress Pty Ltd said:

> If you look at the Small Business Commissioner office in Victoria process, while it's an easy access process it's slow. If I'm having a problem today in small business I need to be able to let the landlord know that I've got someone else on my side very quickly, like literally within 24 hours. I know that there are checks and balances in current processes because you don't want vexatious or frivolous actions commenced but by the same token where there is real distress we need to be able to deal with that quite quickly. (transcript, p. 498)

Other participants suggested that there is a lack of awareness of, or confidence in, the official mechanisms to resolve genuine disputes and/or concerns about maintaining a commercial relationship and this leads parties to hold off referring disputes in the hope of resolving the situation themselves. For example, the Pharmacy Guild of Australia noted that, while few disputes are referred to statutory dispute resolution processes, the Guild receives numerous complaints from constituents about the behaviour of some shopping centre proprietors. The Guild suggested that it was 'hardly a surprise' that little recourse is taken to mediation/arbitration because of:

- the cost — both in terms of money and time away from the business; and
- the practical requirement of maintaining a commercial relationship with a landlord. (submission no. 109, p. 8)

The Franchise Council of Australia offered similar observations (submission no. 117).

A number of participants also claimed that, in some circumstances, tenants do not air grievances or register disputes for fear of retribution. For example, Herro Solicitors thought that while the legal framework was working:

> … in some cases tenants fear that in seeking legal remedy for their issues against the landlord, that the landlord could retaliate against such tenants by refusing to give them good locations, whether in that particular centre or in other shopping centres owned by that landlord. (submission no. 64, p. 3)

The Australian Newsagents' Federation also commented that:

> In reality, the imbalance of market power is so great that many retail tenancy disputes are not reported for fear of retribution. ANF is aware of Members who are reluctant to speak publicly about their dispute with the property's management for fear of retaliation or intimidation in other ways. … With the newsagent's livelihood resting squarely with the landlord, particularly in shopping centres, being perceived as a 'difficult' tenant is considered highly risky. (submission no. 72, p. 5)

In a similar vein, one retailer informed the Commission that:

> The term of those leases are finite and if action were to be taken against a landlord, the

> [retailer] potentially risks non-renewal of their lease, or proposed renewal terms which are unviable. (confidential submission)

Another claimed that:

> … most tenants don't report their concerns because they are intimidated by the shopping centre landlords. (confidential submission)

It was also observed that:

> They are told how deep their pockets are and any litigation would and could lead to major losses. Therefore the tenants in most cases either disappear off the face of the earth or fight a little and then accept some pidly [*sic*] amount they are offered as compensation and sign a confidential agreement thus gagging them from that moment forward. (confidential submission)

Clearly, some individual retail tenants will assess current dispute resolution arrangements as not helpful for their situation and will limit their use of these services. This assessment may be influenced by a concern that accessing formal dispute resolution has the potential to harm their longer term relation with managers of retail space — fear of retribution. Others may judge that difficulties are better dealt with commercially, or that the potential benefits from formal dispute resolution are not justified by the likely financial costs or time. But, if disputes are not taken forward, then there is only limited evidence of unresolved problems.

Unconscionable conduct provisions

Participants' comments on the concept of unconscionable conduct and its application in fair trading and retail tenancy legislation were wide ranging. Some claimed that there were few unconscionable cases because the interpretation of unconscionable conduct sets 'too high a bar' to cover the conduct that the majority of retail tenants complain about. In this regard, the Australian Retailers Association noted that the Reid Committee report recommended protection against 'unfair conduct', but that this concept is significantly different to that of unconscionable conduct:

> The concept of unfair is significantly different to unconscionable and much of the behaviour that is defined as hard bargaining and not unconscionable would have been caught with the provisions outlined in this recommendation … For a retailer to attempt to argue a case of unconscionable conduct the cost and time is prohibitive and the chance of success based on unconscionable conduct is small. (submission no. 119, p. 25)

The Pharmacy Guild considered the unconscionable conduct provisions 'nebulous' and said that pursuing an unconscionable conduct claim was difficult:

> It is also obvious that what is 'unconscionable' is very subjective — hence the creation of a statutory 'non-exhaustive' list to guide decision makers. It is thus very difficult to advise a tenant as to the likelihood of success in bringing an action against a landlord. (submission no. 109, p. 11)

The Law Institute of Victoria also said:

> … the unconscionable conduct provisions of the various states' retail tenancies legislation … suffer from a lack of definition.
>
> There appears to be a reluctance by the courts and tribunals to enter into this area of adjudication and, if anything, a concern to apply these provisions by reference to established equitable principles … In the LIV's view, it would be of assistance if a stronger statement of the application of these provisions is contained in the legislation especially with respect to the conduct of both landlords and tenants in the retail leasing context. (submission no. 27, pp. 2-3)

In a similar vein, the National Retailers Association stated that 'unconscionable conduct legislation has been proved to be largely ineffective' (submission no. 47, p. 11).

Westfield, while suggesting that unconscionable conduct was not a widespread problem, also considered that the coverage of unconscionable conduct provisions was unclear because of a lack of case law:

> Until such time as there is a substantive body of case law developed by Australia's superior courts in relation to TPA S.51AC there will necessarily be uncertainty as to the range of circumstances and situations in which unconscionable conduct within the meaning of TPA S.51AC can be said to apply. (submission no. 85, p. 23)

Other participants were of the view that the provisions are ineffective in curbing unfair behaviour. For example, the SBDC said:

> The SBDC is of the view that section 51AC of the TPA, unconscionable conduct in business transactions, has had little effect in protecting small business from unfair dealings in the marketplace. The notion of unconscionable conduct is considered an uncertain concept and the cost associated with pursuing a claim against larger competitors is a powerful deterrent to the majority of small businesses. (submission no. 81, p. 6)

Another interpretation, however, was that the very existence of the provisions has a significant influence on conduct in the retail tenancy market. For example, the Queensland Retail Traders and Shopkeepers Association, said:

> Landlords appear nervous of the unconscionable conduct provisions and the consequences of adverse publicity if being found to have acted so during negotiations. (submission no. 50, p. 9)

The SCCA submitted that there was no evidence of systemic unfair or

unconscionable conduct by shopping centre owners or managers and that the success of the provisions should not be judged by the 'number of scalps hanging from the ACCC's belt' because the low number of unconscionable conduct complaints shows that landlords are complying with the law (submission no. 83, p. 46).

Herro Solicitors also suggested that limited case law covering unconscionable conduct does not indicate that there isn't action going on below the surface:

> I don't think that unconscionable conduct provisions in both the Retail Leases Act or the Trade Practices Act are not operating. I think that they do operate, because where there is a real case, from my experience, the parties reach a settlement. (transcript, p. 169)

A further comment relating to unconscionable conduct was that the various versions of the unconscionable conduct provisions caused some confusion. For example, the Australian Property Institute said:

> Provisions in various state legislation seek to define Unconscionable Conduct. This however causes confusion with the Trade Practices Act by seeking to expand on those provisions. The legislation should be consistent. (submission no. 70, p. 19)

The 'unconscionable conduct' provisions of the TPA seek to prohibit actions that are unreasonable and offending of good conscience in the circumstances. While the unconscionable provisions set a high bar, there is also a significant incentive to settle an accusation of unconscionable conduct before it proceeds to court — just because the case history is limited does not mean that the provisions are not influencing business conduct.

9.2 Evidence on the incidence and nature of disputes

One measure of the extent of disputation in the retail tenancy market is the number of disputes being brought to government dispute resolution services or to the courts. Another is whether disputes are raised overwhelmingly by one party to the lease rather than the other and, related to this, the reasons for dispute.

Retail tenancy disputes at the State and Territory level

The majority of retail tenancy disputes are handled at the State and Territory level, with a relatively small proportion of claims dealt with at the national level under the provisions of the TPA.

Incidence of disputes

Over 20 000 retail tenancy enquiries a year are collectively received by the agencies administering retail tenancy legislation (table 9.1). In the context of a market consisting of an estimated 290 000 leases, with 58 000 new leases negotiated annually, the number of enquiries is considerable — equivalent to about 40 per cent of the number of leases signed each year. Enquiries are broadly distributed in proportion to the number of retail tenancy leases across jurisdictions.

Enquiries, however, cover requests for information and tenancy advice, including for potential new retail lessees, as well as complaints. The vast majority of enquiries do not indicate a problem — in fact, they are an indication of tenants seeking to become better informed (chapter 8).

Fewer than 2000 retail tenancy disputes at the State and Territory level (less than 1 per cent of the estimated 290 000 retail leases) are referred to formal dispute resolution procedures each year (table 9.1).

The distribution of disputes is broadly in line with the relative sizes of the retail tenancy market in each jurisdiction. Most retail tenancy disputes occur in the larger States of New South Wales, Victoria and Queensland, while there are fewer disputes in the smaller jurisdictions. For example, the Northern Territory recorded just five applications in the last three years.

Comparisons across the jurisdictions of the number of enquiries or recorded disputes needs to be interpreted with care as they are likely to be influenced by:

- the activities of the State and Territory agencies, such as how active they are in promoting the dispute resolution arrangements and facilitating disputes; and
- where the government agencies draw the line between what is classified as an 'enquiry' and a 'dispute', and at what stage an 'informal' dispute becomes a 'formal' one (and this in turn depends on the dispute resolution process in place).

Information on the number and progress of retail tenancy disputes varies across the States and Territories, with the most detailed information available for New South Wales, Victoria and Queensland. For these jurisdictions, the success rate for mediation of retail tenancy disputes appears high.

- Of 824 retail tenancy complaints in New South Wales in 2005-06, 496 (60 per cent) were dealt with informally (that is, before formal application), while 230 (28 per cent) were resolved at, before or shortly after mediation. Twelve per cent of registered disputes were not settled by mediation, with the Registrar issuing a certificate in 97 cases to allow access to the Administrative Decisions Tribunal (ADT).

Table 9.1 **Enquiries, complaints and disputes by State**

	Enquiries	*Complaints/ disputes*	*Disputes settled before proceeding to tribunal or court*	*Disputes dealt with by tribunal/court*
	No. per year	No. per year	%	No. per year
New South Wales (2005-06)	8 232	496 informal 328 formal disputes	60% dealt with informally prior to mediation; 70% of remainder settled at mediation	184 applications were filed and 156 were withdrawn, discontinued or settled without hearing or transfer.
Victoria (2006-07)	6 305	874 applications (mostly disputes)	At least 79% settled before or at mediation	212 cases resolved; around 15% settled through VCAT mediation
Queensland (2006-07)	4 000 to 5 000	1 335 complaints 115 formal disputes	91% settled before formal dispute registered; 83% of remainder settled prior to, during or following mediation	19 disputes heard by Retail Shop Leases Tribunal
South Australia (2006-07)	2 000	Not applicable	Not applicable	40 actions commenced in SA Magistrates Court (2006). Almost half finalised before trial
Western Australia (2006-07)	2 600	272 disputes	Not applicable	52 contested proceedings before the SAT
Tasmania (2006-07)	3 to 4	4 complaints	Not applicable	Data not available
Australian Capital Territory (2006-07)	Not available	Not applicable	Not applicable	64 conferences were held, 38 matters were the subject of orders made by the Magistrates Court
Northern Territory (2004-07)	50	5 disputes since mid-2004	2 disputes (40%) did not proceed to the first conference (since mid-2004)	3 certificates issued, allowing access to the courts. 2 matters heard.
Total	**23 190 to 24 191**	**~3 314 complaints ~1 598 formal disputes**	**~80% settled before proceeding to court or tribunal**	

Sources: Submissions no. 81, 104, 110, 111, 123 and 136; Australian Capital Territory Magistrates Court, personal communication, 23 August 2007; New South Wales ADT (2006, p. 24); New South Wales DSRD (2006, p. 14); New South Wales Retail Tenancy Unit, personal communication, 27 August 2007, 21 September 2007; Northern Territory Department of Consumer Affairs, personal communication, 19 July 2007; Northern Territory Department of Justice, personal communication, 28 September 2007; Queensland Retail Shop Leases Registry, personal communication, 13 July 2007; South Australian Attorney-General's Department, personal communication, 28 August 2007; South Australian Courts Administration Authority, personal communication, 2 October 2007; Commission estimate based on VCAT (2007b, pp 15, 38); Western Australian SAT (2007b); Office of the Victorian Small Business Commissioner, personal communication, 18 September 2007.

- Of 874 applications (mostly disputes) in Victoria in 2006-07, by October 2007 692 (79 per cent) had been settled either before or at mediation, with 73 per cent reaching a successful outcome.
- Of 1335 complaints in Queensland in 2006-07, 1220 (around 91 per cent) were resolved informally. Of the remaining 115 (around 9 per cent), 95 were settled either prior to mediation, at mediation or following mediation but prior to the scheduled hearing before the Tribunal. A total of 19 disputes were heard by the Retail Leases Tribunal.

Relatively few retail tenancy disputes proceed to tribunals or court — around 80 per cent of formal disputes are settled at mediation or before preceding to a tribunal or court hearing (table 9.1). The small variation between jurisdictions in the number of disputes dealt with by tribunals or courts does not seem sufficient to indicate significant differences in the effectiveness of dispute resolution, for matters brought to retail tenancy authorities, or market conduct across jurisdictions.

Nevertheless, the incidence of complaints and disputes is not strictly proportional to the number of leases in each jurisdiction. While a higher number of recorded disputes in one State or Territory could reflect a higher underlying level of friction, it also could reflect a wider knowledge of the existence of the local dispute resolution arrangements and their capacity to resolve disputes outside of the courts. For example, the Victorian Government noted that, since the Office of the Victorian Small Business Commissioner was established, the number of retail tenancy disputes handled by VCAT has declined, while the total number of disputes mediated by the Commissioner and VCAT (combined) has increased — that is, more problems are being resolved through such processes than previously (submission no. 111).

Initiation and location of disputes

The majority of recorded disputes (covering all retail formats) are initiated by tenants — around 63 per cent in New South Wales, 68 per cent in Victoria and 92 per cent in Queensland (New South Wales Retail Tenancy Unit, Office of Small Business, Victoria and Queensland Retail Shop Leases Registry, personal communication).

The proportion of formal disputes involving shopping centres and other retail formats varies substantially between jurisdictions, as does the proportion of shopping centre disputes raised by tenants.

- In New South Wales, 172 (49 per cent) of formal disputes during 2006-07 involved a shopping centre with 96 (56 per cent) of these lodged by tenants

(New South Wales Retail Tenancy Unit, personal communication, 25 September 2007).

- In Victoria, 476 (17 per cent) of all disputes handled by the Small Business Commissioner over the period May 2003 to June 2007 involved a 'large' shopping centre landlord, with 335 (70 per cent) of these disputes lodged by the tenant. Over 80 per cent of shopping centre disputes where the landlord was the respondent, were settled at mediation (submission no. 111, p. 8).
- In Queensland, 213 (71 per cent) of disputes over the period January 2005 to May 2007 involved a shopping centre with 202 (95 per cent) of these disputes lodged by the tenants (submission no. 123, p. 9 and Attachment 8, Queensland Retail Shop Leases Registry, personal communication, 22 August 2007).

Data on disputes involving a shopping centre in New South Wales, Victoria and Queensland indicate that in the vast majority of centres, there have been no disputes and where disputes occur, they have been isolated (table 9.2). In New South Wales, Victoria and Queensland, more than 90 per cent of centres had either no disputes, or only one dispute, in 2006-07. Fewer than 5 per cent of centres had 4 or more disputes.

Table 9.2 **Distribution of shopping centre disputes by State, 2006 basis**
Per cent of all centres

State	*No disputes*	*1 dispute*	*2 disputes*	*3 disputes*	*4 or more disputes*
New South Wales	75	17	5	1	2
Victoria	75	16	3	2	4
Queensland	77	18	3	1	<1

Sources: Commission estimates using 2006 data from table 2.2 and from New South Wales Retail Tenancy Unit for formal disputes in 2006-07 (New South Wales Retail Tenancy Unit, personal communication, 25 September 2007); from Queensland Retail Shop Leases Registry for disputes occurring from January 2005 to August 2007 (Queensland Retail Shop Leases Registry, personal communication, 22 August 2007), pro-rated to 12 months; and from the Office of the Victorian Small Business Commissioner for disputes occurring from May 2003 to 29 August 2007 (Office of the Victorian Small Business Commissioner, personal communication, 4 September 2007), also pro-rated to 12 months.

The Australian Property Institute (API), while agreeing with the Commission that there is a low incidence of disputes overall, suggested that this was not the case in the regional and neighbourhood centres. Using Queensland data, the API indicated that:

> … the incidence of disputes is disproportional in those centres where the landlord is not a professional but an investor unaware of the dynamics of retail businesses. (submission no. DR172, p. 7).

Others also suggested that it is often in the smaller size shopping centres where

problems occur. The State Retailers Association of South Australia said:

> A lot of our problems and the real problems in the association are not with the major ones [shopping centres]. It's certainly with very much smaller. (transcript, p. 830)

Similarly, COSBOA stated that:

> It's the second tier and the third tier ones that are not so transparent, mainly because if they've got things to hide or maybe they just don't know how to handle themselves. (transcript, p. 323)

A possible explanation for why there might be more disputes in the smaller centres is that landlords and centre managers of these centres may be less aware of their obligations under the legislation and be less skilled in conflict resolution than landlords of larger centres. The Commission was told that the large shopping centre managers spend considerable resources on educating their management and leasing staff to ensure that they are aware of their legal and ethical obligations in dealing with tenants. (submission 193, p. 48)

Causes of disputes

The Commission was advised that while retail tenants bringing disputes often list 'unconscionable conduct' in their complaints, in practice, most disputes are determined to relate to occupancy costs, performance of a tenant or landlord under a tenancy contract and the trading amenity provided by the landlord to a trader (box 9.1).

Nevertheless, a significant minority of disputes have involved claims of unconscionable conduct.

- In New South Wales, since 2002, the ADT has heard 29 cases alleging unconscionable conduct. In 4 cases, unconscionable conduct was found to have occurred but of these 2 were overturned at appeal, 1 matter was transferred to the Supreme Court, 5 matters were withdrawn, in 6 matters it was not necessary to determine unconscionable conduct and for the final 13 matters it was found that unconscionable conduct was not made out (New South Wales Retail Tenancy Unit, personal communication, 13 November 2007).
- In Victoria, 14 cases alleging unconscionable conduct have been taken to the VCAT. The tribunal has determined the claim in 13 of the cases. In all 13, the VCAT determined that unconscionable conduct did not occur, including one case where proceedings were brought by the landlord (AUSTLII 2007).
- In Queensland, over the five years from 1 July 2002 to 20 June 2007, the Queensland Retail Shop Leases Tribunal heard 8 cases involving claims of unconscionable conduct. The tribunal found that unconscionable conduct had

occurred in only 1 case (Queensland Retail Shop Leases Registry, personal communication, 3 and 9 August 2007).

- A further two cases were taken to the former Tenancy Tribunal in the Australian Capital Territory, though neither were successful (AUSTLII 2007).

Box 9.1 **Proximate causes of disputes at the State level**

At the State and Territory level, the most common reasons for retail tenancy disputes are:

- rent and occupancy costs, including the:
  - magnitude of rental increases, and
  - magnitude and nature of outgoings charged to tenants;
- issues with facilities, such as air conditioning, car parking, and repair and maintenance;
- impact of renovations/modifications to the shopping centre;
- renewal and termination issues; and
- rent in arrears.

Sources: Submission nos. 81, 104, 110, 123, 136; South Australian Attorney-General's Department, personal communication, 28 August 2007; Office of the Victorian Small Business Commissioner, personal communication, 10 July 2007.

While there has been only a small number of cases where State and Territory tribunals have found that unconscionable conduct has occurred, the cases heard provide some guidance as to what constitutes unconscionable conduct. For example, in the Queensland case, the tribunal in determining that the landlord was 'guilty of unconscionable conduct', took into account:

- the placing of 'for lease' signs on the premises during negotiations for a longer lease term;
- the landlord's negotiating with a major tenant for the claimant's premises at a time when the tenant believed a tenancy agreement had been concluded; and
- the tenant, in the belief that an agreement had been reached, proceeding to renovate and repaint the premises (Queensland Retail Leases Tribunal 2004).

FINDING

The number of retail tenancy disputes lodged with State or Territory authorities is very low relative to the size of the market. Recorded disputes are spread across shopping centres and other retail formats. In most shopping centres, no disputes are recorded. Tenants initiate the majority of disputes.

FINDING

The vast majority of disputes, once registered, are settled before escalation to a tribunal or court.

Enquiries and disputes at the national level

The ACCC recorded around 1119 contacts relating to retail tenancy issues — 875 inquiries and 244 complaints over the period 1 July 2002 to 30 June 2007. Retail tenancy contacts declined from mid-2002 to mid-2006, and from this time have remained steady at about 10 to 15 contacts a month. As the ACCC put it:

> The ACCC recognises that certain retail tenancy related disputes receive a degree of claim coverage but the level of complaints received by the ACCC over recent years has tended to flatten out and indeed decline. (submission no. 128, p. 4)

The 875 enquiries received by the ACCC since July 2002 were predominantly small businesses seeking information or wanting to discuss a dispute they were having with their landlord. In most cases, the ACCC advised an alternative course of action (for example, direct negotiations with their landlord, State and Territory dispute resolution schemes/regulation enforcement options, or private legal action).

The 244 contacts that went on to be classified as complaints were situations where a breach of the TPA was alleged by the complainant, or where the conduct described was identified by the ACCC as a possible contravention of the TPA. The majority of matters treated as complaints concerned the conduct of landlords towards their tenants in the context of retail shopping centres and related to allegations of 'misleading or deceptive conduct' or 'unconscionable conduct'. On the provision of additional information, 65 of these cases were immediately assessed as not amounting to a breach of the TPA, leaving 179 complaints which were then subject to further consideration.

Upon further investigation of these 179 complaints, 108 (or around 60 per cent) were assessed as not constituting a breach of the TPA (table 9.3). The majority of these complaints related to contractual issues, such as rent increases, clauses preventing the sale of certain goods, and the non-renewal of leases which were not matters, of themselves, that would lead to a breach of the TPA.

Another 63 complaints did not progress through all stages of complaints investigation, over half due to insufficient evidence, while a significant number were either referred to other agencies, or resolved by the provision of guidance or information. A small number of complaints were resolved by commercial

negotiation, while a couple were not pursued because the complainant was pursuing private legal action. Currently 8 complaints (that is, less than 5 per cent of the total initial investigations) are under active investigation by the ACCC (submission 128).

Table 9.3 **Outcomes of ACCC investigations of retail tenancy complaints, 1 July 2002 to 30 June 2007**

Outcome/status	*Number*
No breach	108
Insufficient evidence	35
Referred to other agency	13
Guidance / Information provided	10
Administrative resolution	3
Not pursued	2
Active investigations	8
Total	**179**

Source: Submission no. 128, p. 27.

Complaints of misleading and deceptive conduct and of misrepresentation

Some 52 of the 244 contacts treated as complaints by the ACCC related to misleading and deceptive conduct or misrepresentation. (In addition, some of the remaining complaints involving unconscionable conduct claims may have included claims of misleading and deceptive conduct and/or misrepresentation.) Complaints to the ACCC that included an allegation of misleading and deceptive conduct or about misrepresentations in retail tenancy included matters relating to:

- use of a previous tenant's turnover data to determine rent;
- actual or expected customer numbers;
- the method of calculating rent increases;
- failure to disclose conditions imposed on tenants;
- the number of competing stores that would be allowed entry (complainants generally claimed that they were promised exclusivity within a shopping centre); and
- developments proposed or underway (submission 128).

Claims of unconscionable conduct

Some 127 complaints of the 244 contacts treated as complaints to the ACCC (that is, about 11 per cent of the total contacts relating to retail tenancy issues) over the five years to 30 June 2007 included an allegation of unconscionable conduct. The

primary grounds behind the allegations of unconscionable conduct were:

- excessive rent increases;
- refusal to renew lease;
- lessor obstructing sale of business;
- tenant alleging lessor has broken lease agreement;
- general unconscionability (a wide range of non-specific conduct);
- restriction of trade/exclusivity;
- misrepresentations amounting to unconscionability;
- harassment by a lessor;
- threat of legal proceedings;
- misuse of market power amounting to unconscionable conduct; and
- forced relocation.

According to the ACCC, while each allegation is closely considered, only a limited number have evidenced a contravention of Section 51AC:

> … the majority of unconscionable conduct allegations received by the ACCC are discontinued because the facts do not indicate that the conduct is unconscionable within the meaning of the TPA. While the ACCC considers that these matters are sometimes due to a misunderstanding among small business complainants of the concept of unconscionability, under the TPA, it is nonetheless determined to pursue such matters as enable it to clarify the law and thereby firm up a better definition of what constitutes unconscionable conduct. (submission no. 128, p. 30)

In those matters where a possible breach of national significance may occur, the ACCC indicated that it has encountered 'challenges' in bringing actions due to:

- lack of sufficient evidence; and
- subsequent settlement between parties (submission no. 128).

To date there have been three cases of unconscionable conduct in retail tenancy taken by the ACCC (box 9.3). These cases provide some indication of the types of behaviour that the ACCC consider the courts would find to be unconscionable and for which a court determination would be of national public interest.

FINDING

Most disputes brought to the ACCC are resolved through consultation or mediation. Challenges to bringing action on unconscionable conduct include insufficient evidence and settlement between parties. The definition of unconscionable conduct relies on case law.

Box 9.2 **ACCC action under Section 51AC in the retail tenancy sector**

ACCC v Leelee Pty Ltd: In February 1999 the ACCC filed proceedings against Leelee Pty Ltd (Leelee), a commercial landlord, alleging that it had breached section 51AC by imposing unreasonable conditions on a tenant, including increasing the rent contrary to the lease terms and forcing the tenant to charge not less than a particular amount for certain food dishes while allowing his competitors to charge less for the same. In 2001, the court made a consent order with declarations that Leelee had acted unconscionably by consenting to, or giving approval for, another tenant to infringe on the exclusive menu entitlements conferred by Leelee on one of its tenants; and specifying the price at which its tenant sold their dishes in a manner which unfairly discriminated against, or inhibited, the tenant's ability to determine the prices at which its dishes were sold in competition with another tenant.

ACCC v Suffolke Parke Pty Ltd: In September 2001 the ACCC instituted proceedings against Suffolke Parke Pty Ltd (Suffolke Parke), a master franchisee that leased premises to a sub-franchisee, which the ACCC alleged had acted unconscionably by refusing permission for its tenant (also sub-franchisee) to sublet a separate part of shop premises when on two prior occasions it had not objected to such subleasing. The ACCC considered that the refusal was not reasonably necessary for the business interests of the landlord, but rather was in response to the sub-franchisee being involved, with other sub-franchisees, in correspondence from a solicitor to Suffolke Parke about complaints concerning franchising aspects of the business. In 2002, the court declared that Suffolke Parke had acted unconscionably toward its tenant and had breached the Franchising Code of Conduct by refusing to attend mediation. The court's orders included that Suffolke Parke Pty Ltd and its director compensate the franchisee.

ACCC v Westfield Shopping Centre Management Co. (Qld) Pty Ltd (and associated companies and individuals). On 29 October 2001, the ACCC commenced proceedings against Westfield alleging misleading and deceptive conduct and unconscionable conduct in breach of the Act. The ACCC alleged that Westfield acted unconscionably by imposing unnecessary conditions in circumstances where there was a significant difference in the relative bargaining strengths of the parties. Westfield made it a condition of the settlement of private litigation that former tenants must sign a deed of release containing a 'release of liability' clause, requiring former tenants not to commence, recommence or continue any action in connection with the subject matter of their private litigation, including any administrative or governmental investigation against Westfield. The ACCC considered that the condition might have impeded the tenants from approaching or assisting the ACCC in any investigation into Westfield's conduct. Westfield acknowledged that the condition may have discouraged the tenants from approaching or assisting the ACCC, although this effect was not intended.

The ACCC's action was settled on a 'without admissions' basis with Westfield agreeing to pay an amount to the former retail tenants and providing an undertaking that, in future, it will use a specific release of liability clause when entering into settlement agreements with retail tenants.

Sources: Submission no. 128; ACCC, personal communication, 26 September 2007.

Other cases of unconscionable conduct that have been brought to the courts broadly indicate that when one party acts 'unreasonably' to limit the commercial interests of another, the actions of the first could be deemed 'unconscionable' (box 9.3). These cases also help give legal definition to the notion of unconscionable conduct as it relates to Section 51AC, and are informative for industry participants in retail tenancy, as elsewhere.

In the ACCC's experience:

> … unconscionable conduct may be found to exist where retail landlords have in all circumstances acted in a harsh and oppressive manner towards their tenants, taking advantage of their stronger position for other than the legitimate business reasons. In other words, unconscionable conduct as interpreted by the courts in Australia is the type of conduct that is so reprehensible that it is against good conscience. (submission no. 128, p. 32)

The case history also indicates what actions are not likely to be considered unconscionable by the courts. Christensen and Duncan (2005), on examining the types of lessor conduct that retail lessees claim is unconscionable, concluded that:

> A clear principle emerging from the decisions on s51AA and s51AC is that the use of superior bargaining power to drive a hard bargain is unlikely of itself to be unconscionable conduct. (Christensen and Duncan 2005, p. 165)

The unconscionable conduct provisions appear to have been effective in dealing with the most egregious form of conduct in business-to-business transactions in the retail tenancy market.[1] This may be explained by:

- reasonable clarity of what constitutes unconscionable conduct under the TPA in terms of business to business transactions (including an explanatory memorandum associated with the amendment act that created section 51AC);
- a defined case law specific to retail tenancies (despite only a limited number of cases); and
- the ability to hear unconscionable conduct cases in low cost dispute resolution systems due to the drawing down of provisions into retail tenancy law.

1 The Commission found in its review of Australia's consumer policy framework that, in that context, the unconscionable conduct provisions dealing with consumer-business transaction under section 51AA and AB were not effective (see PC 2007).

Box 9.3 **What courts assess as unconscionable**

Case law characterises conduct that the courts see as unconscionable. In *Cameron v Qantas Airways Ltd* (1994), the courts found that, for conduct to be regarded as unconscionable, serious misconduct or something clearly unfair or unreasonable must be demonstrated. In *Qantas Airways Ltd v Cameron* (1996), the courts relied on the *Shorter Oxford* definition of unconscionable as 'showing no regard for conscience; irreconcilable with what is right or reasonable', and also found that, for Section 51AC to be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract 'unfair' or 'unreasonable' or 'immoral' or 'wrong'.

Capabilities of parties are relevant to courts' determinations of unconscionability:

- In *ASIC v Preston* [2005], the court found unconscionable conduct had occurred against what it termed 'gullible persons'.
- In *ASIC v National Exchange Pty Ltd* [2005], the respondent was found to have engaged in unconscionable conduct by setting out to systematically implement a strategy to take advantage of the fact that amongst shareholders there would be a group of inexperienced persons who would act irrationally from a purely commercial viewpoint and would accept the offer [of shares at a significant under value].

Behaviour constraining fair dealing has been deemed unconscionable:

- In *Auto Masters Australia Pty Ltd v Bruness Pty Ltd* [2002], the plaintiff was found to have breached Section 51AC in terminating the defendant's auto repair franchise without complying with the Franchising Code of Conduct and in circumstances found to be capricious and unreasonable.
- In *ACCC v Simply No-Knead (Franchising) Pty Ltd* [1999], the respondent failed in an application to stay proceedings brought by the ACCC under Section 51AC claiming that the respondent had engaged in unconscionable conduct in its dealings with certain franchisees, in its way of dealing with complaints, on the conditions imposed on meetings with franchisees, and by threatening to withhold essential business supplies unless the franchisee complied with certain conditions.

Unsuccessful cases indicate a poor bargain has not been deemed unconscionable.

- In *Macdonald v Australian Wool Innovation Ltd*, [2005] the applicant, who was induced to leave secure employment by representations made by the respondent concerning a research and development venture, was unsuccessful in claiming unconscionable conduct when the venture did not proceed.
- In *Idameno (No 123) Pty Ltd v Angel-Honnibal* [2002], the defendant failed, on the facts, to prove that contract amendments which she had agreed to while recuperating from an addiction, while she was under financial strain and while she was without legal advice, were procured by the plaintiff as a result of unconscionable conduct within the meaning of Section 51AC.

Sources: Miller (2007); ACCC (2001).

Despite the body of court interpretations and professional opinion as to what is and what is not unconscionable, the Australian Retailers Association submitted that there remain misperceptions among players on what is unconscionable conduct:

> Much of the behaviour that people are calling unconscionability or unconscionable is in fact either hard bargaining or unfair. It does not necessarily meet the hurdle of being unconscionable. More importantly, in some of the disputes — and I go back to being critical of some of the legal profession in this regard — when they would wrap up a dispute to take it to the various units, just for good measure they would put unconscionability into it. Guess what the first thing that was thrown was. The unconscionability. So it has been sort of misused in that regard. (transcript, p. 68)

Without prejudicing what may be considered unconscionable by the courts, a number of suggestions received from participants on what 'might' be considered to be unconscionable indicate a perception amongst many retailers that unconscionable conduct provisions cover a wide range of events, including matters relating to rent and occupancy costs (box 9.4). Indeed, the ACCC reported regularly receiving complaints about a broad range of tenancy matters, such as rent increases, relocation of sitting tenants and lease assignment. While the source of these complaints is not necessarily prohibited under the TPA, in some limited circumstances it may be an indication of unconscionable conduct and a potential breach of s51AC requiring investigation and possible action (submission no. 128).

While a case history is emerging in relation to unconscionable conduct, in general, complaints made in relation to Section 52 (prohibiting misleading and deceptive conduct) and Section 53 (prohibiting misrepresentations) can have stronger prospects in the investigation process than those involving allegations of unconscionable conduct. As the Chairman of the ACCC recently said:

> In most unconscionable conduct cases there is also an element of misleading and deceptive conduct, which is much easier to prove. (Samuel 2007, p. 3)

Thus, complaints involving allegations of misleading and deceptive conduct or misrepresentations have stronger prospects in the investigation process than those involving allegations of unconscionable conduct.

FINDING

The threat of action under unconscionable conduct provisions appears to have had an influence on the most egregious forms of market conduct. Nevertheless, further interpretation and clarification could improve understanding of the concept.

Box 9.4 **Examples provided by participants on what might be considered unconscionable conduct**

Confidential submission: '[The landlord's] conduct fits perfectly within the parameters of the definition of 'unconscionable conduct'. They proceeded to double the nett lettable area of the Centre, knowing full well that the increased level of competition within the Centre would result in the failure and demise of many small business tenants'.

Confidential submission: '… the centre here has been talking a major redevelopment for the last 5 years or more. So in turn the small independent business[es] are just continually offered one year leases only, so the landlord will not have to pay anything under a relocation clause. I believe this is unconscionable conduct as nobody has been told of any plans or anything to do with refit, only that it is going to happen but no other information is forthcoming.'

Pharmacy Guild of Australia: ' ''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.' (transcript, p. 345)

LeaseWise Group: 'In the process of negotiation, sure, they will go high and we'll go low and somewhere in the middle, we'll do a deal or not; that's fine. But is it unconscionable for a landlord to say 100 per cent of the time, no matter how good you're doing, "You are going to be moved on"?' (transcript, p. 487)

Law Institute of Victoria: 'Just in our own practice we've had at least three cases where there's been an absolute refusal to renew for arbitrary and unconscionable grounds, we would say, but they're not strong enough to take to court'. (transcript, p. 632)

9.3 Concerns about business conduct

While the Commission heard of good working relationships between retailers and landlords, it was also frequently stated that the conduct of some players in the retail tenancy market was 'harsh' and 'unfair' (also that this type of conduct did not meet the hurdle of being unconscionable and fell outside the dispute resolution arrangements). Such business conduct, it was argued, takes place largely because of imbalances in negotiating power between the players and, according to some participants, is the fundamental problem with the current system. Herro Solicitors, for example, argued that:

> … the Commission's recommendations should focus on dealing with and overcoming the fundamental problems and injustices in the current system… The real issue is not unconscionable conduct or breaches of the *Retail Lease Act* – the current framework

deals with these, the real issue is the bigger picture as to how to create competition so that rather than being dictated to by one landlord, the tenant has a range of options before it or there are safeguards put in place such that this market monopoly is controlled. (submission no. DR175, pp. 9-10)

Majority of concerns related to shopping centre tenancies

The majority of concerns heard by the Commission about business conduct were in relation to large shopping centres.

Many of the participants' comments were raised in the context of lease negotiations. For example, the Australian Retailers Association (ARA), spoke about 'intimidatory behaviour' and 'strong-arm negotiation tactics' at lease negotiation:

> … it really isn't the law but the behaviour and application of the law by the landlords and in particular their employees or agents that is of concern and requiring a code. ... intimidatory behaviour and strong-arm negotiation tactics put business ethics out the window when it comes to some retail lease negotiations. I can go on further about some practices during questions. Suffice to say behaviour needs to change and the master-servant culture that exists within some agents needs to change. (transcript, p. 557)

Also:

> The question to ask is this: what protection does the retail tenant have of abuse of this enormous power the landlord has within negotiation? What protections are there under current law? What rights do they have? The answer is none. Hence this inquiry and indeed other inquiries over the years. More needs to be done at the end of the lease. Perhaps it simply comes down to an ideal of negotiating in good faith. (transcript, p. 559)

COSBOA also commented that:

> … it's a furphy that negotiations for renewal of a lease in a sitting tenant are undertaken in the context of supply and demand for retail space. … It has all to do with what the landlord can get away with and I've seen it too many times to know otherwise. If the landlord can increase the rent, knowing what they know about the lessee's position, it will. 'Can the lessee stay in the same spot and continue to operate? How much rent pain can they bear? Will I lose them? Will they walk away if I push them too hard? Can I push harder? They won't walk away from a relatively new fit-out, will they?' (transcript, p. 285)

In addition, some participants spoke about a lack of trust when negotiating with centre landlords. For example, one retailer, Michael Bradley said:

> … when you're trying to establish a relationship, you have to have trust. There's an agreed perception of how things should be conducted. (transcript, p. 260)
>
> … these fellows are playing the high roller's game. They're playing winner takes all, and these little people that are sitting out here as small business people, they don't

matter. They will crunch them. They will put you through the mixer. (transcript, p.263)

It was also put to the Commission that landlords use delaying tactics. For example, one retailer stated that landlords deliberately delay the return of signed leases to limit public information:

> Landlords have a strategy of delaying or refusing to promptly return executed or registered Leases and Lease Agreements. This is done to prevent the information becoming readily available publicly as it would permit tenants to gather information that would substantiate market rent at a specific shopping centre. (confidential submission)

It was widely acknowledged during the public hearings, that while tough negotiating positions are adopted, the larger shopping centre landlords seek to uphold particular standards. However, another retailer, Graeme Woods also noted that conduct can go astray because of the incentives placed on leasing executives:

> … it's the sort of conduct or behaviour that goes on. Generally you have to accept the fact that your Westfields and your Colonials are very professional people and they usually hire pretty professional people and they've got an image to uphold and they have certain standard[s]. They have training programs and all of that, but you know that's all fine, but there's also pressure on these professionals to perform and get so many deals and that's when they may go off the rails a little bit, but overall they're professional public companies. (transcript, p. 513)

These comments were given life to the Commission during the inquiry through 'horror stories' from both tenants (not just small tenants but also those with multiple sites) and landlords. Indeed, one tenant commented 'that's life'. While it is difficult to find evidence to build the case that shopping centre landlords deliberately take advantage of tenants at lease renewal (tenants can always walk away from lease negotiations), there were some negotiating and conduct matters repeatedly drawn to the Commission's attention including:

- aggressive and evasive negotiating tactics that place tenants at a disadvantage relative to the landlord;
- the open use of turnover data by landlords in lease negotiations; and
- slow registration of leases to establish indefeasibility of title in certain jurisdictions;

It was also drawn to the Commission's attention that some tenants adopt aggressive negotiating tactics (chapter 6). However, many tenants do not equip themselves as well as they might when going into lease negotiations and as a consequence fail to secure leases on the most favourable terms. For example, while it is reported that the large shopping centres offer leases on a take-it-or-leave-it basis, the Commission also heard of a number of cases where tenants had signed 'unsignable'

leases. As discussed in chapter 6, to some extent tenants can counter the imbalances in negotiating power by seeking financial, legal and negotiating advice and knowing at what point in the lease negotiations they need to walk away. But, perceptions concerning the nature of a lease deal can vary. For example, Crosby, Murdoch and Webb (2007) commented that:

> …there is evidence that small business tenants generally are vulnerable to the imposition of unsuitable terms and there is often a very fine line to be drawn between unsuitability and unfairness. (Crosby, Murdoch and Webb 2007, p. 23)

However, Christensen and Duncan (2005) also observed that acting in good conscience in the context of lease negotiations, as interpreted by the courts under current unconscionable conduct provisions, does not require landlords to give up a commercial advantage:

> … significant latitude is given to a lessor in negotiations for a new lease in the absence of any legal obligation to grant one. The fact that requests by a landlord for large premiums for the grant of the lease, significant rental increases, cancellation of negotiations after the tenant has refurbished the premises and threatening to cancel the lease if documents are not returned were not considered to be unconscionable, suggests that most judges consider that good conscience does not require a lessor to give up a commercial advantage or neglect their own interests. (Christensen and Duncan 2005, pp. 172-3)

Delivery of services and accountability

A number of participants also argued that a source of 'great injustice and hardship' in the shopping centre context occurs because shopping centres are unaccountable to tenants for delivery of management services implied by the business relationship with tenants. Herro Solicitors, for example, said:

> It is often assumed that always sales increase in a particular centre – that is not always the case particularly where a centre closes down to refurbish and then struggles to regain its market share … The tenant is obliged to pay rent for the next 5 years notwithstanding that the centre itself is not performing. In this sense the lease protects the landlord and guarantees the landlord a certain return whether or not the landlord delivers by making the centre successful …. The landlord may not acknowledge the failure of the centre and unfortunately are under no obligation to do so. (submission no. DR175, p. 5)

Similarly, one retailer, Howard Kerrsmith, said:

> I've always been of the opinion that you don't mind paying whatever the rent is providing the business is there and the traffic is there and, usually, that's a partnership between the landlord and tenant, which is understood. (transcript, p. 153)
>
> … in that situation where it doesn't work and basically the landlord hasn't worked it out properly, hasn't attracted the traffic flow to the centre, why should the tenant

> suffer? … it seems that percentage rent when sales go well is acceptable, but when the shopping centre causes the turnover to go down, there's no comeback. (transcript, p. 162)

One solution suggested for landlords' non-accountability was a performance guarantee. At the public hearings in Melbourne, Rad Williams, a small retailer, said:

> … as much as the tenant puts up a bond against their performance against paying rent, I think the landlord should have to put up some sort of performance that could guarantee against what they're saying they're going to provide, such as foot traffic, and there should be a code or a standard against how you measure foot traffic and how it's reported because the whole business is around foot traffic. (transcript, p. 522)

Tenants could seek to negotiate some form of accountability on the landlord in the event of non-delivery of the package that they signed up for (for example, the option to renegotiate rent). The Commission was repeatedly advised, however, that it is very difficult to negotiate with shopping centre landlords amendments of this nature.

The National Retailers Association, in the context of market reviews, suggested that:

> The very narrow concept of compensation in very specific cases would at the least temper the more aggressive negotiation that says pay up or out you go, and there is quite a lot of that. It can be a pretty arbitrary and brutal process. (transcript, p. 418)

Ultimately, the nature of accountability agreements between tenants and landlords need to be negotiated by both parties to be successful.

Regulation and tension

A number of participants argued that regulation has not been effective in reducing market tensions for dealing with business conduct issues in the retail tenancy market. The Australian Retailers Association, for example, said:

> The bottom line is that the market needs good landlords and landlords require good tenants, in fact, we need each other. That's an important point. Yet the tenants are saying that they are being mistreated in terms of their investment with the landlord. It is this message from tenants that has been ringing within the ears of legislators for more than 15 years yet although solutions have been suggested from many inquiries and recommendations have been made, little action has been taken and the problems remain. When I say little action what I mean by that is that the legislations have been changed but there doesn't seem to be any change in the application of the law. (transcript, p. 556)

The State Retailers Association of South Australia also said:

> The harsh if not unconscionable tactics of landlords are facilitated by incredibly poor legislation across Australia, which doesn't enable fair play or fair competition in the first instance and as such is used to the disadvantage of tenants by these predators. (submission no. 43, p. 1)

The SCCA went as far as suggesting that the adversarial nature of relationships that had built up in the Australian retail tenancy market is, itself, linked to the highly regulated nature of the industry:

> It is also notable that the relationship between retail landlords and retail tenants in Australia is much more adversarial and more legalistic than is the case in New Zealand. There seems little doubt that the existence of retail tenancy regulation, and the 'win, loss' nature of retail tenancy legislation reviews, is a major contributing factor to this adversarial approach. (submission no. DR193, pp. 52-3)

Crosby, Murdoch and Webb (2007) also commented that in the United Kingdom tenants appear to be less critical of landlord behaviour than in Australia. The explanation provided for this was that shopping centre owners in the United Kingdom need to compete for tenants.

> The situation in the UK appears to be quite unlike that in Australia. There has never been the widespread criticism of landlord behaviour as occurred in the evidence put before the Reid Committee. This is not to suggest that UK landlords behave perfectly but rather that they operate in a very different context and in one that tends to militate against unfair practices.
>
> The adverse comments in Australia have largely been aimed at landlords of retail property and the most obvious point to make is that the retail market in the UK is far more diverse. There is not the same concentration of premises in shopping centres (although this is increasing) and the ownership of shopping centres is spread amongst a far greater number and range of landowners. This means that, rather than being in a dominant position and being able to dictate terms to prospective tenants who have few alternative locations, the owners of UK shopping centres need to compete for tenants. This in itself tends to encourage them to develop a positive image. (Crosby, Murdoch and Webb 2007, pp. 21-22)

The evidence received by the Commission indicates that the accumulation of retail tenancy legislation seeking to govern behaviour through prescribing all aspects of the landlord and tenant relationship has not alleviated market tensions or improved the cost effectiveness of commercial negotiations. The Commission was not presented with evidence to suggest that even more stringent legislation would change the negotiating balance between landlords and tenants, reduce tensions and improve the operation of the market.

Nevertheless, in an environment where there are major differences in negotiating power between small retailers and large landlords and relationships are adversarial, it can be difficult to develop the effective commercial relationships that are

necessary for least-cost business decision making by both landlords and tenants, and consequently, resources can be wasted. This suggests that an alternative approach is required.

FINDING

Legislation has not been effective in addressing general business conduct issues.

9.4 Assessing the case for change

The efficient operation of the market for retail tenancies in Australia is impeded where there are obstacles to tenants and landlords resolving disputes cost effectively or the conduct of tenants or landlords unreasonably limits the activities of other market participants. Available information suggests that formal dispute resolution is working reasonably well and that business choices are not being unreasonably limited, given general market conditions. However, it is apparent that there remain some conduct issues in the operation of the market, particularly in the area of lease negotiation.

A number of suggestions were received to improve dispute resolution and modify market conduct. The suggestions involve:

- further refining dispute resolution processes largely to improve access and transparency;
- further clarifying the concept of unconscionable conduct;
- strengthening unconscionable conduct provisions to provide tenants with greater protection; and
- introducing a code of conduct.

Enhancing dispute resolution mechanisms

Available dispute resolution mechanisms generally offer a low-cost alternative to the courts for those who wish to use them, with only a small proportion of disputes going to the tribunals and courts. Although some participants have suggested that the level of aggravation is higher than indicated by the incidence of formal disputes, the Commission has not received evidence that those who wish to use these arrangements are denied access. For instance, Lease1 indicated that many disputes are resolved prior to proceeding to the formal processes and this occurs partly because the formal arrangements are in place:

> We find that 98 per cent of issues and disputes can be resolved quite amicably before even entering into the formal dispute process. One of our veins is to certainly get

> involved, take the egos and the heat out of it, put the commercial terms on the table and you usually find that both parties will get around the issue, particularly when you advise them of the process and what is the next step. … But saying that, it wouldn't be the case if we didn't have the process of the tribunal in the respective states and territories there to support it, as the next step. (transcript, p, 430)

The various suggestions for change focused on improving accessibility and transparency of dispute resolution in the retail tenancy market including:

- promoting better awareness of dispute settlement processes by developing a single point of contact for all commercial matters (submission no. 84);
- establishing an ombudsman to deal quickly with disputes as a first step in the dispute process (transcript, p. 498-99);
- creating a uniform dispute resolution process across jurisdictions, one suggestion being that the national model be based on the New South Wales, Victoria and Queensland systems (submission no. 88, confidential submission);
- in South Australia, establishing a retail tenancy tribunal (submission nos. 43 and 89);
- in Western Australia, establishing an informal mediation process specialising in commercial tenancy matters, prior to matters going to the SAT (submission no. 81);
- removing claim limits for tribunals (confidential submission);
- requiring landlords to provide information to tribunals in a timely manner (confidential submission); and
- mandating that landlords exhaust dispute resolution processes prior to turning to more expensive court proceedings (confidential submission).

In assessing the various options, issues for consideration include:

- whether specialist services and tribunals would be cost-effective in all jurisdictions, given the scale of disputes in the smaller jurisdictions that are currently without them;
- whether, at the margin, additional government support may formalise disputes that would otherwise have been settled privately between parties; and
- where there is fear of retribution, some parties may only wish to deal with matters privately regardless of government-provided arrangements.

Because of different market and legal structures and the number of industry participants across jurisdictions, the Commission has reservations concerning the likely cost effectiveness of implementing 'uniform' dispute resolution processes across jurisdictions. Nevertheless, there may be merit in establishing more stringent

requirements for parties to mediate or enter into other alternative dispute resolution processes prior to proceeding to a tribunal or court. For example, while there are provisions for mediation in each of the jurisdictions, the requirement for parties to participate is more stringent in some jurisdictions (such as Victoria) than others (for example, South Australia and Western Australia). In Victoria, VCAT may award costs against a party that refuses to participate in mediation where that necessarily disadvantages another party regardless of the outcome of the tribunal hearing. Such provisions have the potential to reduce the costs associated with resolving disputes. Accordingly, there may be merit in adopting these provisions in other jurisdictions.

There may also be merit in considering:

- broadening access to low-cost mediation to cover all small businesses in those jurisdictions where access is restricted to retail tenancies to avoid preferential treatment being afforded to firms on the basis of their activity;
- raising the maximum claims limits on matters that can enter mediation and tribunal hearings to reduce the cost of dispute resolution and demands on tribunal and court resources;
- ensuring mediation services are appropriately targeted at retail and commercial tenancy matters. This possibility would relate particularly to those jurisdictions where tenancy matters are heard by authorities with a wider brief;
- promoting better awareness of dispute resolution processes to help improve the effectiveness of dispute resolution provisions; and
- review tenancy advisory and dispute resolution procedures to accelerate hearing processes, where practicable.

Further extension of low-cost alternatives, where practicable, and more stringent requirements to use such alternatives, is likely to improve the reach of dispute resolution processes. For cases that would otherwise proceed to court, this is likely to reduce the total costs to the community of dealing with disputes.

FINDING

A number of approaches are available to improve the accessibility, effectiveness and scope of dispute resolution. Options for improvement vary between jurisdictions.

Possibilities for clarifying unconscionable conduct

As indicated above, some participants to this inquiry were of the view that only a very limited number of unconscionable conduct cases have proceeded to tribunals

or courts because the interpretation of unconscionable conduct sets 'too high a bar' to cover the conduct that most tenants complain about.

The ACCC has stated that it intends to take a more 'aggressive' approach in the area of unconscionable conduct and that greater clarity will be provided for businesses by creating common law precedent through taking a greater number of cases to court (Samuel 2007 and submission no. 128). Even so, in relation to bringing cases to court, the ACCC is likely to continue to be 'challenged' in the areas of parties providing sufficient supportive evidence to make a case and by parties reaching agreements before the case is heard.

Westfield, while acknowledging that further cases dealing with unconscionable conduct will provide greater clarity and certainty as to the range of circumstances where redress will be provided, also noted that:

> … there is no valid basis for the belief that the courts have applied or will apply over time a narrow interpretation of the relevant statutory provisions based on the traditional equitable of unconscionable conduct. (submission no. DR191, p. 5)

Other market participants, in particular tenants and tenant groups, suggested that the current protection afforded by unconscionable conduct provisions is not enough to prevent small businesses from being 'exploited' by their larger counterparts. One suggestion put forward by Associate Professor Frank Zumbo was for a statutory duty to negotiate in good faith:

> While any statutory definition of 'unconscionable' could usefully rely on the concept of good faith as a means of ensuring the Courts take a broader approach to s 51AC than their presently onerous and very legalistic approach to the section, an alternative would be to enact a stand-alone statutory duty of good faith. Either way, the concept of good faith offers considerable potential as a mechanism for promoting ethical business conduct. Indeed, this is readily apparent from the growing judicial attention and support given to an implied duty of good faith in commercial contracts, especially in New South Wales. (submission no. DR200, p. 16)

However, a statutory duty of good faith would, like unconscionable conduct, also be a matter of interpretation, disputation and testing in the tribunals and courts.

The essence of many of the other suggestions for extending fairness provisions were based on shifting judgements made on fairness from actions (known as procedural unconscionability, as currently addressed by section 51AC), to outcomes or contract terms (substantive unconscionability) (box 9.5). Under the concept of substantive unconscionability, a party would be perceived to have behaved in an 'unconscionable' fashion if the agreed contract has the potential to lead to an 'unfair' outcome.

Such a move has the potential to adversely affect the efficient operation of the

market. In business transactions, a 'hard bargain' does not necessarily constitute unconscionable conduct. Indeed, legislation should not prohibit businesses from negotiating a hard bargain as such an outcome is likely to represent a return to superior business skills by one party. Attempting to legislate what constitutes a 'fair transaction', and what does not, is inherently difficult and is likely to add further uncertainty to the meaning of unconscionability and potentially constrain the efficient operation of the market as returns to superior bargaining skills are eroded, costs of disputation are increased and the efficiency of investment is diminished by increased uncertainty.

Box 9.5 **Notions of unconscionable behaviour**

The following definitions to procedural and substantive unconscionability have been derived:

- *Procedural unconscionability* is concerned with whether the conduct of a business in the making of a contact or during the course of a contract was so reprehensible as to offend good conscience.
- *Substantive unconscionability* is concerned with fairness of otherwise of the terms of the contract.

Source: Zumbo (2007).

It is also possible that regulations relating to fairness may lead to 'moral hazard'. Businesses would be afforded greater protection when undertaking negotiations or in a business transaction, increasing the likelihood of bad decision making through the reduced negative consequence of such decisions. In the Commission's assessment, extending the principle of unconscionable conduct is likely to place constraints on the efficient operation of the market and should be avoided.

In addition, the Commission received no compelling evidence during the inquiry from those advocating extending the provisions of unconscionable conduct that such an approach would be effective in reducing market tensions and the cost of contracting. Moreover, the Commission also does not consider it appropriate to inject broad new notions — for which the benefits have not been established and which could drive a further wedge between the retail tenancy market and the broader market for commercial tenancies — into commercial law through the medium of retail tenancy legislation.

FINDING

Extending unconscionable conduct provisions in an attempt to regulate for 'fair' outcomes is likely to introduce a number of inefficiencies and market uncertainty.

Introducing a code of conduct

Some participants suggested that there could be merit in introducing an industry code of conduct as a way of dealing with 'harsh' business conduct and conduct that does not fall within the scope of the legislation. The Franchise Council of Australia (FCA), for example said:

> The type of conduct that ought to be illegal, such as bullying, taking advantage of end of term inequity of bargaining power, massive rental hikes and unfair conduct in relation to tenancy mix will clearly not be considered to be unconscionable. Further, the ability of the ACCC to intervene and help facilitate settlement is in doubt given that at least one major landlord has indicated it will only deal with such allegations in the courts.
>
> It is therefore recommended that instead of relying on an ambiguous definition of 'unconscionable conduct', reforms in the retail tenancy market take the form of an industry code of conduct (submission no 117, p. 37)

The FCA's recommendations for the proposed code included quite prescriptive elements (for example, 'sitting tenants must be protected from excessive end of term rental increases') to govern aspects of the landlord-tenant relationship.

The case for a industry code of conduct as a means of dealing with conduct issues needs to be considered in light of the failure of the legislation to govern behaviour and address business conduct in the retail tenancy market. If a industry code of conduct simply represents a switching (or re-badging) of prescriptive legislation to self-regulation, then the benefits are likely to be minimal (if there are any at all) and business conduct problems will remain, as none of the underlying issues are addressed.

Nevertheless, an industry code that seeks to establish good leasing practices (the objective of the original retail tenancy legislation) may have merit as a strategy for addressing conduct issues. Such a code would involve landlords and tenants setting out their own 'rules of the game' focusing on issues of acceptable processes and transparency (but avoiding interfering in the commercial relationships between landlords and tenants). Such an approach could be effective in moderating the adversarial nature of relationships and the more extreme negotiating tactics. By focusing on the environment in which businesses relationships are formed (given the supply and demand for retail space), such an approach has the potential to improve the cost-effectiveness of commercial decision making (fewer small businesses may be discouraged from entering the shopping centre market and/or forced out of market) and the operation of the retail tenancy market.

FINDING

An industry code of conduct that seeks to establish good leasing practices but avoids interfering in the commercial relationships between landlords and tenants has the potential to improve the operation of the market.

9.5 Summing up

Considering the size of the retail tenancy market, the overall number of formal disputes is very small. While the majority of disputes are raised by tenants, a significant proportion are raised by landlords. Further, the incidence of disputes is distributed across all retail formats. The majority of disputes brought to retail tenancy authorities and the ACCC are resolved through consultation or mediation, outside the tribunals and courts.

Disputes cover a wide range of issues facing tenants and landlords. A relatively small number are heard on the basis of allegations of unconscionable conduct. While the tribunals and courts have determined few instances of such behaviour, the legal consideration of these allegations has shed some light on the type of behaviour that the tribunals and courts see as unconscionable.

The dispute resolution systems are working reasonably well and are widely accessible. Because of different market and legal structures and the number of industry participants across jurisdictions, the Commission has reservations concerning the likely cost effectiveness of implementing a 'uniform' dispute resolution process across jurisdictions. However, potential efficiency benefits are likely to be available from improving accessibility to dispute resolution processes and strengthening requirements, as appropriate, for parties to use low-cost alternatives prior to being permitted to take a case to a tribunal or court.

Case law has been established to define what is meant by unconscionable conduct. However, it is evident that the concept is not as widely understood, by both tenants and landlords, as it should be. There would be merit in ensuring that market participants were better informed of the concept. Further hearing of unconscionability claims could benefit this process. Although suggestions were made to relax the meaning of unconscionability, the Commission did not receive evidence to suggest that this would reduce tensions in the retail tenancy market. Rather, such a measure could add to uncertainty and industry costs.

There are some remaining business conduct issues in the retail tenancy market. While these conduct issues may not represent breaches of retail tenancy legislation

and therefore fly under the radar of dispute resolution mechanisms, they can still cause inefficiencies in the retail tenancy market. Extension of regulation is unlikely to be effective in redressing these remaining conduct issues. However there may be some merit in a industry code of conduct that seeks to alter the environment in which landlord-tenant relationships are formed.

10 Assessment and alternative approaches to regulation

The Commission was asked to report on the operation and regulation of the retail tenancy market in Australia, and the scope for further regulatory reform. While the Commission's assessment is that overall, the retail tenancy market is operating well (box 10.1), it is evident from this inquiry that there are also tensions between many tenants and landlords, and a considerable volume of ineffective or overly prescriptive legislation.

Detailed prescriptive regulation that has attempted to address tensions by targeting particular aspects of the commercial agreements between retail tenants and landlords, has not 'fixed' many of these problems. Rather, it has added complexity, inconsistency and increased compliance and administrative costs (chapters 6 to 9). It is also not readily apparent that prescriptive retail tenancy legislation on facets such as lease terms, has afforded the retail tenancy market substantial efficiency improvements, compared with outcomes in the less regulated broader commercial tenancy market.

The Commission's assessment is that there is not a strong case for further detailed regulation of the retail tenancy market. However, there are alternative approaches that could improve the operation of the market. This chapter assesses possibilities for improvement, while recognising that retail tenancy legislation is a State and Territory matter. It first presents participants' views on the unintended aspects of the current mix of legislation that hamper the operation of the market. The potential to reduce the extent to which retail tenancy legislation prescribes commercial outcomes is then considered, along with the merits of a retail tenancy framework that is consistent between jurisdictions, options to increase market information, and potential instruments to act as a 'circuit-breaker' to the existing tensions in the operation of many retail tenancy leases, particularly in shopping centres.

In considering these alternatives, the question addressed by the Commission is not whether 'good' leasing practices are pursued in the context of the current retail tenancy legislation, but rather, whether there are new or different approaches that could generate net economic and social benefits (including a reduction in administrative, compliance and information search costs) for society as a whole.

Box 10.1 **The retail tenancy market is operating well**

The Commission considers the market for retail tenancy leases to be operating well overall. Generally there is competition between landlords for tenants and between tenants for retail space.

- In the shopping centre segment of the market, the Commission was advised that centre managers continually seek to attract tenants (both anchor and specialty) that best suit their local market and attract the most customers to the centre. In the larger shopping centres, in particular, there is often considerable competition between potential tenants for access to retail space.
- In other segments of the market, including retail strips, the Commission was advised that landlords compete with each other to attract desirable tenants. While there are clearly tradeoffs associated with alternative potential locations, tenants do generally have a choice of more than one location for their business.

In both the shopping centre segment and the broader market, more desirable tenants and shopping locations are able to negotiate more favourable lease terms and conditions (chapter 6 and 7). More generally, a variety of lease terms and conditions are negotiated, and occupancy costs vary between retail formats and retail categories — as would be expected in a well-functioning market.

The Commission found that a large amount of market information and professional advice is available to those who seek it. The Commonwealth, States and Territories have a variety of education and advisory programs for small business and/or retailers, to advise of steps they could take to inform themselves of lease obligations and avail themselves of professional advice commensurate with lease commitments and business risk. Furthermore, a number of retail advisory services and tenant representative organisations with access to market information and collections of market benchmark data, have emerged in recent years and there is evidence that more retailers are making use of these. Nevertheless, the extent of information on the market that is available, does vary considerably between parts of the market and between states. There is also evidence that many market participants still do not make use of available information (chapter 8).

The Commission found no evidence that businesses are leaving retailing at a faster rate than other service activities in the economy — exit rates for retail businesses are comparable to those in other service activities (chapter 2). Further, the survival of retail businesses in shopping centres is comparable to survival rates of retail businesses elsewhere. Despite relatively low vacancy rates in shopping centres, the majority of retailers in these centres are offered, and accept, new leases — although it is recognised that the take up of a new lease or indeed business 'survival' does not in itself, indicate the comparative 'health' of a business or the satisfaction of its owners with the lease conditions to which they have agreed (chapters 8).

10.1 Views on aspects of regulation that hamper market operation

The regulatory approach to date has been to add detailed prescriptive provisions to the legislation governing the relationship between retail landlords (especially shopping centres) and tenants. A number of participants to this inquiry, including small businesses, argued that regulation in the retail tenancy market has gone 'too far'— intruding into commercial negotiations, limiting flexibility and having unintended consequences for some parties. In this context, the Commission was told that aspects of retail tenancy regulation unduly prescribe lease terms and conditions, and are unnecessarily different across jurisdictions. Such aspects of retail tenancy regulation constrain the operation of the retail tenancy market or raise costs to parties without providing significant benefits. For example, one participant said:

> Australia is almost unique in having established a very detailed and prescriptive set of rules and regulations that govern all aspects of the retail tenancy relationship, beginning before a retail tenant signs a lease.
>
> This legislation restricts and in some areas prohibits the terms and conditions the parties who fall within this legislation can agree to. Consequently this legislation operates as a significant constraint on the effective operation of the retail tenancy market. (confidential submission)

Similarly, the Franchising Council of Australia

> … accepts that another attempt at more prescriptive legislation may not be the most fruitful course in addressing well-documented market problems. (submission no. DR174, p. 1)

In discussing approaches to regulation in the retail tenancy market, the Australian National Retailers Association (ANRA) submitted that:

> When considering the need for a new approach to retail tenancies, we should examine the situation in New Zealand. ANRA members who have a presence in both countries believe the system in Australia is over-regulated and inconsistent with multi-layered legislation. While the New Zealand market is vibrantly competitive, Australia in contrast has a small number of linked landlords controlling the market making it necessary to 'build in' tenant protections to the system. (submission no. 92, p. 6)

Some participants also expressed concern about the 'intrusion in commercial negotiations' and the risk that this 'may result in a less dynamic and diverse and a more contrived market place' than may otherwise have been the case (confidential submission). In a similar vein, it was suggested by the Shopping Centre Council of Australia (SCCA) that the existence of detailed regulation in Australia has led to a 'protectionist mentality on the part of many retailers in Australia', and that:

> … the response of many retailers and retailer associations in Australia to the inevitable risks and uncertainties of retailing is to call for even more government intervention and regulation. (submission no. 83, p. 7)

In relation to the costs of 'more' regulation, the SCCA argued that little attempt was made in the past to properly consider the cost (to property owners, tenants and consumers) of further expanding retail tenancy regulation, nor was consideration given to alternative, less-intrusive means of achieving desired outcomes.

Some of the costs imposed by regulations covering the retail tenancy market are presented in box 10.2. While comprehensive estimates of the additional cost of retail tenancy legislation were not available, the Commission was advised that a change in retail tenancy legislation in any one State or Territory has been estimated to impose a once-off cost to a national landlord of around $68 000, in present day terms (confidential submission).

However, a number of participants associated with retailer interests disputed that the costs of compliance with regulation are significant. For example, the National Retail Association (NRA) stated that:

> It should be recognized that costs of compliance should be considered against the total investment well in excess of $100 billion, in retail property and businesses, and the economic costs to parties of non-compliance with a Code of Practice and/or relevant legislation, and are therefore negligible particularly for corporate landlords. (submission no. DR162, p. 3)

Also,

> Reference to aspects of the legislation having 'added to compliance and administrative costs' if quantifiable should be compared with the added value that some aspects of the legislation could give to property values by improving the 'quality' of leases and their consequent rental values. It is a small price to pay for better quality outcomes for all stakeholders, compared with the very substantial costs to all stakeholders of poor investment decisions. (submission no. DR162, p. 9)

The Council of Small Business of Australia (COSBOA) also judged that compliance costs are not a significant part of the costs faced by tenants:

> With capital costs in the hundreds of thousands and the lease commitments in hundreds of millions of dollars perhaps — perhaps millions of dollars — costs of compliance which range from a few hundred dollars to a few thousand dollars are a paltry amount of money relative to the protection that a lessee would be obtaining if it were otherwise the case. (transcript p. 285)

Box 10.2 **Compliance costs imposed by regulation**

Administrative and compliance costs imposed on the retail tenancy market by regulation may include the costs of:

- legal and financial advice required by tenants (in some states) prior to signing a lease;
- site surveys and mortgagee approvals required (in some states) prior to registration of a lease;
- lease registration;
- training landlords' management and leasing staff to ensure they comply with eight different sets of retail tenancy regulation and unconscionable conduct provisions of the *Trade Practices Act 1974;*
- providing the required disclosure documentation;
- preparing and auditing outgoings statements;
- preparing and distributing marketing and promotion statements;
- meeting procedural requirements for rent reviews, lease renewals and lease terminations;
- complying with relocation, planning and demolition requirements when redeveloping a shopping centre;
- land tax and lease preparation.

There could also be additional costs to taxpayers associated with:

- government bureaucracies established in each State and Territory to administer retail tenancy regulation;
- information and publications developed for retail tenants;
- the operation of retail tenancy mediation and dispute resolution services.

It is noted that some of the activities that generate these costs may provide net social benefits and therefore be worthwhile. It is only those costs that are excessive or unnecessary that should be reviewed. Further, in the absence of retail tenancy regulation, a proportion of these costs would still be incurred. For example, shopping centre owners and managers would still need to provide training for leasing staff and pay for the preparation of leases. But according to the SCCA, 'the administrative complexity and therefore compliance costs would undoubtedly be much less'.

Source: SCCA submission no. 83, p. 20.

A further concern related to the additional compliance costs faced by businesses subject to retail tenancy regulation compared to those businesses subject to more general commercial tenancy regulation. As set out by the SCCA:

> … retail tenancy is subject to compliance costs that commercial tenancies are not. These extra costs are inevitably incorporated in the cost of the tenancy and therefore in consumer prices. This puts retail property at a significant disadvantage to other commercial property. (submission no. 83, p.17)

Aspects of the regulation considered to be 'unnecessary' in the current environment were also brought to the Commission's attention. Two examples included:

- provisions under Victoria's Retail Leases Act which require that certain details of signed leases be provided to the Small Business Commissioner; and
- the system for security deposits introduced to the New South Wales Retail Leases Act in 2006.

Other concerns on retail tenancy regulation raised by participants to this inquiry related to:

- retail tenancy legislative provisions that have confused or frustrated the execution of tenancy contractual obligations;
- the inadequacy of existing tenancy regulation in reducing tensions that can arise in the management of retail tenancies in shopping centres;
- differences in retail regulatory provisions between jurisdictions that have raised compliance and administrative costs; and
- unintended effects of broader regulations, such as those for zoning and planning.

Legislative provisions hinder execution of contractual obligations

While the initial intent of much of Australia's retail tenancy legislation was to reduce abuses of bargaining power and information imbalances between shopping centre landlords and small retail tenants, some participants stated that the many changes to retail tenancy legislation in the recent past have inadvertently tilted the balance of protection heavily in favour of tenants, particularly those not in shopping centres — disadvantaging small landlords and frustrating the execution of some provisions in lease contracts.

Several participants noted that there are aspects of retail tenancy regulation related to lease termination for non-payment of rent which delay or frustrate the ability of landlords to achieve contractual outcomes (submission no. DR159 and submission no. 124). For example, one small landlord submitted that tenants under the current regulatory environment can contrive to avoid their contractual obligations and still retain tenancy:

> I would like to state how extremely unfair the current NSW Retail Tenancy Act is towards landlords of small suburban shops that they do not have the power in cases like mine to

> terminate a tenant's lease and remove them from the property when the tenants are clearly and consistently in breach of the lease conditions. (submission no. 124, p. 2)

Similar comments were made by the Real Estate Institute of Australia (REIA):

> Retail tenancy legislation has been moving in a direction that, arguably, now favours the rights of tenants over landlords. Landlords can now find it exceedingly difficult to remove problem tenants without detailed explanation, multiple notifications, lengthy tribunal hearings (or court hearings), orders to assist the tenants in their business activities and significant costs arising from these delays. (submission no. 111, p. 15)

The prospect that tenancy legislation and its administration might systematically enable tenants or landlords to avoid contractual obligations is of concern. While the Commission did not receive evidence that such frustrations have imposed a significant cost, this issue appears to be of more relevance to non-centre tenancies (about which the Commission received fewer submissions). Given that the majority of the retail tenancy market is located outside of centres (chapter 2), the costs are potentially significant overall.

Existing regulatory instruments inadequate for centre tenancies

Some inquiry participants suggested that the existing regulation of retail tenancies and the resulting retail lease documents are inadequate to either describe or govern the management of shopping centre tenancies. Herro Solicitors stated in relation to retail leases that:

> This whole idea of a lease: I don't even know if it is the right legal document any more for a shopping centre … It's a document that used to work, but I think there's something else that should be in its place; something linked to centre performance. (transcript, p. 184)

Retail tenancies in shopping centres involve a management component that is additional to the rental of physical retail space in other non-centre retail formats. The additional management services that are part of the 'shopping centre package' and which tenants purchase are the skills of the centre manager in operating the centre — including through advertising, refurbishment and centre maintenance — to maximise foot traffic for the incumbent tenants. There can also be many detailed differences between leasing in retail strips and in centres and, in practice, the extent of these differences can vary considerably between localities. The major points of difference between a lease in a retail strip and that in a managed shopping centre raised in this report are summarised in a stylised manner in table 10.1.

Table 10.1 **Leasing in retail strips and centres**

The specialty tenant and landlord relationship

Market participants	
Size, number and ownership structure of tenants (chapter 2)	Both strips and centres can have a large number and variety of tenants, although more tenants in larger centres are part of a national chain or franchise.
Size, number and ownership structure of landlords (chapter 2)	Retail strips tend to have many small landlords who are individuals, partnerships or small companies. Larger centres usually have a single landlord, often a national or international corporation. Some smaller centres are owned and managed by individuals or small companies.
Property management (chapter 2)	Leases in retail strips tend to be managed by the landlord, a local real estate agent or another local professional. Larger centres usually have 'in-house' centre management that is often a large company specialising in shopping centre management. The manager of leases in retail strips is mainly concerned with management of the retail space and may have little direct influence on the shopping environment. In shopping centres, the shopping environment is micro-managed through varying the tenant mix, promotion of the centre, and monitoring of tenant performance.
Leasing environment	
Shopper foot traffic (chapter 7)	Individual tenants and landlords in shopping strips may have little influence on 'walk by' foot traffic. They may however, influence their customer base by advertising efforts and the attractiveness of retail services. In centres, tenancy mix and management decisions are typically focussed on maximising overall centre foot traffic.
Lease terms and options (chapter 6)	Leases in retail strips often exceed 5 years and can have multiple options. Whilst 'drawcard' tenants in centres may also have long leases with options, leases for specialty tenants in centres are usually of about 5 years with no option to renew.
Fit out requirements (chapter 7)	There are usually no landlord specified fit out requirements in retail strip leases. Centre leases typically involve detailed fit out requirements.
Outgoings (chapter 7)	Outgoings for retail strip shops are typically limited to site-specific use-associated costs (electricity, water etc). For shops in centres, outgoings also include costs for shared centre facilities and management, and can vary from year to year at the landlord's discretion.
Turnover disclosure (chapter 7)	Retail turnover is typically disclosed by tenants to centre landlords, but not to retail strip landlords.
Rent setting (chapter 7)	Rent in retail strips is negotiated between parties that typically have little control of the general shopping environment. Rent negotiations in centres are heavily influenced by tenancy mix requirements of centres, and the nature and expected performance of the tenant's business.
Information (chapter 8)	Lease information is typically simpler and more accessible in shopping strips compared to centre tenancies. Centre landlords typically have more information on tenants and the immediate leasing environment than do landlords in retail strips.

(continued next page)

Table 10.1 (continued)

Goodwill and the value of the business	
Business value (chapter 6)	Goodwill that depends on location accrues to the property owner (the landlord) in both retail strips and centres. The only goodwill that is transferable on the sale of a business is that related to the product/brand of the business.
Lease expiry (chapter 6)	On lease expiry, the value of a trading right is exhausted. A retail business heavily dependent on securing a particular location for viability (in a strip or centre) would therefore have little or no value.
Conduct and disputes	
Business conduct and disputes (chapter 9)	Disputes are not concentrated in either shopping strip or centre formats. Tensions associated with commercial negotiations and disputes are heightened: in relations between small specialty tenants and large landlords; and where there is strong demand for retail space (such as in large shopping centres or in proximity to a 'drawcard' tenant).

To some extent, the retail leasing market has adapted to these changing needs and there are now acknowledged differences in leases for shopping centre space, compared with leases for retail space in other formats. The Australian Newsagents Federation (ANF) noted that:

> Shopping centre retail leases, in addition to traditional property rights, contain accompanying elements not often present in normal retail leases including management provisions and obligations similar to franchise agreements and management contracts. As a result, shopping centre managers are in a position to micro manage retail businesses through a series of predetermined key performance indicators. For those retailers relocating to a shopping centre from other retail formats the impact of these additional obligations is often unclear. (submission no. DR179, p. 8)

The SCCA noted that retail leases for tenants in shopping centres typically include provisions for the centre manager to collect additional information from the tenant (such as store turnover) in order to perform this management service:

> … landlords do this [collect turnover information from their tenants] to micro-manage their centres … They are able to keep track of individual tenants — see how they are performing — to know whether corrective action needs to be taken with a particular tenant. (transcript, p.93)

While these centre management aspects are often spelled out in lease documentation, a number of inquiry participants indicated that centre management is largely unaccountable under existing legislation, for their performance in delivering management services to tenants and that this contributes to tensions. The manner in which shopping centre leases are negotiated has also been highlighted in the inquiry, with use of aggressive and evasive tactics commonplace (chapter 9).

The inability of the existing regulatory structure to deal with matters of conduct, particularly in the shopping centre segment of the market, elevates the need for a consideration of alternative instruments in the market.

Inconsistent legislation between jurisdictions imposes costs

Landlords and tenants who operate in more than one State or Territory submitted that the lack of consistency in retail tenancy regulation between jurisdictions imposes unnecessary administrative and legal costs (box 10.3).

While State retail tenancy regulation has largely been formed by the jurisdictions 'borrowing' from each other when legislating, much of the initial harmony was undone as a result of subsequent State-based reviews. As Professors Duncan and Christensen note, there has been a:

> … tendency for the reviewers in each jurisdiction to naturally consider what was last done in another State or Territory most recently reviewed, the result being piecemeal reform, not based upon any nationally agreed principles, but upon 'ad hoc' problems in the last reviewed jurisdiction. (submission no. DR153, p. 1)

Similarly, another participant suggested that:

> … the States have continued to leapfrog each other as they attempt to take the best bits of others' legislation and remove those that do not work as well. Although this approach may have led to more consistent legislation and conformity in certain aspects, in the main it has not and has often led to more frequent change and greater inconsistency which creates increased compliance costs and inefficiencies for both landlords and tenants. (confidential submission)

Participants provided examples of inconsistencies, including differences in:

- retail businesses covered by retail tenancy legislation;
- disclosure statements, including when they must be given to prospective tenants and the form and content of disclosure statements;
- the type and frequency of rent reviews;
- how outgoings are calculated, including whether land tax is payable and the recovery of lease preparation costs;
- duration and days on which particular tenants can trade;
- how security deposits and bank guarantees are to be held by the landlord;
- relocation and demolition clauses; and
- provisions for unconscionable conduct.

Box 10.3 **Participants' views on consistency in retail tenancy legislation**

Australian National Retailers Association — 'ANRA members are all nationally-based retailers with outlets in all States and Territories. Lease arrangements are therefore often with a few nationally based landlords, but differing regulatory requirements make it impossible to negotiate one uniform agreement with each landlord. Instead, separate agreements are forged to satisfy the different regulations and then weeks are spent while lawyers reconcile the range of inconsistent regulations. This is a time-consuming and costly exercise that is unacceptable to both landlords and retail tenants'. (submission no. 92, p. 6)

Australian Retailers Association — 'The different approach taken by the states does cause confusion especially with those retailers who trade across state boundaries'. (submission no. 119, p. 4)

Westfield — 'A degree of further cost and inefficiency which nationally operating landlords, such as Westfield, need to contend with arises from inconsistencies between retail tenancy laws in the various States and Territories (which give rise among other things to a lack of uniformity between States and Territories in the provisions of retail leases in use within different jurisdictions) and inconsistencies between State and Federal laws (for example, in some States the drawn down unconscionable conduct provisions of retail lease laws do not replicate TPA S.51AC as they specify a more extensive list of specific matters to which regard is to be given in determining whether unconscionable conduct has occurred'. (submission no. 85, p. 16)

Coles — 'Consistency across the states would provide for easier understanding, cheaper administration costs and fewer areas for dispute or debate'. (submission no. 48, p. 1)

General Property Trust Group — 'As a result of each state and territory having its own legislation it is very difficult for national retailers and landlords to keep abreast of all the differences from state to state. This requires extensive training for executives on the relevant retail lease legislation and additional legal resources to keep on top of all the various regulations. Each landlord needs to update standard documentation for each state and territory. It goes without saying that additional costs are being expended by having to update eight versions of disclosure statements, leases, assignment documentation, etc rather than one common form of documents'. (submission no. 34, p. 2)

Duncan and Christensen — '… there are still what could only be described as irrational differences in approach to the same issues between some jurisdictions which simply cannot be justified by claims of the need to comply with other existing property legislation affecting leases generally in any one particular jurisdiction. (submission no. DR153, p. 2)

Real Estate Institute of Australia — '… independent regulation creep has led to the development of numerous inconsistencies between the various jurisdictions, which when viewed from a national perspective, are likely to be constraining the efficiency of the retail tenancy market. (submission no. DR154, p. 2)

A notable example of discrepancies between various pieces of legislation relates to the definition of a retail business. The Law Council of Australia submitted that:

> … childcare centres, dentists, internet café, bakery, travel agency, service stations and bowling and cinema centre … in some instances … are covered by the Acts in various States and in some cases, they are not so covered. (submission no. 68, p. 2)

The Australian Property Institute also said:

> Various state legislation attempts to include or exclude, for various reasons, different types of property. Generally the result is cumbersome. By limiting the application to prescribed premises, problems associated with offices being caught in the legislation will not occur. (submission no. 70, p. 6)

Professors Duncan and Christensen suggested a number of advantages that could be afforded by a more consistent approach to retail tenancy regulation across jurisdictions:

> There is sufficient commonality at present to initiate some national approach to regulating this market, either through COAG or another mechanism which would ultimately over a period lead to greater harmonisation and consistency of application nationally. It might also lead to more regularity in reviews of the legislation on a nationally agreed timeframe with major reforms being introduced once into all jurisdictions instead of on the irregular and random time frames which now exist. (submission no. DR153, p.2)

While national consistency was advanced in order to avoid the additional compliance and administrative costs that arise from jurisdictional differences in tenancy legislation, the Commission did not receive specific evidence to enable the quantification of these additional costs. Nevertheless, the high incidence of tenants, franchisors and landlords operating across jurisdictions suggests that such costs could be significant, particularly for those businesses that operate within the shopping centre segment of the market (chapter 2).

Planning and zoning laws affect competition

Some participants in this inquiry recognised that while planning and zoning restrictions are essential for urban planning, they also pose some limit on the supply of retail space, particularly at the shopping centre level. Indeed, the SCCA noted that 'by seeking to support CBDs and suburban centres, centres policies arguably impose greater planning constraints on shopping centre development than on retail strip development' (submission no. 83, p. 24).

The practice of limiting new retail developments to either existing developments (such as through expansion) or in certain retail zones was also seen as creating barriers to the establishment of new retail concentrations. The ACCC noted that the

establishment of factory outlet complexes 'can often be impaired by structural constraints that include, for example, planning and zoning requirements' (submission no. 128, p.8). Similarly, the Australian Retailers Association (ARA) claimed that:

> … the existing legislation and regulations enforcing land use and zoning decisions have created a position, which significantly reduces the ability of extending the land available for use as retail except in the areas of greenfield sites associated with new subdivisions. (submission no. 119, p. 5)

The SCCA even suggested that planning restrictions, by regulating investment in centres, were beneficial:

> … abolishing planning restrictions might raise the prospect of wasteful (excessive) use of scarce investment resources … investment providing an excess supply of retail space would not be viable over time, and investors doing their 'sums' would recognise this and (not) act accordingly. (submission no. DR193, pp. 24-26)

A number of participants argued that the limited supply of shopping centre sites has increased the ownership concentration of retail space (box 10.4). Indeed, evidence of such commercial advantage has been demonstrated by some landlords disputing, through the courts, retail establishments in areas zoned for bulky goods. As stated by the Bulky Goods Retailers Association:

> In relation to bulky goods/homemaker retailing there are wide ranging inconsistencies between the States in relation to both of these key regulations. This results in uncertainty and contributes to inefficiencies in the operation of national businesses. In recent years there has been a significant increase in legal disputes arising from these inconsistencies.
>
> There has also been an increase in legal disputes arising from the fact that the market is constantly evolving while planning regulations remain static. Planning policy needs to keep pace with current and future markets in order to provide certainty for the industry. (submission no. 126, p. 6)

Retail strips and local shopping areas do not appear to have faced the same supply pressures. In fact, as noted in chapter 2, with the emergence of larger shopping centres, the overall share of occupied retail space that is in shopping strips has declined, with vacancy rates generally higher in the shopping strips than in the CBDs and the larger shopping centres.

A number of retail developments have also emerged outside of current planning regulations, and potentially offer competition to existing retail centres (box 10.5). The distinction between bulky goods zoning (which allows a certain type of retailing) and general retailing appears arbitrary, especially if sufficient public infrastructure exists to support retailing at the bulky good sites.

Box 10.4 **Participants' views on planning and zoning regulation and bargaining power of landlords**

Australian Retailers Association — 'The current planning regulations covering the zoning of retail has created an oligopoly of approximately twelve landlords that control a substantial part of the retail shop leases market especially within the shopping centre industry'. (submission no. 119, p. 26)

ACCC — noted that planning and zoning requirements for factory outlet complexes 'ultimately precludes competition and strengthens the bargaining position of individual landlords in their negotiation with regional shopping centre tenants'. (submission no. 128, p.8)

Southern Sydney Retailers Association — The 'existing retailing hierarchy' have protected themselves from competition by the manipulation of state government planning regulations, which has enabled them to obtain monopolistic powers over independent retailers which they have ruthlessly exploited'. (submission no. 90, p. 1)

Finally, planning and zoning restrictions for retail space have had flow-on effects to property and tenancy markets more generally. The ARA submitted that:

> The zoning restriction has contributed to the escalation of the price of land in the correctly zoned areas resulting in higher rents and less opportunity for other developments on cheaper land that may have to go through the rezoning process. (submission no. 119, p. 26)

The extent that planning and zoning regulations have altered the market provision of retail space is unclear. Despite this, these types of restrictions do influence the quantity and location of retail space available and are likely to affect competition in the retail market. This, in turn, can influence outcomes in the retail tenancy market.

Box 10.5 **Developments outside the scope of planning policies**

Not all retail developments have had to abide by State and Territory planning polices. The most well known cases are the establishment of direct factory outlets (DFOs) on airport land (similar developments have occurred on mixed bulky goods and industrial zoned lands).

Airports obtain the land necessary for their operations under Commonwealth leases, with planning arrangements under control of the Australian Government (PC 2002, 2007b). This means that developments on airport land (including commercial operations that are not directly connected with the operation of the airport, such as retailing) are not subject to State or Territory planning controls.

Recently, DFOs and homemaker centres have been established on land leased from airports — that is, land outside planning centres. This land is also often available at lower cost than retail zoned land.

Developments on airport land have faced opposition from both existing retail developments and State and Territory planning authorities. For example, many local councils, such as Randwick City Council, Brisbane City Council and the Launceston City Council complained that developments of this type have not faced the same level of scrutiny or public consultation as other retail developments. In particular, they claim that the economic and social effects, including on traffic and congestion, have not been considered (Brisbane City Council 2006; Launceston City Council 2006; and Randwick City Council 2006).

10.2 Main features of an alternative approach

In the Commission's assessment, regulation of the retail tenancies market should, in the first instance, maintain and bolster those parts of the State and Territory legislation that are working effectively. In particular, dispute settlement and information disclosure have effectively addressed market impediments related to transaction costs and information differences, and should remain part of the regulatory framework. To address the outstanding concerns and the unintended consequences of existing retail tenancy legislation, the Commission's assessment is that an alternative approach should also:

- ensure that the parties to a retail lease have sufficient information to fully understand the implications of their contract;
- progressively unwind the current retail tenancy legislation in each State and Territory in areas that have sought to include specific provisions in contracts, such as formulae for annual rental increases, minimum lease terms, assignment and outgoings inclusions;

- move, where practicable, towards national consistency in legislation, lease documentation and the availability of market information; and
- facilitate the shift towards a less restrictive, nationally consistent framework and seek to ease tensions that exist predominantly in the shopping centre segment of the market, through the introduction of an industry negotiated national code of conduct for shopping centre leases.

The design principles developed in chapter 5 provide a means to guide policy development affecting the market for retail tenancies. In brief, any regulation of the landlord-tenant relationship should only proceed with caution and should not seek to rewrite the current rules and laws that govern standard business contracts. Also, as with all regulation, non-regulatory approaches should be evaluated prior to extending the current mix of retail tenancy laws.

Maintain dispute settlement processes and information disclosure provisions

Two major components of the current mix of retail tenancy legislation — namely dispute settlement and lease disclosure statements — appear to be working effectively in reducing the transaction costs associated with disputes and improving the information available to participants when entering tenancy agreements (see chapters 9 and 8, respectively).

In all jurisdictions except Queensland and New South Wales, the suite of dispute resolution processes (including mediation and tribunal hearings) are not restricted to retail tenancies. Rather, they extend to small businesses in the broader market for commercial tenancies (chapter 4). Thus, available dispute resolution processes contribute to cost–effective outcomes for small businesses in the commercial tenancy market in these jurisdictions.

In New South Wales and Queensland, the borderline for tenancies that can and cannot use the dispute resolution procedures is defined by the retail tenancies legislation. An alternative approach should aim to provide access to low cost dispute resolution processes for all small-business retail and commercial tenancies in each State and Territory. This approach would potentially lower transactions costs associated with dispute resolution and reduce constraints on economic efficiency arising from differences in the treatment of different types of businesses.

The Commission notes that access to unconscionable conduct provisions are already available to all ‘small’ businesses in the retail and commercial tenancies market.

Inquiry participants indicated that lease disclosure provisions have effectively reduced the information gap between retail tenants and landlords (chapter 8). While maintaining these provisions as part of an alternative regulatory approach, there is some scope to enhance the transparency of decision making through design improvements, such as the greater use of simple language and the addition of a one page summary of key lease conditions. Such provisions could also be adopted in the broader commercial tenancy markets, if it were deemed appropriate and cost effective by industry participants.

Reduce the level of prescription in the legislation

Retail tenancy legislation contains many provisions regulating the tenant–landlord relationship, which unduly intrude into the commercial contractual arrangements negotiated between landlords and tenants. Examples of such provisions in retail tenancy legislation include minimum lease terms, first right of refusal provisions, liability attached to assignment and outgoings inclusions (box 10.6). Provisions relating to security of tenure (chapter 6) and occupancy costs (chapter 7) do not appear to have been effective in influencing the market, and to the extent that they bite, may have constrained efficiency. Moreover, some participants argued that the tenancy legislation and its administration have hampered the operation of the market and raised costs unnecessarily (section 10.1).

In the Commission's draft report, a winding back of legislative provisions that intrude into negotiated contractual arrangements was canvassed. Such an approach would provide the added benefit of reducing the differences that exist between regulation in the various States and Territories. This would also more closely align the framework governing retail tenancy leases with the broader market for commercial tenancies.

Professors Duncan and Christensen observed that:

> Provisions which do not achieve their purpose, or only do so at great cost or complexity in process should be repealed … Where there is cogent evidence that compliance with existing requirements is either ignored, becomes too costly, time consuming or otherwise complex, it is time to repeal the provisions establishing those requirements. (submission no. DR153, p. 4)

The REIA consider that:

> … a specific review should be implemented by governments to examine the potential to remove key restrictions across all jurisdictions in areas including minimum (or maximum) lease terms, preferential rights of lease renewal, assignment and sub-letting, rent reviews, limits on rent inclusions, and recoverable outgoings. (submission no. DR154, p. 6)

Box 10.6 **Examples of overly prescriptive legislation**

Minimum lease terms

Minimum lease terms reduce market flexibility, restricting both tenants and landlords in the choice of lease terms (chapter 6). Such restrictions can make it difficult for tenants and landlords to negotiate tenancy agreements that are mutually beneficial, hindering transactions. Also, these provisions can effectively become a maximum lease term which is not necessarily in the commercial interests of landlords or tenants. Removing these provisions could reduce constraints on efficient market operation.

Options for preferential right to renew or extend a lease

Rights to renew are included in retail tenancy legislation in South Australia and the Australian Capital Territory (chapter 6). However, the provisions are highly qualified so as not to reduce the rights of a landlord over leased premises. They are therefore likely to be ineffective in adding to tenant's security of tenure. To the extent that the provisions have had an impact, they may hinder a landlord in choosing a tenant who (in the landlord's commercial judgement) would make best use of the retail space. This would potentially lower productivity.

Lease assignment

Retail tenancy legislation includes provisions to govern lease assignment (except in Tasmania — chapter 3). These provisions have potentially introduced inefficiencies and represent a departure from common law. Under common law, the assignor had a strong incentive to choose the most (potentially) productive and successful purchaser, as the landlord had the option to recover any assignee default losses, from the assignor through 'privity on contract' (Bradbrook, MacCallum and Moore 2002). However, retail tenancy legislation has removed this option, and has created an incompatibility in the incentives of a tenant and landlord. The assignor now has an incentive to choose an assignee with the greatest willingness to pay (that is, an assignee with the most optimistic assessment of their trading ability), regardless of their potential success. As incentives are no longer aligned, the removal of liability on the assignor could increase the reluctance of landlords to agree to assignment.

Experience in the United Kingdom shows that with the removal of the liability of the assignor, alternative market mechanisms for this to remain arose. Since reforms were made to the Landlord and Tenants Act in 1996 to remove liability for the assignor, it has become common for leases to include provisions that enable the landlord to obtain a guarantee from the assignor of the assignee's performance (Questbook 2007).

Outgoings inclusions

Retail tenancy legislation in each jurisdiction requires leases to clearly specify the level of outgoings, how they are determined and apportioned to the lessee, and how they are to be recovered by the lessor (chapter 3). While disclosure of such information is likely to be mutually beneficial to landlords and tenants, the prescription of which expenses are included in outgoings is likely to unduly restrict commercial negotiations.

Broadly, an approach involving less prescriptive legislation could reduce constraints to the efficient operation of the retail tenancy market and lower compliance and administrative costs incurred in implementing the legislation and adapting to, what has become, frequent regulatory change.

Relax planning and zoning controls

The Commission has not considered whether *specific* planning and zoning regulations might have an impact on the efficient operation of the retail tenancy market. Nevertheless, there appears to have arisen at each level of government, a range of planning policies and development procedures which can have the effect of restricting the availability of retail space and its use. These regulatory controls potentially reduce competition between shopping centre landlords, and increase the bargaining power of landlords vis-à-vis their tenants, by reducing tenants' ability to relocate close by and preserve their business after lease expiry.

The effect that planning and zoning regulations have on competition for retail space is an issue that needs to be more thoroughly and widely considered by State and local planning authorities. In particular, the restrictiveness of existing planning and zoning policies could be reviewed as part of the proposed broader moves to ease the prescriptiveness of current regulations governing the retail tenancy market.

Move towards national consistency

A range of participants to this inquiry expressed support for the adoption of a national retail tenancy framework on the grounds that it would reduce compliance costs. But concerns were also expressed over the potential for a national framework to overlap with the current State and Territory legislation (box 10.7).

The Commission recognises that achieving nationally consistent retail tenancy legislation would not be an easy task and is not something that is likely to happen in the short term. Retail tenancy law is a matter for State and Territory governments and, in practice, national consistency would have to be achieved through the alignment of tenancy legislation and regulation that exists in each jurisdiction. There is, however, scope for a move towards a 'model' for national consistency. A number of industry participants support the continuance of current legislative measures, with a view to harmonisation around minimum leasing standards across retail tenancy laws. Other participants supported a national approach based on a simplification and reduction in the extent of the legislation.

Box 10.7 **Support for a national framework**

Landlords, multi-jurisdictional retail tenants and tenant organisations expressed a strong preference for a national framework. Despite this, differences exist over what a framework would look like. On one hand, some participants expressed support for the continuance of the current measures, albeit at a national level. For example, the Franchise Advisory Centre stated:

> The Centre would wholly support moves to bring about standard national retail leasing legislation, rather than the piecemeal state-by-state legislation which currently exists, and which adds unnecessary compliance costs to franchisors as they grow their systems nationally. (submission no. 76, p. 2)

The ARA advised that:

> … in developing uniform regulation it is essential that it reflects the best practice and not the lowest common denominator as wanted by some. (submission no. 119, p. 28)

On the other hand, some participants suggested that legislation be simplified and reduced when adopting a national framework. For example, REIA stated:

> The REIA strongly supports greater simplification and harmonisation of retail tenancy legislation across all Australian jurisdictions. It is a fact that many landlords and tenants operate in multiple jurisdictions and are continually frustrated by the lack of consistency in this and other regulatory areas … Ideally, a nationally uniform tenancy code should be developed and adopted by all Australian States and Territories. (submission no. 112, p. 11)

Similarly, ANRA indicated that:

> ANRA is supportive of the streamlining of varying State and Territory legislations … (submission no. 92, p. 3)

Also from the SCCA:

> … the drafting of a Commonwealth Bill, to be negotiated with the States and Territories, in consultation with relevant stakeholders, would also present an opportunity to critically scrutinise existing regulation with a view to removing any unnecessary regulation. (submission no. 83, p. 3)

Westfield similarly expressed a preference for national legislation, but cautioned that legislation by both the Australian Government and individual States and Territories would not be efficient:

> … nationwide uniform retail tenancy laws are desirable, but only on the basis that the States voluntarily surrender their legislative powers to the Commonwealth in this field. It is acknowledged that this would be difficult to achieve as a matter of political reality. There is no case for an overlay of Federal regulation which, apart from questions of constitutional validity, would only exacerbate existing regulatory inefficiency and attendant administrative cost. (submission no. 85, p. 4)

The Law Council of Australia recommended

> … that a uniform approach be adopted by all States and Territories based on the Uniform Companies Code in that, a model law was prepared and then passed by each State and Territory. (submission no. 68, p. 2)

Irrespective of the approach taken, in developing such legislation, differences between jurisdictions would need to be considered to avoid burdening smaller jurisdictions with provisions not relevant to their market. For example, provisions considered relevant for larger jurisdictions such as New South Wales and Victoria would not necessarily be appropriate for smaller jurisdictions such as Tasmania and the Northern Territory, where there are fewer transactions, less formality and arguably greater ease in reaching agreement through commercial negotiation.

FINDING

Less prescriptive legislation and greater harmony in legislation between jurisdictions could improve the efficiency of the retail tenancy market and lower compliance and administrative costs.

Introduce a national code of conduct for shopping centre leases

Concerns were repeatedly raised by tenant and landlord representatives in this inquiry about the manner in which lease negotiations are often conducted (particularly in shopping centres) and way in which lease provisions are implemented (chapter 9). Under these circumstances, it can be difficult to develop effective commercial relationships that are necessary for least-cost business decision making by both landlords and tenants, and resources can be wasted. While dispute resolution mechanisms in retail tenancy legislation have been effective, they are limited to cases where there has been a breech of lease or legislative provisions. As discussed in chapter 9 and section 10.1, the accumulation of retail tenancy legislation that has sought to influence conduct through prescribing aspects of the landlord–tenant relationship has not been successful in improving relationships between landlords and tenants or alleviating tensions. This suggests that an alternative way of dealing with business conduct is required.

Where such situations have arisen in other parts of the economy, codes of conduct have been introduced to outline responsibilities and standards of behaviour or practice that can be expected of businesses. The term ‘code of conduct’, however, is used to cover codes that vary widely in coverage and operation — from mandatory enforceable industry wide codes and regulation to voluntary codes (that may or may not be binding or enforceable), and there are fundamental differences in the operation of these codes.

Regulated codes of conduct, including *mandatory* enforceable codes under the TPA (such as the franchising code of conduct), are little different in operation to other regulation. These codes set up rules and constraints which all prescribed businesses are bound by. The main difference between mandatory codes and government

legislation may be the greater scope for industry to determine the content of a mandatory code.

To date, only a few codes have been mandated under the TPA. The franchising code of conduct that was established to deal with similar concerns to those expressed in the market for retail tenancies is one example of a mandatory code. The franchising code has set in place mechanisms for dispute resolution and established best practice templates, such as a pro-forma disclosure statement (submission no. 76).

In contrast, *voluntary* codes contain a set of rules and/or guidelines that a business, as a signatory to the code, voluntarily agrees to abide by in their dealings with other businesses. Agreement to abide with a voluntary code can be a signal to other market participants of the willingness of a businesses to operate within the set standards. In this respect, a voluntary code of conduct is akin to a corporate social responsibility program.

The success of a voluntary code is dependent on the nature of a code, including the enforceability of its provisions and the ramification for breaches of the code. To instil confidence in the code, it is necessary that the code have sufficient 'teeth' to ensure compliance and that there be an avenue for dispute resolution. One method of enhancing the strength of a voluntary code is by having the code enforceable by the ACCC — that is, prescribed under the TPA (box 10.8). Although there are now several voluntary codes of conduct in Australia (box 10.9), each operates within its respective industry without being prescribed under the TPA.

Past attempts to develop voluntary codes of conduct in the retail tenancy market have had mixed success. An example of a *national* voluntary code in the retail tenancy market is the casual mall licensing code of conduct (chapter 3) which was developed by landlord groups (including the SCCA) and tenant advocates (including the ARA) (submission nos. 18 and 83). In contrast, a voluntary shopping centre code of conduct on outgoings was drafted by the ARA in 2002, but did not receive necessary support for implementation (ARA 2003).

At the *state* level, codes of conduct for retail tenancies have generally not endured. For example, a voluntary code of conduct in New South Wales did not succeed and was followed by formal legislation (submission no. 119). Failure of the code has been variously attributed to non-compliance by many landlords who were signatories to the code (submission no. 136); to the short time span given for the code to work prior to introduction of legislation (just over 2 years); and to the fact that it was introduced at a time when Victoria and Queensland were moving down a legislative path to retail tenancy regulation (transcript, p.105). In the Australian Capital Territory, a mandatory code of conduct for commercial and retail leases applied from 1994, before it was replaced by legislation in 2001.

Box 10.8 **Codes of conduct and the TPA**

The TPA makes provisions for both mandatory and voluntary codes of conduct. If an industry code is declared as a prescribed voluntary code under the TPA, participation is voluntary, but the ACCC can take action against signatories for breaches of the code. The purpose of prescribing a code is to strengthen a voluntary code in an industry that has not otherwise been able to meet the code's objectives.

The government will only consider prescription of a code of conduct if:

- the code would remedy an identified market failure or promote a social policy objective;
- the code would be the most effective means for remedying that market failure or promoting that policy objective;
- the benefits of the code to the community as a whole would outweigh any costs;
- there are significant and irremediable deficiencies in any existing self-regulatory regime — for example, the code scheme has inadequate industry coverage or the code itself fails to address industry problems;
- a systemic enforcement issue exists because there is a history of breaches of any voluntary industry codes;
- a range of self-regulatory options and 'light-handed' quasi regulatory options have been examined and demonstrated to be ineffective;
- there is a need for national application as state and territory fair trading authorities in Australia also have the options of making codes mandatory in their own jurisdiction.

For both mandatory and voluntary codes, where there are provisions that are potentially anticompetitive, the code must be authorised by the ACCC. Authorisation provides immunity from legal action under the competition provisions of the TPA and is granted if it can be demonstrated that these provisions provide net public benefits.

Source: ACCC (2005)

There was widespread support from both tenant and landlord representatives for a code of conduct in the retail tenancy market, with most proponents expressing a preference for such a code to be mandatory. Support for a national code of conduct, albeit mandatory, was expressed by business groups such as COSBOA (submission no. 94) and other groups such as RICS Oceania (submission no. 39). The Law Institute of Victoria (LIV) suggests that:

> While the LIV believes that it would be beneficial to provide for special controls in respect of shopping centres, it does not believe that these will be effective if limited to a voluntary code of conduct. (submission no. DR147, p. 2)

The NRA also believe that a code of conduct would fail if voluntary:

> Based on experience and commercial imperatives, no landlord would unilaterally and voluntarily enter into and observe a Voluntary Code that was enforceable. (submission no. DR162, p. 3)

Box 10.9 **Selected codes**

Mandatory codes

- *Tasmanian Code of Practice for Retail Tenancies* — mandatory regulation, similar to retail tenancy legislation in other jurisdictions. It appears to work successfully, albeit in a relatively small market.
- *ACT Commercial and Retail Leases Code of Practice* — mandatory regulation, similar to retail tenancy legislation in other jurisdictions, replaced by Leases (Commercial and Retail) Act in 2001.
- *Franchising code of conduct* — mandated and enforceable under TPA. Appears to be well regarded within industry.

Voluntary codes

- *New South Wales Retail Tenancy Leases Code of Practice* — voluntary code adopted in 1992, similar to legislation in other states, replaced by legislation two years later.
- *Casual Mall Licensing Code of Practice* — voluntary industry code, only come into effect in 2008, so it is not yet possible to gauge its effectiveness
- *Motor Vehicle Insurance and Repair Industry Code of Conduct* — voluntary industry code, generally viewed as effective in resolving friction between insurers and repairers.
- *United Kingdom code of practice for commercial leases* — voluntary code that contains only very general recommendations, with no scope for dispute resolution or consequences of breeches. Analysis of the code has found that it is having little direct effect on negotiations and that some aspects of the code are rarely followed (Crosby, Murdoch and Hughes 2005).

However, a drawback of a code of conduct that is mandatory would be the need for arbitrary coverage guidelines. This means that the code would be prescriptive and could simply replace current State and Territory legislation with a national set of regulations (or could even overlay the current set of legislation). A voluntary code of conduct would avoid this drawback. Indeed, some tenancy groups expressed support for a code of conduct to be established to replace the current legislative arrangements.

As stated by the ANRA:

> Given the complex and inconsistent nature of the current framework, any new approach must seek to streamline and simplify the system to allow a level playing field for landlords and tenants alike. In that vein, ANRA is supportive of light-handed regulatory measures such as Codes of Conduct. Any proposed changes must be assessed carefully to a minimal cost impact for retailers and shoppers alike. (submission no. 92, p. 10)

Star Shots Photography noted that:

> The code of conduct for casual mall leasing … appears to be effective. It also operates on a national basis. A similar code in relation to retail leases would also have national application and would get around the problem of State Governments not being able to agree on all issues. (submission no. DR181, p. 1)

Lease1 similarly suggest that in a market in which there are varying lease formats given the diversity of ownership, retailers and statutory bodies, a code of conduct can offer consistent and commercially prudent minimum standards across the nation (submission no. DR163, p. 2).

The SCCA cautioned that market participants would need some assurance that prescriptive legislation would be wound back, before a voluntary code of conduct could be negotiated:

> … we believe it is too much of a leap of faith for owners, given our experience over the past decade or so, to enter into negotiations on such a code without a clear commitment from all state and territory governments that the quid pro quo will be delivered; that is, that we would be released from retail tenancy legislation (transcript, p.80)

In its submission, SCCA outline several other issues that would need to be addressed before a code of conduct could operate successfully in the market (submission no. DR193). In particular, they note a need to ensure that there are no inconsistencies between a code of conduct and State and Territory legislation; that differences between centres are accounted for; and that dispute resolution services are available to deal with disputes that might arise under a code.

A number of other participants suggested that in order for a code to be successful, consultation with all relevant groups would be necessary when establishing the specific standards of conduct under which business transactions should occur. A code of conduct would need to be developed to cover the main segment of the market over which concerns have arisen — shopping centres — but remain open to all market participants. The REIA noted that:

> … any code of conduct would need to be developed in consultation with both landlords and tenants and be binding across the entire industry. A code should not be costly to industry and should not impose more compliance requirements ... It maybe problematic

> and difficult to achieve a truly workable code of conduct that is supported by both the landlord and the tenant. (submission no. DR154, p. 10)

In a similar vein, the Retail Traders' Association of Western Australia (RTAWA) stated:

> The RTAWA strongly supports this path [code of conduct] of self-governance in preference to further legislation; however, all stakeholders would need to be closely involved in the drafting of such a code. (submission no. DR171, p. 4)

A voluntary national code of conduct for shopping centre leases could help establish clear rules for the conduct of shopping centre leases and resolve many of the difficulties raised by participants of the inquiry. *Industry–developed* ground rules could also be effective in reducing resources spent on disagreements and legislative reviews. A code of conduct should be an industry initiative and be administered by the industry itself. While it would generally only be in the event of a failure of an industry-based code to meet its agreed objectives that the code would need to become enforceable under the TPA, consideration could be given to prescribing the code under the TPA, because of its likely national importance.

Within the code of conduct, an understanding of what constitutes acceptable conduct and standards of fair trading could be established — including conduct during end of lease negotiations and accountability of parties to the lease (box 10.10). Importantly, the code should avoid intrusions into normal commercial relations between tenants and landlords and not attempt to specify or regulate, on an industry-wide basis, the outcomes of commercial negotiations.

The code of conduct could form part of a new regulatory framework — it could lower the level of transactions, compliance and administrative costs of operating in the retail tenancy market (relative to the current legislative approach) and help facilitate the removal of the more prescriptive elements of current State and Territory regulation.

FINDING

The development of a voluntary national code of conduct for shopping centre leases could help establish clear rules of conduct and resolve many difficulties raised by participants, and facilitate the removal of ineffective and inefficient elements of the legislation.

Box 10.10 **Possible scope of a voluntary national code of conduct for shopping centre leases**

A national code of conduct for shopping centre leases could include provisions for:

- standards of fair trading, particularly in relation to;
  - initial lease negotiation, offer and acceptance;
  - managing change during a lease term, including for variations in rent, fit-out requirements, relocation and redevelopment; and
  - conduct at the end of a lease and offers of negotiation for a new lease.
- standards for transparency in lease costs, including;
  - the use of 'effective rent' or 'comparison rent' figures; and
  - provisions for efficiency auditing of centre outgoings, which are separately charged to tenants and subject to change during a lease.
- prompt lodgement of lease summary page on publically accessible lease register;
- information provision and accountability in relation to centre operations, including in relation to foot traffic and centre turnover;
- internal dispute resolution processes and access to those processes before lodgement of a formal dispute; and
- conduct in disputes lodged by tenants with formal dispute resolution processes.

The code should avoid intrusions into normal commercial decision making of tenants and landlords and not attempt to specify or regulate, on an industry-wide basis, such matters as:

- minimum lease terms or specific options for lease renewal;
- rent levels and their determination;
- the trading rights of individual tenants or the tenancy mix of shopping centres; and
- the ability of shopping centres managers to decide whether to re-enter into a new lease agreement with an incumbent tenant.

Further develop the small business tenancy office model

There is a framework in place in most States and Territories for the provision of retail leasing advice and to direct complaints on retail tenancy matters. The agencies established under these frameworks vary between jurisdictions in terms of their accessibility to non-retail businesses and their integration with other parts of the regulatory framework (table 10.2). A small business tenancy office in each State and Territory could be used as a focal point for the collection and dissemination of information on commercial (including retail) tenancies and to further improve the

handling of complaints on tenancy matters. That is, the small business tenancy office could have both advisor and dispute resolution (or ombudsman) roles.

Advisors and ombudsmen exist in other markets in order to facilitate dispute settlement and provide a focal point for information and complaints. For example, the role of the Banking and Financial Services Ombudsman is to:

> … provide an accessible, independent dispute resolution service to individuals and small business customers of financial services providers. (BFSO 2007, p.1)

Similarly, the role of the Franchising Code Mediation Advisor 'is to conduct the initial assessment of the complaints and appoint a mediator' (ACCC 2007, p.1).

Table 10.2 **Existing government retail advice services by State**[a]

State/Territory	*Organisation*	*Coverage*
New South Wales	Retail Tenancy Unit (Department of State & Regional Development)	Retail small businesses
Victoria	Office of the Small Business Commissioner	All small businesses
Queensland	Retail Shop Leases Registry (Department of Justice & Attorney-General)	Retail small businesses
South Australia	Office of Consumer & Business Affairs	All businesses
Western Australia	Small Business Development Corporation	All small businesses
Tasmania	Office of Consumer Affairs & Fair Trading (Department of Justice)	All businesses
Northern Territory	Office of Consumer & Business Affairs (Department of Justice)	All businesses
Australian Capital Territory	Office of Regulatory Services (Department of Justice & Community Safety)	All businesses

a In addition to these listed agencies that specifically provide advice on retail leasing, there are other organisations, departments and hotlines in each State and Territory that provide more general advice services for businesses, including retail businesses.

Whilst the dominant focus of the small business tenancy office may be retail tenancies, other commercial tenancies should not be excluded from access to the services provided. Nor should the establishment of a small business tenancy office replace existing mechanisms in each jurisdiction. Rather, the office could operate within the existing framework to:

- provide a single focal point for information about retail (and other commercial) tenancies, including what information tenants should consider prior to signing a lease and summary information on current leases in segments of the retail tenancies market;

- provide advice to potential tenants and landlords in relation to their lease responsibilities and rights;
- provide initial advice on complaints before these progress through the relevant tribunal or court or to the ACCC for dispute settlement;
- collect and report data on the number and type of complaints (at various levels) that occur each year in each jurisdiction; and
- report on developments in the retail tenancy market and their effect on the relationship between landlords and tenants and the efficient operation of the market.

The Commission was advised that in some states at least, there is scope for improving links between government agencies that deal with tenancy matters. For example, the Small Business Development Corporation (SBDC) of Western Australia advised that:

> … the links between dispute resolution bodies, such as the State Administrative Tribunal in Western Australia, and advisory bodies, such as the SBDC need to be significantly improved. Improving these links would better clarify dispute resolution procedures, interpretations of the *Commercial Tenancy (Retail Shops) Agreements Act 1985* (CTA) and facilitate more efficient resolution of retail tenancy disputes. To date, the SBDC has found it difficult to establish an effective relationship with the SAT. (submission no. DR194, p. 12)

The creation of a focal point for retail tenancy market participants should enhance the effectiveness of information dissemination and dispute settlement processes, without adding further administrative layers to the operation of retail tenancies.

Some additional administrative costs would necessarily be involved with the creation of a small business tenancy office. Also, the effectiveness of such an organisation in helping to inform decision making by participants in the retail tenancy market would depend on how well participants are able to use information provided. If individuals are not currently making use of available information (from State registrars and the ACCC), then it is possible that creating a single focal point for information flow and dispute settlement processes would not lead to a material benefit for market participants or the Australian economy as a whole.

FINDING

Potential exists for the role of government small business and tenancy agencies to be strengthened in the areas of information provision, the scope of dispute resolution and in achieving national consistency.

10.3 Summing up

A movement away from prescriptive retail tenancy legislation could improve the operation of the retail tenancy market by removing barriers to its efficient operation. Such a move could also bring about greater harmony between legislation that exists in all States and Territories. Nevertheless, a less prescriptive approach should not seek to remove or replace other aspects of the legislation that are working well in each jurisdiction, such as dispute resolution processes and information disclosure.

Recognising that the focus of retail tenancy legislation has been on the relationship between small tenants and shopping centre landlords, there would be merit in an industry-developed, national code of conduct for shopping centre leases. This would facilitate the unwinding of the prescriptive elements of the current retail tenancy legislation. However, a code should not be developed to add an additional layer of regulation on the market and should only be pursued if the current legislative arrangements are to be reformed.

Finally, the creation of a small business tenancy office in each State and Territory could address participant concerns as to the availability of market information and facilitate moves toward national harmonisation in the operation of retail tenancies.

11 The Commission's recommendations

The Commission was asked to make recommendations for improving the retail tenancy market in Australia and to identify, and where practicable quantify, the likely benefits and costs of those recommendations for retail tenants, landlords, investors and the community generally. The Commission's recommendations seek to reduce unwarranted constraints on the retail tenancy market, improve the efficiency with which it operates and provide a pathway to lowering compliance, administration and information search costs.

The case for change in the regulation and conduct of the market for retail tenancies in Australia depends on evidence of impediments to economic efficiency in the market and related problems in current arrangements, as well as the capacity of various options for change to address those shortcomings.

Much of the current regulatory framework was developed primarily to address the concerns of small tenants operating in shopping centres. However, there is a larger group of retail landlords and tenants who do not operate in centres, but are still subject to retail tenancy legislation. Yet other retail landlords and tenants are excluded from the coverage of the legislation, either unintentionally or by design. The Commission is also cognisant of the fact that in many parts of Australia, the retail tenancy market operates effectively with little regard to regulation. Changes to the regulatory framework should not add regulatory burden in such areas.

Against this background, this chapter initially provides the Commission's assessment of the scope for regulatory improvement. The chapter then outlines measures, drawn from preceding chapters, that the Commission considers would improve the efficiency of the market and ultimately, lower compliance, administrative and information search costs. Finally, some suggestions are made for implementation of the Commission's recommendations and an assessment is provided of likely adjustment issues and impacts of the recommendations.

11.1 The scope for regulatory improvement

The Commission considers that aspects of the current regulatory framework for retail tenancies have improved the operation of the market. In particular:

- disclosure requirements have improved awareness and knowledge of small landlords and tenants (chapter 8);
- there is a culture of lease registration in some states which, in conjunction with market developments, has improved the accessibility and transparency of information on the retail tenancy market (chapter 8);
- considerable information is provided in most jurisdictions on retail leasing and considerations for starting small businesses (chapters 8 and 10);
- mediation and dispute resolution procedures have provided a low cost alternative to tribunals and courts (chapter 9); and
- the introduction of unconscionable conduct provisions into the TPA and State legislation has afforded additional protection for small business in dealings with large business (chapter 9).

Notwithstanding these improvements, submissions to this inquiry and the Commission's own investigations suggest that the introduction of legislation has not significantly altered some aspects of leases (such as the average term of tenancies) or perceptions of imbalances in negotiating positions (chapters 6 and 7). Concerns were expressed about large shopping centre landlords, in particular, having considerable negotiating power in determining lease conditions. This negotiating power of landlords is seen to arise through superior information on centre operations and the performance of competing tenants; it persists because of the availability of a large number of tenants seeking retail space in centres. The existence of this negotiating power is claimed to harm the interest of small tenants, and is presented as an argument against the adoption of an alternative, less restrictive, legislative approach.

The Commission recognises that retail tenancy within shopping centres often involves quite different arrangements from retail tenancy in other settings such as retail strips. Entry and exit in the shopping centre segment of the market may also be more tightly controlled than in other retail locations, in part owing to relatively low vacancy rates and to in-house lease management. However, the Commission considers that the shopping centre 'package' is a retail tenancy arrangement that tenants can either accept, negotiate around, or reject in favour of other tenancy options elsewhere. Hard bargaining; an unwillingness to seek professional negotiating, financial or legal advice; varying business fortunes; and disappointments in performance within shopping centre or other retail formats, should not be confused with economic market failure and do not make the case for government intervention in the retail tenancy market.

The Commission also accepts that a shopping centre might be the preferred venue for many retailing activities, with retail space in centres highly prized by

prospective and existing tenants. However, the decision to bid for that space, in terms acceptable to the landlord, is a commercial one, and the consequences of this decision does not make the case for government intervention.

The Real Estate Institute of Australia (REIA) suggests that the perception of an imbalance in negotiating power is inherent within the landlord–tenant relationship:

> While tenants should (and do) have certain rights to the unimpeded enjoyment of premises as per the tenancy agreement, no amount of regulation will alter the fact that the landlord is the owner of the premises (enjoying the normal rights of ownership under common law) and the tenant is a temporary occupant. To try and regulate otherwise simply adds unnecessary administrative and compliance costs. (submission no. DR154, p.2)

However, the legislation does appear to have had some unintended adverse impacts on market participants. In particular, the Commission has been made aware that prescriptive legislation has not adequately dealt with conduct issues that have arisen in the negotiation and operation of many retail leases, particularly (but not limited to) leases in shopping centres (chapter 9).

The prescriptive legislation has also raised compliance and administrative costs for those landlords and tenants who operate in multiple jurisdictions and for those who wish to negotiate lease conditions that are more suited to their commercial circumstances than lease conditions that may be inherent in prescriptive legislation (chapter 10).

The Commission's assessment is that the case for further prescriptiveness in tenancy legislation is weak. Instead, an alternative approach is warranted. Such an approach should maintain, and where practicable, improve the features of the current system that appear to be working well — dispute resolution, and information and disclosure — but should also:

- introduce a more focussed approach to regulation of retail tenancies, particularly in shopping centres, to ease existing tensions in the negotiation and operation of many shopping centre leases;
- progressively unwind the current prescriptive retail tenancy legislation in each State and Territory in areas that have sought to govern market behaviour, such as minimum lease terms, assignment and outgoings inclusions;
- move, where practicable, towards national consistency in lease documentation, legislation and in the provision of retail tenancy information and services.

The Commission's recommendations are intended to encourage efficient investment, enhance operational efficiency and potentially lower compliance, administrative and information search costs. Coincidentally, the simplification in

retail tenancy regulation inherent in the recommendations is likely to bring about a closer alignment between the operation of retail tenancies and processes in the broader market for commercial tenancies.

The Commission acknowledges that an alternative approach to regulation of the market will not only take time to implement, but also that the benefits may not be evident for a number of years — possibly beyond the lease terms of many current market participants.

11.2 Actions to improve the operation of the retail tenancy market

Measures for the immediate future

There are several measures that should be implemented in the immediate future (for example, within two years) to move towards an alternative regulatory approach. The measures would:

- avoid more stringent and prescriptive regulation;
- improve the transparency and accessibility of information on leasing processes and lease documentation;
- collate lease information and enable public access;
- improve the national consistency of tenancy information;
- further clarify and align provisions of unconscionable conduct; and
- ease existing tensions in the negotiation and operation of many retail tenancy leases, particularly in shopping centres.

Avoid more stringent and prescriptive regulation

The Commission's preferred approach to retail tenancy regulation involves retail tenancy legislation that is less prescriptive of commercial outcomes for retail tenancies, and where practicable, more nationally consistent. Reforms toward such a framework need to be deliberate and progressive and avoid a piecemeal overlapping national/state framework. Accordingly, in the immediate future, States and Territories should not pursue measures that increase the prescriptiveness of retail tenancy legislation, particularly where it is unclear that there are substantial efficiency improvements, compared with outcomes in the less regulated broader commercial tenancy market. This pause in legislative change would be a precursor to the introduction of greater self-regulation in the retail tenancies market, the

removal of many of the restrictive provisions in tenancy legislation and, where practicable, a move towards more nationally consistent retail tenancies regulation. Adherence to this broad guideline is likely to reduce the extent and costs of adjustment in each jurisdiction.

In the immediate future, States and Territories should not pursue measures that increase the prescriptiveness of retail tenancy legislation nor further widen the gap between the retail tenancy market and the broader market for commercial tenancies.

Improve the transparency and accessibility of information

The accessibility and transparency of information pertaining to retail tenancy leases has increased significantly through the adoption of disclosure statements, tenancy documentation and information services (chapter 3). The vast majority of participants in the public hearings conveyed the view that increased disclosure in the retail tenancy market in recent years has been a significant improvement. Also, state retail tenancy agencies, for the most part, now provide a substantial amount of relevant information for market participants. These developments have been directed at increasing the effectiveness of decision making by small business, including, but not confined to, dealings with large well resourced landlords. However, the Commission was also advised that 'too much' information, particularly of a technical nature, can be confusing to traders and be an impediment to effective commercial decision making, and that many do not use available information and advice services (chapter 8). The Commission's assessment is that increased transparency and information has contributed to improvements in market operation, but the extent of improvement and cost effectiveness is less clear.

Despite past efforts, it was suggested that there are still knowledge and information gaps, often with small landlords and tenants (chapter 8). Possibilities for further development that should be considered, include:

- greater use of simple language in all tenancy documentation and the addition of a one-page summary containing key provisions in the lease and disclosure statements; and
- providing clear contact points in each jurisdiction for information on the retail tenancies market and government services, including improved links between relevant agencies that deal with tenancy matters (in particular, between small business tenancy agencies, tribunals that handle tenancy disputes and the State land titles offices which handle registration of leases).

The Commission does not see a need for substantial additional *government* provision of information in the retail tenancy market. Nevertheless, there is scope for refinement to existing processes in each State and Territory — focusing on simplification, disclosure and accessibility of existing government services and lease documentation.

RECOMMENDATION 1

State and Territory governments should take early actions to further improve transparency and accessibility in the retail tenancy market. They should:

- ***Encourage the use of simple (plain English) language in all tenancy documentation.***
- ***Provide clear and obvious contact points for information on lease negotiation, lease registration and dispute resolution.***
- ***Encourage a one page summary of all key lease terms and conditions to be included in retail lease documentation.***

Lodgement of lease information and public access

Information imbalances between small tenants and shopping centre landlords in lease negotiations was a common concern of tenants and tenant organisations (chapter 8). To redress this information imbalance, tenant organisations, landlords and other participants made a number of suggestions to the Commission, including: mandating the registration of leases under state property law; requiring the lodgement of lease details with an independent third party organisation, at either a national or state level; and the removal of restrictions on disclosure of lease conditions to third parties.

The first of these suggestions has the advantage that under current property laws in each State and Territory, registration of fixed term leases (generally of more than three years) is already possible and offers certain legal protection (chapters 3 and 8). Despite the legal protection afforded to the lessor and lessee by registration, the Commission understands that, in most jurisdictions, a significant number of fixed-term leases for retail space are not registered and for those that are, there can be a significant lag between the signing of the lease and registration.

However, the decision of whether to register a lease or make it available to a third party is ultimately a commercial one by the contracting tenant and landlord albeit influenced by jurisdictional practices. The Commission's judgement is that it would not be appropriate to mandate the registration of leases (chapter 8).

Nevertheless, the Commission accepts that lodgement of lease information with an independent agency would potentially enable public searches of leases and increase information on the retail tenancy market. Additional information on the market could improve the decision making of smaller tenants or boost their confidence in lease negotiations, for a low additional cost. Furthermore, to the extent that lease information is able to be lodged (not restricted by the inclusion of non-disclosure clauses in leases), lodgement would potentially provide a source of information for use in market valuations. The Commission considers that lodged lease information should not necessarily include information on incentives and 'side deals'. Such a requirement would be difficult to enforce and would not significantly add to market information.

One way for the lodgement of lease summaries to be implemented is through the creation in each State and Territory, of a site that collects and enables public access to the one-page summary of leases. Such a site may be provided, updated and maintained by either a government agency or by the private sector and may form a part of existing State lease recording or registration facilities. While lodgement on such a site should not be mandatory, to increase lodgements and thereby market information, consideration should be given to offering an inducement to those retail tenancy market participants who choose to lodge their lease summary. For example, such inducements may take the form of reduced access costs for market information from the site.

RECOMMENDATION 2

To increase the transparency of the market, State and Territory governments should, as soon as practicable, facilitate the lodgement by market participants of a standard one page lease summary at a publicly accessible site.

Improve the national consistency of tenancy information

A common concern raised by businesses that operate across jurisdiction boundaries, was the additional costs imposed by the need to tailor leases to the different requirements of respective State regulations (chapter 10). The Commission accepts that additional costs are incurred and that differences can be an impediment to expansion (particularly for small firms). However, what is less clear is the extent of additional costs and constraints on expansion, and whether they are linked to different retail tenancy laws or other areas of difference (for example, differences in property or building regulation). The Commission also notes that for lessors and lessees operating in only one jurisdiction, cross jurisdictional differences are of little or no concern.

A single national legislative framework was suggested by a cross section of participants as a way of addressing this concern. Recognising State and Territory jurisdiction over retail and commercial tenancies more broadly, a single national legislative framework is beyond the scope of this inquiry. Nevertheless, some steps towards national *consistency* are possible.

In the immediate future, the first step towards a nationally consistent tenancy framework could be achieved through the development of a national reference lease that contains a key set of items (and terminology) to be included in all retail tenancy leases and in tenant and landlord disclosure statements. This reference lease should focus on establishing transparency of lease obligations, but should not be prescriptive of actual lease terms and conditions — matters properly the subject of commercial negotiation. The set of items to include would represent a minimal level of information to be consistently reported in lease documentation. It should be flexible enough to enable changes over time in the detail required in particular components (such as outgoings) and to enable extension to different retail formats or premises.

The Commission also notes that while a significant amount of information is available on tenancy enquiries and disputes in each State and Territory, it is not readily available in a format that enables a broad analysis of tenancy disputes or a comparison between jurisdictions (chapter 9). Nationally consistent information on tenancy enquiries, complaints and disputes would aid evaluation of the operation of the dispute resolution processes and the nature and causes of disputes.

RECOMMENDATION 3

State and Territory governments, in conjunction with the Commonwealth, should seek to improve the consistency and administration of lease information across jurisdictions in order to lower compliance and administration costs. They should:

- ***Encourage the development of a national reference lease with a set of items (and terminology) to be included in all retail tenancy leases and in tenant and landlord disclosure statements.***
- ***Institute nationally consistent reporting by administering authorities on the incidence of tenancy enquiries, complaints and dispute resolution.***

Further clarify and align provisions for unconscionable conduct

A number of participants submitted that further clarification of what is unconscionable conduct is warranted, citing differences in legislative provisions between jurisdictions and the small number of test cases heard by tribunals and courts at the national and State levels (chapter 9). Other participants suggested that

the criteria for what is unconscionable conduct should be relaxed. The Commission recognises that the interpretation of unconscionability is contentious and that there is debate concerning whether unconscionability should focus on 'conduct' in commerce or be broadened to focus on commercial 'outcomes'.

The Commission's assessment is that it would be inappropriate to extend the concept of unconscionability applying to business-to-business transactions in the retail tenancy market. Such a refocusing would constrain the operation of the tenancy market, lower efficiency and would be unlikely to resolve the broader business conduct issues in the market (chapter 9). However, ongoing measures to improve clarity would be beneficial. Such measures could include achieving better community recognition of the distinction between unconscionable conduct and other matters affecting the landlord–tenant relationship, such as adherence to contractual obligations and deceptive or misleading conduct. The Commission also notes the intention of the ACCC to further test unconscionability claims in tribunals and courts (chapter 9). There are strong incentives for businesses to settle disputes involving unconscionability claims before proceeding to tribunal or court, and the Commission considers that it would not be appropriate for government to contrive to bring cases before the courts.

In addition, the Commission's assessment is that a detailing of the significance of differences in jurisdiction-specific provisions relating to unconscionable conduct and, where practicable, alignment of legislated definitions across jurisdictions, could lower the incidence and cost of disputation.

RECOMMENDATION 4

The significance of jurisdictional differences in the provisions for unconscionable conduct, as applying to retail tenancies, should be detailed by State and Territory governments in conjunction with the Commonwealth, and aligned, where practicable.

Measures to reduce tensions and improve efficiency

As a next step towards improving the operation of the retail tenancy market in Australia and moving towards national consistency, changes should focus on a shopping centre code of conduct. A national code of conduct for shopping centre leases could ease existing tensions in the negotiation and operation of many retail tenancy leases in shopping centres and facilitate a transition toward greater self-regulation. It would also facilitate the removal of those aspects of tenancy regulation that attempt to prescribe commercial outcomes and drive a wedge between the retail tenancy and commercial property markets. Work toward these

measures should be initiated as soon as practicable to enable implementation over the next two to three years.

Voluntary national code of conduct for shopping centre leases

The Commission recognises that retail tenancy within shopping centres often involves quite different arrangements to retail tenancy in other settings such as retail strips, and that furthermore, the majority of concerns and suggestions for change that were raised by participants of this inquiry (and in previous inquiries and reviews), relate to retail tenancies in shopping centres. Despite the prominence of large shopping centre landlords in discussions relating to conduct, it is evident to the Commission that concerns about conduct are also present in the second and third tier centres (regional, sub-regional and neighbourhood centres) (chapter 9).

As outlined in chapter 10, the Commission does not advocate further prescriptive legislation to address these ongoing concerns — it would be inappropriate to further constrain the shopping centre model through regulation or to introduce further regulatory measures that provide no efficiency improvements in the retail tenancy market, compared with outcomes in the broader commercial tenancy market.

As an alternative to further prescriptive legislation, the Commission's assessment is that there are a number of issues — largely specific to shopping centre tenancies — that could be covered by self-regulation of market participants through an *industry developed* and accepted national code of conduct for shopping centre leases (chapter 10).

Such a code could include:

- standards of conduct at all stages of lease negotiation, operation and termination;
- measures to improve the transparency and accountability of tenancy management within centres, including provision of effective rent figures and lodgement or registration of leases; and
- conduct of dispute resolution, prior to a dispute proceeding to a mediator, tribunal or court.

However, a code of conduct should *not include* measures that prescribe possible outcomes of commercial negotiations, such as minimum lease terms. That is, it should act to improve the cost-effectiveness of practices of both landlords and tenants in shopping centres, but avoid undue interference in normal commercial relationships and associated bargaining between parties.

The Commission considers that a *voluntary* code of conduct offers several advantages over a mandatory code:

- It would act as a readily identifiable signal for prospective tenants and landlords, of the willingness of potential parties to a retail lease to conduct business according to agreed and transparent standards.
- It requires no arbitrary coverage definitions, as potentially any retail landlord or tenant could agree to adhere to its provisions.

A voluntary code may be implemented and enforced by the retail tenancy sector — that is, self-administered — or it could proceed to become a prescribed voluntary code that is enforceable by the ACCC. Because of the national importance of a code, the Commission considers that it would be appropriate for the code to be prescribed under the TPA.

A voluntary code, or any other measure, could not be expected to remove tensions associated with commercial negotiations, hard-bargaining and business failure, or the choice of business model adopted in shopping centres. However, it would provide scope to delineate the 'rules of the game' in a way that would potentially reduce the extent of protracted and adversarial negotiations, improve efficiency in the market through lower transaction costs and improve investment decisions for both landlords and tenants. The code of conduct could be referred to in State and Territory legislation and any modifications or updates to the code take effect nationally to avoid the potential for inconsistent legislative changes in each jurisdiction.

While a code of conduct would be of most benefit to shopping centre tenants and landlords, its introduction would also potentially benefit the broader community by enabling the more prescriptive aspects of the current State and Territory regulation to become redundant and be repealed and by reducing the need for legislative reviews.

RECOMMENDATION 5

State and Territory governments in conjunction with the Commonwealth, should facilitate the introduction, by landlords and tenant organisations in the industry, of a voluntary national code of conduct for shopping centre leases that is enforceable by the ACCC. The code should:

- ***include provisions for standards of fair trading, standards of transparency, lodgement of leases, information provision and dispute resolution; and***
- ***avoid intrusions on normal commercial decision making in matters such as minimum lease terms, rent levels, and the availability of a new lease.***

Remove constraints on commercial decision making

The Commission was advised of a number of areas in which retail tenancy regulation is unduly prescriptive or frustrates the execution of commercial contract obligations and rights, and thereby imposes costs on participants in the shopping centre and broader market for retail tenancies (chapter 10).

In particular, the Commission's attention was drawn to some differences between the regulation of retail tenancy leases and the less prescriptive regulation of the broader market for commercial leases. Mandatory retail lease provisions, such as the right to renew a lease or the imposition of a minimum lease term (which does not reflect commercial reality for many businesses), tend to drive a wedge between the market for leases under retail tenancy regulation and the broader commercial tenancy market and provide no clear public benefits. The prescription of which expenses are included in outgoings is also likely to unduly restrict commercial negotiations.

The legislated guidelines for the assignment of retail leases also differs, in most jurisdictions, from that in the broader commercial tenancy market. Application of those guidelines could have unintended adverse side effects including the restriction of businesses from entering or leaving the retail tenancy market and lower productivity of businesses in the market (chapter 10).

The Commission's assessment is that provisions in retail tenancy legislation (such as minimum lease terms, preferential rights of renewal, lease assignment and outgoings) should be evaluated using the principles set out in chapter 5. Retail tenancy provisions that potentially constrain the efficient operation of the retail tenancy market, or that do not provide any clear public benefit, should be removed.

RECOMMENDATION 6

State and Territory governments should remove those key restrictions in retail tenancy legislation that provide no improvement in operational efficiency, compared with the broader market for commercial tenancies.

Further measures for the medium term

The Commission recommends further regulatory changes over the medium term (two to five years) in order to lower administration and compliance costs for governments and businesses operating with retail tenancy regulation and explore opportunities to reduce planning and zoning constraints on the supply of retail space.

Improving national consistency of tenancy regulation

The Commission's assessment is that there is merit in moving toward a national approach to retail tenancies through the establishment of nationally consistent reference or model legislation. The idea of a national approach is compatible with a simplification of regulation in the market and the adoption of a national code of conduct for shopping centre leases. It is also consistent with increased alignment in the operation of retail tenancies with practices in the broader commercial tenancy market. There has been considerable support for a national approach, from a cross section of market participants (chapter 10).

A nationally consistent reference or model for retail tenancy legislation should be guided by the principles provided in chapter 5 and focus on provisions that establish lease rights and commercial processes, rather than prescriptive guidelines for contractual outcomes (for example, it would avoid provisions that specify minimum lease terms and other conditions). Fundamental differences between retail formats could be enabled through use of alternative schedules in the model legislation. The model would be available to be referred to in each State and Territory's legislation or codes of practice, as determined appropriate by the jurisdiction, with minimal jurisdiction-specific provisions (chapter 10).

During consultations, the Commission's attention was drawn to the view that the less populous jurisdictions potentially did not need as detailed and complex legislation as the more populous jurisdictions that have larger and more complex local economies. This view is evidenced by current regulatory differences between jurisdictions. To reflect differing needs while maintaining consistency with the national model, the model legislation should contain broad principles for retail tenancy regulation that are relevant in every jurisdiction, such as processes for lease negotiation, operation, dispute resolution and information disclosure. A State or Territory's legislation would then refer to the model legislation for national consistency, but also include regulations specific to that jurisdiction's retail tenancy market.

RECOMMENDATION 7

As unnecessarily prescriptive elements of retail tenancy legislation are removed, State and Territory governments should seek, where practicable over the medium term, to establish nationally consistent model legislation for retail tenancies, available to be adopted in each jurisdiction.

Explore opportunities to reduce constraints on the supply of retail space

The Commission considers that there is scope to increase retailing opportunities and competition in the retail tenancy market for the benefit of new entrants to the sector and consumers more generally. While recognising the merits of zoning and planning controls in enhancing public amenity and economising on the use of public infrastructure, the application of such controls restrict the availability and use of retail space and can reduce competition. The Commission believes that it would be appropriate for State and Territory governments to examine the potential to relax those zoning and planning controls that unduly restrict the availability of retail space and the conditions under which it is utilised.

RECOMMENDATION 8

While recognising the merits of planning and zoning controls in preserving public amenity, States and Territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation.

Longer-term regulatory focus

The focus of tenancy regulation in the longer term should shift from shopping centres to the retail tenancy market more generally. This would be possible following the introduction of a voluntary national code of conduct for shopping centre leases and a corresponding reduction in those aspects of retail tenancy legislation that are prescriptive of commercial outcomes. Any further regulatory changes should build on the benefits of the above recommended changes.

In particular, States and Territories should seek to maintain national consistency in tenancy regulation in the longer term and reduce differences between the operation of retail tenancies and the operation of tenancies in the broader market for commercial leases. Inconsistency in tenancy regulation potentially raises business costs and may hinder business expansion across jurisdictions. The Commission's assessment, therefore, is that the most appropriate approach to lower compliance and administrative costs in the longer term would be for each State and Territory to implement a nationally consistent regulatory framework, by reference to nationally consistent model legislation.

Consideration should also be given to enabling tenancy information and dispute resolution services to be available (in those jurisdictions that do not already do so), to small businesses in the commercial leasing market, as well as those in the retail tenancy market.

11.3 Implementation, adjustment issues and impacts

Implementation options

The power to regulate with respect to property and the leasing of property resides under the Constitution, with the States and Territories. Consequently, a number of the Commission's recommendations for retail tenancy regulation can only be effected by the States and Territories.

Some of the recommended changes could be implemented independently in each jurisdiction. For example, each State and Territory could, within their retail tenancy market, act to:

- further improve transparency and accessibility;
- enable market participants to lodge lease summaries at a publicly accessible site;
- relax key legislative restrictions; and
- examine planning and zoning controls (recommendations 1, 2, 6 and 8).

These aspects of regulatory change could be facilitated by a small business tenancy office in each State and Territory (as described in chapter 10).

However, given an overall goal for increased national consistency, some coordination and agreement between States and Territories would be necessary to implement the following aspects of an alternative regulatory framework for retail tenancies:

- improving national consistency and administration of lease information;
- aligning provisions for unconscionable conduct;
- facilitating the introduction of a voluntary national code of conduct for shopping centre leases; and
- establishing and implementing nationally consistent legislation for retail tenancies (recommendations 3, 4, 5 and 7).

Consistency in information provision and unconscionable conduct provisions

To improve the consistency and administration of lease information and bring about greater alignment in unconscionable conduct provisions, some coordination and agreement is necessary between jurisdictions. This may be facilitated by the creation of a working group (consisting of industry and government representatives from each jurisdiction) to operate either within the COAG framework or under the

guidance of an agency in the Australian government (such as the Office of Small Business).

Development of a code of conduct

The development and introduction of a voluntary national code of conduct for shopping centre leases should primarily be an industry initiative and be administered by the industry itself. To ensure the workability of the code, it should be adopted (or not) in its entirety by landlords and tenants — rather than enabling market participants to choose which parts they wish to adhere to. Those landlords and tenants who do become signatories to the code should (while governments are relaxing constraints in retail tenancy regulation), then be exempt from the related provisions of state retail tenancy legislation.

For signatories of the code, dispute resolution would be governed by provisions in the code and be coordinated with existing dispute resolution services and small business tenancy agencies. Formal monitoring procedures should be established in each jurisdiction to ensure that once the code of conduct is operational, restrictive provisions of state retail tenancy legislation are repealed. The Commission recommends that the code be enforceable by the ACCC. A less stringent requirement that could be considered is for industry to administer and enforce the code.

Achieving national consistency in legislation

Under the current division of legislative power between States and the Commonwealth, national consistency in regulation between the States and Territories would require the creation of 'model' legislation. The model legislation could contain broad principles for retail tenancy regulation that are relevant in every jurisdiction, such as processes for lease negotiation, operation, dispute resolution and information disclosure.

There are several possible options for the *creation* of this legislation and for the process by which it is adopted. One option to facilitate the creation of model legislation is for an agency within the Australian Government (such as the Office of Small Business) to coordinate the development of legislation in conjunction with representatives from States and Territories and from industry. State and Territory representatives may include the small business tenancy office in each jurisdiction. Another option could involve the establishment of a working group comprised of representatives from each jurisdiction, to operate within the COAG framework. Under either of these options, the model legislation could be drafted by one of the states, but not formally enacted.

Several legislative approaches are available to achieve nationally consistent *adoption* of the model legislation in each State and Territory. One approach is for the model legislation to be enacted, without modification, in each jurisdiction. Such an approach may be inflexible to jurisdiction-specific circumstances and it could be difficult to maintain the timeliness and consistency of updates. In the retail tenancy market, such an approach is unlikely to be workable, given differences in property law and the retail tenancy market between jurisdictions.

An alternate approach for nationally consistent adoption is for the model legislative provisions to be referenced (either in part or in its entirety) in the retail tenancy legislation of each State and Territory. State or Territory specific regulations may also be included in each jurisdiction's relevant tenancy legislation to account for differences in background law. This approach to the achievement of national consistency has merit and is preferred by the Commission as it would enable future agreed amendments to the model being applied throughout Australia at the same time, while maintaining flexibility for jurisdiction-specific requirements, and avoids the need for regular updates to legislation in each jurisdiction.

Adjustment issues and impacts

Reforming the retail tenancy market along the lines suggested by the Commission is likely to improve the efficiency of its operation, and be of benefit to Australian consumers and the economy more broadly. It is evident that information and skill gaps persist in the sector, that the current framework is constraining business decision making, and that additional costs are incurred due to differences in State and Territory regulation. While inquiry participants have indicated that these costs are not high for an individual business, cumulatively, they could be substantial for the community — particularly if passed on by retailers as higher prices to consumers. Furthermore, to the extent that tenancy legislation does impose a burden on businesses, it may be more of a burden for smaller landlords and tenants. Studies of compliance with regulation in other sectors of the economy indicate that the burden of compliance can be disproportionately larger for small businesses (NARGA 2005; Bickerdyke and Lattimore 1997).

Addressing identified gaps and shortcomings is likely to increase flexibility in lease terms, improve business and government decision making and lower administrative and compliance costs. However, there has been little quantitative evidence provided to this inquiry to indicate the *magnitude* of potential reform benefits or the costs to industry and government of achieving those benefits.

It is acknowledged that some of the recommendations may, by changing the operating environment for landlords and tenants, alter the risks and returns

associated with operating in the retail tenancy market. For example, more flexible lease terms would enable tenants to negotiate leases that better align lease terms with business models. More information about lease markets would aid aspiring retailers to better choose their preferred retail model: whether it be an operation in the managed environment of a large shopping centre or a stand alone operation in a shopping strip. Further, improvements in efficiency and lower compliance costs could have wider implications for the financial institutions supporting tenants and property owners/managers, and for the investment and superannuation funds which invest in shopping centres in particular.

However, in formulating options for change, it should be noted that the focus of this inquiry — as defined by the terms of reference — is on the efficiency of the retail tenancy market. While it is not possible, nor appropriate, to assess the impact on individual traders and businesses (this will depend on how they respond to change), it is possible to indicate the broad direction of benefits. For example:

- An improvement in the efficiency and effectiveness of regulations affecting the market and dispute resolution procedures should directly benefit small landlords and tenants.
- Enabling the lodgement of lease summaries at a publicly accessible site should improve market information and assist in market valuations and lease negotiations of small landlords and/or tenants.
- Clarifying and testing the meaning of unconscionability should protect small business from egregious conduct and reduce constraints on negotiation options and commercial decision making.
- Introduction of a voluntary national code of conduct for shopping centre leases is likely to be of direct benefit to the operation of tenancies within centres, reducing tensions and the costs of doing business. It should also reduce the costs of retail tenancy regulation to the broader tenancy market and costs to the community of separate state regulatory updates to deal with shopping centre-specific issues.
- Increasing the flexibility of landlords and tenants in lease negotiations should improve the economic efficiency of business decisions.
- Reducing inconsistencies in the regulation of retail and commercial tenancies and in the regulation of tenancies across jurisdictions should reduce compliance costs to businesses operating in the respective markets, and associated adverse allocative effects arising from those differences.

Balanced against these benefits, additional government administrative costs could be incurred in collating or providing additional tenancy market information; dealing with information requests and disputes; investigating and prosecuting for violations

of a voluntary code of conduct; and in developing and applying national reference lease documentation and nationally consistent tenancy regulation.

However, as noted in the Commission's assessment, reforming the retail tenancy market along the lines recommended is likely to improve the overall efficiency of the market and provide benefits for the Australian economy and consumers.

A Consultation

A.1 Conduct of the inquiry

Following receipt of the terms of reference, the Commission placed advertisements in national newspapers inviting public participation in the inquiry. An initial circular and issues paper was released in June 2007.

The Commission received a total of 211 submissions, with 140 received prior to the release of the Draft Report. These submissions are listed in section A.2. (An asterisk indicates that the submission contains confidential material.) All public submissions are available on the Commission's website.

The Commission consulted with a range of interested parties. A listing of the visits and informal discussions undertaken is provided is section A.3.

The Commission also undertook public hearing after the release of the draft report in most Australian capital cities. A listing of the hearing participants is provided in section A.4.

The Commission would like to thank all those who have contributed to the inquiry.

A.2 List of submissions

Participant	*Submission no.*
Amiott Retail Services	95
AMP Capital Investors Pty Ltd	87*
Angus and Robertson, Edwardstown SA	142
Australian Competition and Consumer Commission	128
Australian National Retailers Association	92
Australian Newsagents' Federation Ltd	72*, DR150, DR179
Australian Property Institute Inc	70, DR172
Australian Retail Lease Management	96*, 105*, DR189, DR196, DR205, DR206*, DR210*
Australian Retailers Association	119
Barry & Nilsson Lawyers	DR164
Mr Don Blunt	36*

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Participant	*Submission no.*
Mr Peter Branch	13*
Bright Eyes Sunglasses	32
Brittcal Pty Ltd	42*
Ms Jenny Buchan	139
Bulky Goods Retailers Association	126, DR201
Mr Perce Butterworth	56
Byron Bay Longboards	5*
Mr Brett Carlton	80
Carnaby Holdings Pty Ltd	24*, DR158
Centro Properties Group	77*
Chamber of Commerce and Industry Western Australia	DR192
Chesterton Corporate Property Advisors	97
Chief Minister – Australian Capital Territory	103
Coles Group	48
Colonial First State Property Management Pty Ltd	78, DR199*
Competitive Foods Australia Pty Ltd	122, DR177, DR186
Constantine & Co	DR160
Corporate Property (Qld) Pty Ltd	61*
Council of Small Business of Australia	94*
Professor Neil Crosby	84
Mr Bruce Crowe	102, DR173*
Mr Antonino De Lorenzo	93*
Department of Justice – Northern Territory	104
Department of Justice – Tasmania	110
Mr John Dickson	2
Professors WD Duncan and S Christensen	DR153
Ms Jacquie Eckford	12*
ELETRA Pty Ltd	60
Emil Ford & Co - Lawyers	DR182
Erina Fair Tenants Action Group	44*, DR180*
Eye Site Optical Pty Ltd	116*
Foodco Group Pty Ltd	106*
Franchise Advisory Centre	76
Franchise Council of Australia	117, DR174
Ms Erika Elizabeth Gay	21*
Hairq Pty Ltd	37*
Herro Solicitors	64, DR175, DR184*
Mrs Julie Huang	6*
Ms Vicki Hurst	DR168
Hype DC Pty Ltd	8*
Indcorp Franchisees' Association of Australasia	140*
Investment & Financial Services Association Ltd	52
Ipswich Leisure Pty Ltd	30
Jack Russell Art Galleries	1*
Mr Emile Jansen	DR185
Jones Lang Lasalle	62*

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Participant	*Submission no.*
Jonny's Donuts	4*
Kaos Surf	DR152*
KIKKI-K	23*
Kingley's Chicken Pty Ltd	9, 19, 41, DR149
Knight Frank Australia Pty Ltd	79
Law Council of Australia	68
Law Institute of Victoria	27, 141, DR147
Law Society of New South Wales	98*
Law Society of South Australia	DR197
LEASE1	31, DR163
LeaseWise Group Pty Ltd	DR165
Leasing Information Services	33*, DR156
Lenard's Pty Ltd	53*
Lend Lease Retail	59*
Mr Emmanuel Livanos	38*
Lottery Agents Association	63
Manna Confectionery Pty Ltd	DR143
Mr and Mrs P and N Mason	15*
MD Brick Pty Ltd	14*
Minister for Consumer Affairs – South Australia	99
Ms Karen Moore	11*
National Association of Retail Grocers of Australia	82
National Pizza Association	DR155
National Retail Association Ltd	47, DR162
Mr Con Natsis	127*
New South Wales Government	136
newsXpress Pty Ltd	51, DR169
P & S Business Brokers	73*
Panache Salons Pty Ltd	107*
Perron Group of Companies	58
Pharmacy Workshops Pty Ltd	DR187
Phatboys Thai Restaurants	20
Piper Alderman	101*
Post Office Agents Association Ltd	10
Property Council of Australia	66, DR203
QIC Properties Pty Ltd	46, DR204*
Queensland Government	123
Queensland Lease Consultants	54*, 108*, 120
Queensland Retail Traders and Shopkeepers Association	50, DR190
R & K Hansen Pty Ltd	49*
Raine & Horne Charlestown	DR159
Real Estate Institute of Australia	112, DR154
RejuvaNation Health and Lifestyle	17*
Retail Food Group Limited	69*
Retail Traders Association of WA	65, DR171
RICS Oceania	39

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Participant	*Submission no.*
Mr and Mrs Robert and Toni Thomas	22*
Mr and Mrs Ken and Jill Roberts	55*
Mr Gregory Schellnack	25*
Senator Andrew Murray	DR178
Shopping Centre Council of Australia Ltd	83, 138, DR193, DR202
Mr Steve Simpson	DR167
Small Business Development Corporation	91, DR194
Soothill & Associates	121
Southern Sydney Retailers Association, Inc.	90, 113, 114, 131, 134, 137, DR195
Southwick Goodyear Pty Ltd	40
Starshots Franchising Pty Ltd	16*, DR181
State Retailers Association of SA Inc, Drycleaning Institute of Australia (SA) and Shoe Repairers Association of SA	43
State Retailers Association of SA, Inc.	129
Stockland Trust Management Ltd	88*, 100*
Subway Systems Australia Pty Ltd	28
Tauren Pty Ltd	DR170
TCM Consulting	DR183
Tenancy Solutions	29*
The Bra Shop NSW Pty Ltd	35
The GPT Group	34
The Lease Police	89
The National Opal Collection	130*, 135
The Newsagents Association of NSW & ACT and Newstrade Advisory Services Pty Ltd	DR176
The Newsagents Association of NSW and ACT and Newsagents Australia	75
The Pharmacy Guild of Australia	109, DR208
The RETAiL Alert Group (Australia)	DR209
The Watchmaker	26*
Todd Trevaks Retail Consultant	DR166
Tom Komninos Pharmacies Pty Ltd	74*
Trevor and Angela Camage	7*
Tribe, Conway & Company	DR144
U2 Clothing Co Pty Ltd (KAOS Surf)	3*
Victorian Government	111, DR198
Western Australian Retailers Association	118*
Westfield Group	85, DR191
Mr Bruce York	18, DR157*
Yum! Restaurants Australia Pty Ltd	45*
Associate Professor Frank Zumbo	DR200
Details withheld	57*
Details withheld	67*
Details withheld	71
Details withheld	86*

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Participant	*Submission no.*
Details withheld	91*
Details withheld	115
Details withheld	124
Details withheld	125
Details withheld	132*
Details withheld	133*
Details withheld	DR145*
Details withheld	DR146*
Details withheld	DR148*
Details withheld	DR151
Details withheld	DR161
Details withheld	DR188*
Details withheld	DR207*
Details withheld	DR211*

A.3 Visits and informal discussions

Sydney

AMP Capital Investors Pty Ltd
Australian National Retailers Association
Australian Property Institute
Australian Retailers Association
Department of State and Regional Development
Egan National Valuers
Erina Fair Tenants Action Group
John L Hill & Co.
Landmark White
Leasing Information Services
Lend Lease Retail
Macquarie CountryWide Management Limited
New South Wales Department of State and Regional Development
Property Council of Australia
Shopping Centre Council of Australia
Small Business Summit (July 2007)
Stockland Trust Management Ltd
The GPT Group
Valad Property Group BGRA 2007 NSW Forum
Westfield Group
Associate Professor Frank Zumbo, UNSW

Melbourne

Bulky Goods Retailers Association
Erina Fair Action Group
LeaseWise
Minter Ellison
Office of the Victorian Small Business Commissioner
The Lease Police

Brisbane

Bank of Queensland
Professors Sharon Christensen and Bill Duncan, QUT
L.J. Hooker Commercial, Brisbane
National Retailers Association
Retail Shop Leases Registry, Queensland Government

Adelaide

Balfours Bake Café
Carrig Chemists
Independent Property Advisors
Office of Business and Consumer Affairs, South Australia
NASA Services
Southwick Goodyear
State Retailers Association of SA Inc
Tenancy Solutions

Canberra

ACT Office of Fair Trading
Australian Competition and Consumer Commission
CB Richard Ellis
Colliers International
Council of Small Business of Australia (Teleconference)
Department of Industry Tourism and Resources – Office of Small Business
National Federation of Independent Business – ACT Branch
Real Estate Institute of Australia
The Treasury
Wellsmore & Co

Tasmania
Office of Consumer Affairs and Fair Trading (Teleconference)

Northern Territory
Office of Consumer and Business Affairs (Teleconference)

A.4 Public hearing participants

Date	*Participant*	*Transcript page no.*
Canberra		
1 February 2008	The Pharmacy Guild of Australia	2 – 13
	Real Estate Institute of Australia	14 – 26
	Australian Newsagents' Federation Ltd	27 – 39
	Kingsley's Chicken Pty Ltd	40 – 50
Sydney		
4 February 2008	Australian Retailers Association	53 – 68
	Hype DC Pty Ltd	69 – 77
	Shopping Centre Council of Australia	78 – 105
	Southern Sydney Retailers Association	106 – 133
	Erina Fair Tenants Action Group	134 – 150
	Michael Bradley	151
5 February 2008	Carnaby Holdings Pty Ltd	153 – 164
	Herro Solicitors	165 – 185
	Leasing Information Services	186 – 206
6 February 2008	Bruce Crowe	208 – 219
	Bruce York	220 – 235
	Ken Roberts	236 – 246
	Michael Bradley	247 – 265
	Council of Small Businesses of Australia	266 – 324
7 February 2008	Associate Professor Frank Zumbo	325 – 343
	The Pharmacy Guild of Australia	344 – 357
	Competitive Foods Australia Pty Ltd	358 – 380
	The Newsagents' Association of NSW & ACT Ltd	381 – 399
Brisbane		
11 February 2008	Barry Nilsson Lawyers	402 – 409
	National Retail Association	410 – 423
		439 – 441
	Lease1	424 – 433
	The Pharmacy Guild of Australia	434 – 439
	Queensland Retail Traders & Shopkeepers Association	442 – 455

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Date	*Participant*	*Transcript page no.*
Melbourne		
13 February 2008	Australian Property Institute	456 – 478
	LeaseWise Group	479 – 491
	newsXpress	492 – 504
	Geoff Hechtman and Graeme Woods	505 – 515
	Tauren Pty Ltd	516 – 524
	Todd Trevaks Retail Consultant	525 – 534
	Simon Forsyth	535 – 553
	Australian Retailers Association	554 – 572
15 February 2008	Franchise Council of Australia	573 – 591
	TCM Consulting	592 – 601
	Veritax Business Consultants	602 – 621
	Law Institute of Victoria	622 – 642
	The Pharmacy Guild of Australia	643 – 658
	Newsagency Concepts	659 – 663
Perth		
18 February 2008	Pharmacy 777	666 – 676
	The Pharmacy Guild of Australia	677 – 687
	Retail Traders Association of WA	688 – 708
	WA Retailers Association and Australian Newsagents' Federation Ltd	709 – 741
	Tia Belau Pty Ltd	742 – 756
	Savills	757
	Whistle Stop Kiosk	757 – 758
Adelaide		
20 February 2008	The Pharmacy Guild of Australia	762 – 778
	Manna Confectionery	779 – 792
	State Retailers Association of SA	793 – 835

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THE HONOURABLE CHRIS PEARCE MP

Parliamentary Secretary to the Treasurer
Federal Member for Aston

0 3 OCT 2007

Mr G Banks AO
Chairman
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Mr Banks

Thank you for your letter of 21 September 2007 to the Treasurer seeking an extension to the reporting date for the Productivity Commission inquiry into the market for retail tenancy leases in Australia. The Treasurer has asked me to respond to you on his behalf.

I understand that the Commission has engaged in extensive consultation and has identified a number of issues that warrant further investigation before the Commission can issue a draft report and that several key submissions have only recently been lodged with the Commission. I therefore agree to the extension requested. The Commission should now provide a final report to the Government by 31 March 2008.

I look forward to receiving a copy of the Commission's report.

Yours sincerely

CHRIS PEARCE

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