SUBMISSION by
THE PHARMACY GUILD OF AUSTRALIA to the PRODUCTIVITY COMMISSION

INQUIRY INTO THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

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1. The Pharmacy Guild of Australia

1.1 The Guild is a national employers' organisation registered under the *Workplace Relations Act 1996*, which functions as a single legal entity rather than a federation. It was first established in 1928 and currently has Branches in every State and Territory. The Guild's members are the pharmacist proprietors of some 4,500 community pharmacies, which are small retail businesses operating throughout Australia. Almost 80% of all pharmacist proprietors are Guild members.

1.2 Community pharmacy makes a significant contribution to the Australian economy with an annual turnover of $8 billion and $200 million in tax revenue, employing some 15,000 salaried pharmacists and 25,000 pharmacy assistants. Through the Pharmacy Assistant Training Scheme, the Pharmacy Guild provides a significant career path for young Australians, particularly young Australian women.

1.3 The Guild's mission is to service the needs of proprietors of independent community pharmacies. The Guild aims to maintain community pharmacies as the most appropriate primary providers of health care to the community through optimum therapeutic use of medicines, medicine management and related services. A range of services are provided to members including:

(a) to negotiate an ongoing Agreement between the Government and the Guild to facilitate suitable conditions for approved pharmacies to dispense under the PBS, including an appropriate level of remuneration;

(b) to maintain close liaison and negotiation with governments, manufacturers, wholesalers and other organisations involved in the health care delivery system;

(c) to implement strategies to enhance the professional role of pharmacists and to assist community pharmacists practising in rural and regional areas of Australia to ensure that the current network of community pharmacies in Australia is maintained; and

(d) to provide economic and management information to community pharmacists to assist them in making their pharmacies more efficient.

2. Executive Summary

2.1 Retail Tenancy and Community Pharmacy

2.1.1 Conditions around retail tenancy, particularly in shopping centres, is one of the issues most commonly raised by small businesses as an example of where they encounter unfair trading practices which impact negatively on the operation of their businesses. They believe they have no protection against this unfair behaviour because they have no bargaining power against the might of the shopping centre owner and because the Trade Practices Act is inadequate in this respect.

2.1.2 With regard to community pharmacy, this is certainly the major area of dispute.

2.2 Trade Practices Act

2.2.1 The collective bargaining provisions contained in the *Trade Practices Act* are cumbersome and the ambit of section 51AC illusory.

2.2.2 In that context, there is desirability for parliaments to make clear what behaviours are not permissible. Prohibition of asking for "key money" should clearly be contained in legislation, as well as defining with greater clarity key concepts such as the determination for market rent for leases.

2.2.3 To do so would:

- lower transaction costs – all parties will know what behaviour is proscribed and what is not;
- reduce the need to have matters resolved by arbitration – particularly when, in the alternative, the nebulous concept such as "unconscionable conduct" is being assessed;
    - reduce information asymmetry – tenants (both sitting and prospective) will need to reduce the areas that they would have to research prior to commencing negotiations; and
    - address the clear inequality of bargaining power between tenants, who are typically either sole traders, partnerships or $5 companies, and listed corporations.

2.3 Uniform Tenancy Legislation

2.3.1 There should be uniform retail tenancy legislation. A body, perhaps the Small Business Ministerial Council at the direction of COAG, should bring together those provisions currently contained in Australian retail tenancy legislation into one Bill that all Australian jurisdictions can incorporate by reference or, alternatively the Australian Parliament could enact relevant legislation using legislation similar in nature to the *Independent Contractors Act 2006.*

2.4 Further Additions to Tenancy Legislation to be included Australia wide

2.4.1 The following further provisions should also be included in any amendments to Australia's retail tenancy law.

2.4.2 Access to a rent review on a market value basis, or short-term compensation, on application by a tenant should be provided where there is:

(a) a general downturn in the overall economy, such as shown by negative CPI, or a change in local environmental conditions which has a negative impact on business in the area;

(b) refurbishment of a complex, particularly where it continues over a long period of time and impedes store traffic into a business;

(c) the addition of a competitor (eg. in the context of pharmacy, another pharmacy) to the mix of the shopping centre; and

(d) particular alterations to statute affecting the particular tenant.

2.4.3 The goodwill or the "going concern value of existing fixtures and fittings" are not to be subsumed into the rent during rent negotiations.

2.4.4 There leases require compulsory refurbishment by the tenant, there should be a compensatory increase in the length of a lease term.

2.4.5 There be complete transparency in the negotiation process – the landlord should be required to disclose to the prospective tenant and professional adviser on a "privileged" basis the data and assumptions used by the landlord in calculating the proposed rent, as well as the overall Moving Annual Total (MAT) sales figures and trends, figures for total speciality sales, particular retail categories and customer counts and trends and the rent payable by the larger "anchor" tenants.

2.4.6 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.

2.4.7 For those shopping centres calculating rent on the basis of the turnover performance by retail category (as one significant retail landlord does), the leases of like shops must be compared with the leases of other like shops.

2.4.8 It is not appropriate for percentage rents to be charged on pharmacy revenues. Percentage rents have been 'statute barred' in some jurisdictions and should be barred in all other jurisdictions.

2.4.9 There should be a demolition clause included in the lease which specifies that, in the case of the demolition of the centre, appropriate compensation will be paid to tenants.

2.4.10 In the event of lease renewal not being offered, there should be compensation for the "going concern" value of existing tenants fixtures and fittings, to the extent that they would be relevant to a new lease.

2.4.11 Section 29 of the Retail Shop Leases Act 2004 (Qld) should be used as the model to ensure uniformity in the manner by which current market rent for a tenancy is determined.

3. The Rationale Behind Retail Tenancy Legislation

If all parties to a lease adopted good and fair business practices, there would be little need for the regulation of retail tenancies. Unfortunately this is not always the case. Governments across Australia have recognised this and have introduced retail tenancies legislation that establishes minimum requirements to promote fair outcomes. This legislation is intended to encourage an environment of fairness so that landlords and tenants mutually benefit. The government has legislated to ensure that a party does not unfairly take advantage of its superior information and negotiating power to the detriment of the other party.

Minister for State and Regional Development, introducing the Retail Leases Bill into the Victorian Parliament 10 October 2002 p.516

3.1 Retail tenancy legislation is remedial legislation. It recognises both:

- the clear imbalance of the relative bargaining position of the listed companies operating the larger shopping centres and small business tenants such as pharmacies; and
- the information asymmetry between companies specialising in the leasing of commercial properties and small business operators who may only have to consider leasing issues a couple of times during their business career.

3.2 In introducing the Retail Leases Bill into the NSW Parliament in 1994, the Minister for Small Business and Regional Development said:

> In an ideal world this bill would not be necessary. In an ideal world parties to a retail leasing agreement would be fully aware of their own and the other party's commitments and obligations before they entered into such a lease agreement. Issues arising during the course of an agreement would be dealt with according to the terms of that lease agreement, and any disputes would be dealt with through negotiation between the parties. The truth of the matter, however, is that retail tenancies are often a matter of contention, and have been for a long time. All honourable members would have received representations on such matters - many of them quite distressing given that they are matters that have a fundamental effect on the ability of people to get on with their business and earn a living.
>
> The bill I have introduced today is intended to foster good leasing practices in the retail industry, nothing more and nothing less. The Government does not wish to interfere in commercial agreements between two parties. It seeks to ensure that retail leasing agreements are explicit as to the requirements of both parties and that they are entered into from a position of reasonably equal negotiating strength. [1]

3.3. The legislation was introduced after both a mandatory code of practice made under the NSW *Fair Trading Act 1987* and a voluntary code of practice failed due to (amongst other reasons) significant non-compliance with the documents.[2]

3.4 The underlying imbalance of negotiating power between landlords and tenants, recognised by Australian legislatures during the 1990s (including the Australian Parliament, remains - as evidenced by enactment of legislation such as section 51AC of the *Trade Practices Act 1974*).

[1] NSW Legislative Assembly *Hansard* 20 April 1994 p.1547
[2] Ibid p.1548

3.5 Therefore, Australian legislatures have:

- prohibited *per se* contractual devices such as ratchet clauses and key money;
- required, in most jurisdictions, leases to be at least of 5 years duration; and
- required disclosure statements to be provided to prospective tenants, so information is available such as to allow quality decisions to be made.

3.6 This style of remedial legislation is particularly important for the pharmacy sector, as Australian parliaments have decided that it is in the public interest that only pharmacists or companies controlled by pharmacists may operate pharmacies, which, as with any other small business tenancy, must be able to operate on a "continuity of business basis".

3.7 Businesses with these structures can never have the same bargaining power as the listed corporations that typically own or operate the larger shopping centres that serve Australian shoppers.

3.8 Whilst the Shopping Centre Council of Australia media release[3] responding to the announcement of this reference suggests there is a "remarkably low" level of disputation – that is to say, few cases are referred to statutory dispute resolution processes – the Guild receives numerous complaints from constituents about the behaviour of some shopping centre proprietors.

3.9 It is 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 – involved in preparing for dispute resolution; and
- the practical requirement of maintaining a commercial relationship with a landlord.

3.10 A representative selection of complaints received by the Guild is contained in case studies appended to this submission.

3.11 The Guild is therefore of the view that specific retail tenancy legislation should be retained, with the additional provisions, discussed later in this paper, added. At the very least, these provisions should remain to improve the equality of bargaining provisions between tenants and operators of "retail shopping centres".[4]

[3] Shopping Centre Council of Australia *Productivity Commission Inquiry Into the Market for Retail Tenancy Leases* Media Release 19 June 2007

[4] The consensus position of what is a "retail shopping centre" is a cluster of 5 shops in the same general spatial location, as is the case in Queensland, WA and the NT.

4. The Trade Practices Act

4.1 There is some suggestion that amendments to the *Trade Practices Act 1974* creating:

- the ability for small business to collectively bargain with larger entities; and
- the unconscionable conduct provision created in section 51AC of the Act

may provide the mechanisms to deal with the imbalance of bargaining power between landlord and tenant.

4.2 However, the collective bargaining provisions are cumbersome. It is theoretically possible for all the tenants in a particular complex to band together to negotiate with the landlord. However, there would need to be:

- a common start dates and lengths of lease;
- both a common goal and a set of common terms they can all agree to;
- a common "target" (as the legislation describes it) landlord[5];
- a willingness to provide some commercial in confidence data to the bargaining agent; and
- a consensus about who will be the bargaining agent representing the group

before a collective bargaining application could commence.

4.3 Under the new collective bargaining provisions, so long as formalities have been complied with, the Australian Competition and Consumer Commission (ACCC) has correctly indicated that in determining whether it proposes to object to a collective bargain it must decide whether the threshold "public interest test" – that the benefit to the public that would result or is likely to result is not outweighed by the detriment to the public – has been met.[6]

4.4 However, the prescribed application form indicating the information that the ACCC thinks it is necessary to conduct a "desk top" public interest assessment, requires such specific points of submission and the provision of such detailed evidence with respect to issues such as:

- market definition;
- public detriment; and
- public benefit

that it would be difficult for a group of small business operators in the retail tenancy environment to have either the resources or the skill set to marshal the required information that a highly trained public sector economist would consider sufficient to determine "public interest", without professional assistance.[7]

[5] For an example of the use of the term "target" in legislation in the Act, see subsection 93AB(1)
[6] ACCC *Guide to Collective Bargaining Notifications* January 2007 p.3
[7] See the requirements required by Form GA *Notification of Collective Bargaining* contained in Schedule 1 to the *Trade Practices Regulations 1974*, particularly Part C.

4.5 It is also the case that each individual business operates under its own circumstances, for example, having different profitability levels, operating under either a new or a soon to be expired lease, or being a franchisee whose franchisor may not want to "rock the boat" etc.[8] Thus a "one size fits all" conclusion, that collective bargaining implies, is simply not realistic.

4.6 It is therefore no surprise that at the time of writing, no group of small businesses in the retail tenancy environment have notified the ACCC that they are entering into a collective bargain with another larger entity.[9]

4.7 Moreover, the ambit of section 51AC may be regarded as illusory. The section lists a number of circumstances that a court may "have regard to" when considering whether a party is involved in unconscionable conduct.

4.8 It is noted that the explanatory memorandum to the Trade Practices Amendment Bill (No.1) 2007, currently before Parliament, says that the Bill adds "the capacity of one party to unilaterally amend a contract" to what is described as the "non-exhaustive list of matters" that *can* be considered when considering whether a party has displayed unconscionable conduct.[10]

4.9 Recent cases that have considered the section, such as *Bowen Investments Pty.Ltd v. Tabcorp Holdings Ltd*[11] and *Coggin v. Telstar Finance Company (Queensland) Pty.Ltd*[12] have held that the notion of unconscionability used in the section is wider than that recognised by the common law in Australia.

4.10 However, as the Full Federal Court said in the leading case of *Hurley v. McDonalds Australia Ltd*:

> For conduct to be regarded as unconscionable, serious misconduct or something **clearly unfair or unreasonable**, must be demonstrated - *Cameron v Qantas Airways Ltd* (1994) 55 FCR 147 at 179. Whatever "*unconscionable*" means in sections 51AB and 51AC, the term carries the meaning given by the Shorter Oxford English Dictionary, namely, actions **showing no regard for conscience**, or that are **irreconcilable with what is right or reasonable** - *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246 at 262. The various synonyms used in relation to the term "*unconscionable*" import a **pejorative moral judgment** - *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246 at 283-4 and 298.[13]

[8] It is no surprise that the one collective bargain notification apparently made, from the South East Potato Growers Association (A91057, lodged 9 July 2007), constituted a group of people with extremely similar interests and providing a bulk commodity to a small discrete market of purchases (potato farmers providing potatoes to a single large frozen food manufacturer)

[9] The ACCC collective bargaining register (http://www.accc.gov.au/content/index.phtml/itemId/773840/fromItemId/6031), when accessed on 27 July 2007 indicates that "there are no collective bargaining notifications under consideration".

[10] See paragraphs 2.35 and 2.150 of the Regulatory Impact Statement, and the clause note to Item 5 contained in the Explanatory Memorandum of the Trade Practices Legislation Amendment Bill (No.1) 2007, as originally circulated by the Treasurer

[11] [2007] FCA 708 (18 May 2007). See in particular paragraph 73

[12] [2006] FCA 191 (10 March 2006). See in particular paragraph 57

[13] [1999] FCA 128, paragraph 22. Underlining added. Other emphasis in the original.

4.11 It is also noted that the NSW Court of Appeal has said in *Attorney-General of New South Wales v. World Best Holdings and Ors* in relation to NSW legislation being similar in construction to section 51AC[14]*:*

> 121 The Ministerial Second Reading speech, quoted above, **indicates a similar concern to distinguish what is unconscionable from what is merely unfair or unjust**. Even if the concept of unconscionability in s62B of the *Retail Leases Act* is not confined by equitable doctrine, as the decisions under s51AC of the *Trade Practices Act* suggest, **restraint in decision-making remains appropriate. Unconscionability is a concept which requires a high level of moral obloquy. If it were to be applied as if it were equivalent to what was "fair" or "just", it could transform commercial relationships in a manner which the Minister expressly stated was not the intention of the legislation. The principle of "unconscionability" would not be a doctrine of occasional application, when the circumstances are highly unethical, it would be transformed into the first and easiest port of call when any dispute about a retail lease arises**.
>
> ……...
>
> 123 There is a suggestion that the Tribunal in the present case may have adopted an unacceptably low standard. After setting out its conclusions, the Tribunal found: "we consider the conduct of WBH to be quite unacceptable ... having regard to normal industry standards and practices" (at [69]). It then proceeded to determine what were called "the legal issues", including unconscionability, by identifying which of the considerations in s62B(3) of the *Retail Leases Act* were applicable without further analysis of matters of fact and degree that need to be considered when applying a test of unconscionability. **If, as appears likely, a test of "unacceptable conduct" were adopted, this is a far lower standard than unconscionability**.
>
> 124 The matters to be considered under a retail tenancy claim, turning on the contract and well-established doctrine, were intended by Parliament to continue to have considerable scope**. The Parliament was careful to ensure that the amorphous and ambiguous term, "unconscionability", did not come to completely override the legal rights and obligations created by the lease relationship. Parliament did not intend that "unconscionability" claims could be made so readily as to virtually take the place of retail tenancy claims. They needed to meet a high standard of moral obloquy**.[15]

4.12 It follows that section 51AC (and other similar provisions, as applied in State and Territory retail tenancy legislation) only adds a minor gloss to the traditional concept of "unconscionable conduct" – something which has disappointed many in the retail sector who were under the impression that the section went much further.

4.13 The phrase underlined in the extract from *Hurley* cited above also suggests merely adding "non-exhaustive" matters to be considered does not particularly aid courts to determine what it is the Parliament is attempting to achieve with the provision.

4.14 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.

4.15 A lot of money could therefore be spent for no return, even if an individual retailer had the resources and willingness to challenge a listed corporation, with whom the retailer still has to maintain a commercial relationship.

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[14] Section 62B of the *Retail Leases Act 1994* is, as far as relevant, drawn identically to section 51AC of the *Trade Practices Act*

[15] [2005] NSWCA 261. Emphasis added.

4.16 This uncertainty, together with the need to introduce substantial evidence so as to allow tribunals to act (including lower level administrative tribunals in states such as NSW and Victoria that must interpret legislation adopting the general legislative structure of section 51AC) means that these provisions offer little utility to small business.

4.17 In that context, there is desirability for parliaments to make clear what behaviour is and is not permissible, in the same way that prohibition on asking for "key money" is clearly contained in legislation, as well as defining with greater clarity important principles, such as how market rent for leases should be determined.

4.18 To do so would provide these public benefits:

- lower transaction costs derived from reducing complexity in negotiations – all parties will know what behaviour is proscribed and what is not;
- reduction in the need to have matters resolved by arbitration – particularly when the alternative is to determine whether the nebulous concept of "unconscionable conduct" is present in a particular case, offering savings in cost and time;
- reduction in information asymmetry – tenants (both sitting and prospective) will be able to reduce the areas that they would have to research prior to commencing negotiations; and
- reduction of the clear inequality of bargaining power between tenants, who are typically either sole traders, partnerships or $5 companies, and listed corporations, by ensuring as far as practicable that the tenant who builds value in a business is able to retain it.

4.19 These are reasons why, in a recent submission to the Senate Standing Committee on Economics, the Fair Trading Coalition called for section 51AC to be amended to *proscribe*:

- unilateral variation of contract or associated conduct;
- the termination of contract by one party without just cause or due process;
- the bringing into existence of documents or policies after signing the contract which are then binding and which can also be used to vary the original agreement or contract; and
- the presentation of "take it or leave it" contracts or agreements.[16]

The submission discusses some of the issues that should be clearly set out in legislation.

[16] Fair Trading Coalition *Submission to the Senate Standing Committee on Economics Inquiry Into the Provisions of the Trade Practices Legislation Amendment Bill (No.1) 2007 and the Trade Practices Amendment (Predatory Pricing) Bill 2007* 13 July 2007 p.6

5. Possible Additions to Retail Tenancy Legislation

5.1 Periodic Access to Rent Review on a Market-Value Basis

5.1.2 With the *per se* prohibition of ratchet clauses, landlords have chosen to alter rents using formulae such as base rate plus CPI, or base rate plus 1-2%, or straight uplifts such as an increase in rent of 5% p.a. For all intents and purposes, rents still go up and never down, and have over the longer term increased at a greater rate than aggregate specialty tenant sales, which obviously lead to higher retail prices for consumers.

5.1.3 It is noted that between 2000-01 and 2005-06, total specialty shop sales have only increased by $289 per sq.m or 4.33%; with a CPI increase of 15.3%, gross rents have increased by $262 per sq.m, indicating that over 90% of incremental sales have accrued to gross rent.[17]

5.1.4 There are some circumstances where this can be regarded as being unconscionable with regards to small business tenants, given that rent relief is typically given to anchor tenants in similar circumstances.

5.1.5 Access to a rent review on a market-value basis, on application by a tenant, should be provided where there is:

- a general downturn in the economy;
- refurbishment of a complex;
- the addition of a competitor (eg. in the context of pharmacy, another pharmacy) to the mix of the shopping centre; and
- particular alterations to statute affecting the particular tenant. For example, in the context of pharmacy, much of the remuneration comes from the operation of Pharmacy Agreements between the Australian Government and the Pharmacy Guild. In particular, these Agreements determine how much a pharmacist receives for providing medicines to consumers under the Pharmaceutical Benefits Scheme (PBS). An alteration to the remuneration formula can particularly impact on the viability of the pharmacist providing important health related services to the Australian community. Having rents continually increase without regard to this change in circumstance is clearly irreconcilable with what is right or reasonable. (See Appendix 3.)

5.1.6 This provides a reasonable outcome as this allows the landlord to receive, and for the tenant to pay, a fair market rent given the particular circumstances.

[17] Information drawn from comparing information contained in JHD *Retail Averages* March 2002 and *Regional Centres UrbisJHD Retail Averages 2005/2006*

5.2 Specific Pharmacy-Related Tenancy Issues

(See Appendix Three)

5.2.1 Statistically, approximately 70% of total pharmacy income derives from prescriptions and revenues that are directly related to supplying vital medicines to the Australian Community. Therefore, this revenue is substantially determined by Government policies and pricing controls, funding, and regulation of the number and location of pharmacy businesses for 'industry efficiency' purposes. Prescription turnover growth far exceeds prescription gross profit dollar growth.

5.2.2 The necessary pharmacy approval number is issued by the Government, to facilitate affordable, equitable access to services across all areas of Australia. The approval number is not issued by the Landlord, nor do landlords' actions materially affect the community's demand for pharmacy services.

5.2.3 The mark-up margins of prescription medicines are strictly controlled effectively at a maximum of 10% or less – which is undoubtedly one of, if not the lowest margin in the retail 'spectrum'.

5.2.4 The registered pharmacist, who must be on duty at all times, must be professionally qualified (four-year university degree), and needs to have additional industry training, before being eligible to independently commence business in his/her own business.

5.2.5 An increasing proportion of a pharmacist's time – driven by both community and Government expectation – is the provision of advisory and counselling health services relating to prescription and other medicines and health issues, for example obesity, diabetes, smoking cessation, etc. In general, pharmacists do not generate cost recovery revenue from the provision of these services. With a chronic shortage of doctors, this role is likely to increase.

5.2.6 The landlord, whether on a 'main street' or in a shopping centre, does not generate this demand; however it is an essential component of a shopping centre tenancy mix, and differs from most other retailers in being a destination in its own right – ie. a rent 'giver' or contributor rather than a rent 'taker' that trades off the anchors and other tenancies. Retail pharmacy must however compete with low-rent majors and other retailers for virtually all of its non-prescription business, on which it depends to 'subsidise' particularly the National Health Scheme (NHS)/PBS component of its income. Most such pharmacies operate at a relatively high level of retail efficiency.

5.2.7 The pharmacy located in a shopping centre must also compete with its peers in 'main street' locations, which enjoy much lower rents but are subject to the same Government regulations and other cost inputs. The consumer cost of PBS medicines is fixed for the vast majority of medicines and can not be discounted or surcharged.

5.2.8 For the above and other reasons, percentage rents have been 'statute barred' in some states, and arguably that has been the intention in other states, but compromised by poor drafting of legislation in those states.

5.2.9 In any event, it is no more appropriate for percentage rents to be charged on pharmacy revenues in shopping centres, than it would be for other professional services provided in shopping centre tenancies such as medical practices, accountancy/legal practices and others.

5.2.10 Market rental values for pharmacies can in most cases be reasonably assessed by 'benchmarking' a particular pharmacy against the average shop areas, passing gross rents in total and on a dollars per square metre basis – by reference to the type of shopping centre, for example, single supermarket, double supermarket, single and double discount department store, sub-regional, regional, and larger regional centres (as reported upon annually by Urbis JHD, in conjunction with the Shopping Centre Council of Australia). As market rents must be by definition 'reasonable', such outcomes can be checked and balanced against the particular pharmacy and its necessity to maintain profitability comparable to its "main street" competition. Surveys by the Pharmacy Guild extending to factual financial data of a large number of pharmacies can establish these benchmarks.

5.3 Leases

5.3.1 Business continuity is an important factor to small businesses such as pharmacies. Having a degree of security of tenure is important so that reasonable employment security for employees can be provided.

5.3.2 It is also important in circumstances such as the death of the registered pharmacist operating the business, or where there is a need to refinance a business or restructure any partnership operating the pharmacy – circumstances which have led some landlords to seek to impose a higher level of rent.

5.3.3 A lease term must be of sufficient length so as to be able to amortise all costs of establishment, operation, ongoing investment and trade to normal profitability.

5.3.4 However, many leases proceed on the basis that there is a high probability that leases will be renewed. Rental structures reflect this. This investment can include the purchase price of the business (or establishment costs), fitout (often fixed to walls) and building the brand value of the business as a business or as an established business trading at the location.

5.3.5 Most Australian jurisdictions effectively require landlords to offer leases over a five-year term – a period which 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. This is particularly so, given that the space usually only includes a floor and walls - the rest of the fitout is done at the expense of the business. In the case of pharmacies, fitouts are quite complex to accommodate prescription and other scheduling requirements. As a result, they usually are very expensive.

- It is noted that 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.

5.3.6 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. A reasonable term is necessary to repay debt.

5.3.7 Where leases are terminated against the wishes of tenants, where they are unable to relocate elsewhere, not only do tenants lose their business investment, they also are required to pay redundancy costs for their staff. There is no compensation for tenants to recoup these costs.

5.3.8 The value of the goodwill of a business is essential to the operation of a small business; without receiving value for it, the business cannot be sustained. It is simply wrong for a landlord to effectively capture any part of this goodwill. After all, a tenant cannot claim a rebate or recovery for the increase in the property value of the landlord's asset arising from the performance of the tenant.

5.3.9 An example of "capturing" goodwill is to decline to extend the lease of a tenant, but then immediately re-lease the same premises to another tenant on an as-is basis – the new tenant and the shopping centre gain the advantage of the goodwill built up by the previous tenant.

5.3.10 It is the experience of community pharmacies, made known to the Pharmacy Guild, that when renegotiating leases, landlords make an offer on a "take it or leave it basis" as someone else (unspecified as to use or identity) will take the premises. In the event of a similar use, this provides the landlord with the opportunity to secure a rental premium with the benefit of the existing lessees' fitout/services, and lessees' business goodwill arising from continuity of business, rather than the necessity to start up a substantially new business.

5.3.11 It is therefore desirable for legislation to make clear that:

(a) The goodwill or the "going concern value of existing fixtures and fittings" is not subsumed into the rent during rent negotiations.

(b) That there be complete transparency in the negotiation process – the landlord should be required to disclose to the prospective tenant and professional adviser on a "privileged" basis[18] the data and assumptions used by the landlord in calculating the proposed rent, as well as the overall Moving Annual Total (MAT) sales figures and trends, figures for total speciality sales, particular retail categories, customer counts and trends and the rent payable by the larger "anchor" tenants.

This will address a major difficulty faced by tenants when negotiating with landlords – the information asymmetry between the parties - without harming the landlord's capacity to negotiate with the tenant, or extracting a fair market value without lapsing into unconscionability.

[18] "Privileged" inasmuch as it would be a criminal offence for the tenant and professional adviser to provide the information to anyone else

The rationale in providing this information is similar to that which led the government to require petroleum producers to post on the internet the wholesale terminal gate prices that the petroleum producers are prepared to offer wholesale customers. It allows small business to make informed business decisions.[19]

(c) For those shopping centres calculating rent on the basis of the turnover performance by retail category (as one significant retail landlord does), the leases of like shops must be compared with the leases of other like shops.

For example, Urbis JHD publishes a table of retail averages in co-operation with the Shopping Centre Council of Australia. Pharmacies are combined with cosmetic stores – clearly substantially different businesses.[20]

The effect of this is to inappropriately combine pharmacies with specialist cosmetics retailers, thus inflating shop numbers, reducing average shop size and revenues, and inflating the occupation cost/sales ratios for the relatively low-margin pharmacies.

The false perception given to landlords by this inappropriate categorisation prejudices the viability of pharmacies providing services to shoppers in such shopping centres, which is a net public detriment given the statutory role pharmacies play in providing subsidised medicines to the community under the Pharmaceutical Benefits Scheme.

(d) In the event of lease renewal not being offered – there is compensation for the "going concern" value of the existing tenants' fixtures and fittings, to the extent that they would be relevant to a new lease – a particularly salient point given that for taxation purposes the Australian Taxation Office assumes 5% depreciation of fixtures and fittings (that is, there is an expectation that fittings etc. have a 20 year life). This would encourage more reasonable fitout and refurbishment requirements under leases, to better match the lease term, and a "bona fide" lease renewal process that would render any such payment unnecessary in most circumstances, as well as encouraging business continuity and investment.

Some governments have attempted to address this issue. One such example is Article 23 of the *Business Tenancies (Northern Ireland) Order 1996*. It is attached as an appendix to this submission. So that the party that creates the value (the tenant) does not see it captured by another (the landlord or an incoming tenant), it is appropriate for such a provision be contained in legislation.

5.3.12 Should these proposals be accepted, landlords and tenants will be in the position of negotiating on a more equitable basis, and would enable specialty tenants such as pharmacists to maintain their investment in high cost and innovative retail formats increasingly sought by demanding customers as competition increases.

[19] See Part 2 of the *Trade Practices (Industry Codes (Oilcode))Regulations 2006*
[20] See for instance *Regional Centres Occupancy of Shops UrbisJHD Retail Averages 2005/2006* Table 2.5

6. National Uniformity

6.1. There are some inconsistencies between the jurisdictions. For instance, most jurisdictions effectively require landlords to offer tenants a minimum of five-year leases. However, Queensland does not.

6.2 The way that market rent reviews are required to be calculated varies. For instance, most jurisdictions require a determination of the rent that would be payable between a willing landlord and a willing tenant.[21]

6.3 However, in Queensland, current market rent is required to be determined on the basis of rent that would reasonably be expected to be paid for the retail shop if it were unoccupied and were offered for leasing for the use for which the shop may be used under the lease or a substantially similar use, on the basis of gross rent less lessor's outgoings payable by the lessee, and on an effective rent basis (i.e. having regard for incentives paid by a landlord to a prospective lessee).

6.4 Conversely, in Western Australia the law requires "relevant factors, matters or variables used in proper land valuation practice (to have) been taken into account….".

6.5 This approach confuses the distinction between the valuation principles for landed property and the value of a highly specific lease of a particular property for income-producing purposes. It has led to the curious outcome of using the market value of a lease for a liquor store and a pharmacist to be used when determining the market value of a delicatessen.[22]

6.6 Such outcomes are contrary to the important concept of the management of complementary tenancy mixes in shopping centres that recognises the different economics and roles of particular uses.

6.7 There would be an advantage in having one law, or the same legal requirement in each jurisdiction, regulating the landlord/tenant relationship, so that as far as practicable, tenants in similar positions should get the same outcomes wherever they are in Australia.

6.8 Should such legislation become uniform, then industry association bodies such as the Pharmacy Guild could provide general advice to its members which would reduce the costs involved in determining the rights and obligations of a tenant, and being kept abreast as to changes in the legislation as they occur.

6.9 It is clear that the corporation's power of the *Constitution* is able to regulate the conduct of constitutional corporations. It is the power used to support legislation such as the *Independent Contractors Act 2006*.

[21] In the ACT, the terminology is "willing but not anxious" landlords and tenants.
[22] Vo and Another v. Reyne Pty Ltd [2006] WASAT 233 (WA State Administrative Tribunal 31 July 2006)

6.10 Following the December 1997 agreement to introduce key minimum standards into retail tenancy legislation, referred to in the Commission's call for submissions, there is now at least a degree of similarity between Australian jurisdictions.

6.11 Ten years on, the time is right for a body, perhaps the Small Business Ministerial Council at the direction of COAG, to bring together these provisions currently contained in Australian retail tenancy legislation into one Bill.

6.12 All Australian jurisdictions could then incorporate the template into their statute books, in the same manner as the *National Electricity Law* has been adopted in most Australian jurisdictions.[23] Alternatively the Commonwealth could exercise the powers contained pl. 51(xx) of the *Constitution* and implement legislation similar in nature to the *Independent Contractors Act 2006*.

[23] For example, section 6 of the *National Electricity (New South Wales) Act 1997* applies as a law of NSW the Schedule to South Australia's *National Electricity (South Australia) Act 1996* as the *National Electricity (NSW) Law*.

Appendix One

Article 23 of the Business Tenancy (Northern Ireland) Order 1996

Compensation where order for new tenancy is opposed on certain grounds

23.—(1) Where a landlord—

(a) has served—

(i) a notice to determine a tenancy to which this Order applies, or

(ii) in response to the tenant's request for a new tenancy, a notice under Article 7(6)(b) stating that he will oppose a tenancy application by the tenant,

and the notice states that a tenancy application by the tenant would or will be opposed, on any of the grounds specified in sub-paragraphs (e), (f), (g), (h) and (i) of paragraph (1) of Article 12; and

(b) either—

(i) in consequence of the landlord's notice the tenant does not make a tenancy application or, if he has made such an application, withdraws it, or

(ii) on hearing a tenancy application by the landlord or a tenancy application by the tenant, the Lands Tribunal, on any of the grounds mentioned in sub-paragraph (a), grants the former application or dismisses the latter; and

(c) the circumstances are such that paragraph (7) does not apply, then, subject to the provisions of this Order, the tenant shall be entitled on quitting the holding to recover from the landlord by way of compensation a sum determined in accordance with the following provisions of this Article.

(2) That sum depends upon the period immediately preceding the termination of the current tenancy during which the occupation conditions have been complied with ("the qualifying period") and shall be ascertained by multiplying the net annual value of the holding by, for each of the qualifying periods set out in column 1 of the following Table, the respective multiplier set out in column 2:

TABLE

Qualifying period	Multiplier
Not exceeding 5 years	2.5
Exceeding 5 years but not exceeding 10 years	5
Exceeding 10 years but not exceeding 15 years	7.5
Exceeding 15 years	10

(3) The occupation conditions are—

(a) that during the whole of the qualifying period, premises being or comprised in the holding have been occupied for the purposes of a business carried on by the occupier or for those and other purposes; or

(b) that, if during the qualifying period there was a change in the occupier of the premises, the person who was the occupier immediately after the change was the successor to the business carried on by the person who was the occupier immediately before the change.

(4) For the purposes of paragraph (2) the question of net annual value of the holding shall be referred to the Commissioner of Valuation and shall be decided as follows—

(a) the net annual value shall be that value shown in the valuation list in force under the Valuation Acts at the date on which the landlord's notice under Article 6 or, as the case may be, Article 7(6), is served;

(b) where no such value is so shown with respect to the holding but such a value or values is or are shown with respect to premises comprised in or comprising the holding or part of it, the net annual value of the holding shall be taken to be such value as is certified by the Commissioner of Valuation to be attributable to the value or values so shown;

(c) where the net annual value of the holding cannot be ascertained in accordance with the foregoing provisions of this paragraph, it shall be taken to be the value which the Commissioner of Valuation certifies would on a proper assessment be the value to be entered in the said valuation list as the net annual value of the holding.

(5) The Department of Finance and Personnel may by an order made subject to affirmative resolution vary (by substitution, addition or omission) the periods or multipliers (or both) set out in the Table in paragraph (2); and may by regulations made subject to negative resolution prescribe the procedure in connection with references under paragraph (4).

(6) In this Article the reference to the termination of the current tenancy is a reference to the date of termination specified in the landlord's notice to determine, or, as the case may be, the date specified in the tenant's request for a new tenancy as the date from which the new tenancy is to begin.

(7) This Article does not entitle a tenant to compensation where—

(a) the landlord is a public authority; and

(b) the tenant was aware of that (or should have been aware of it) at the time when he entered into his contract of tenancy; and

(c) the contract of tenancy, or an agreement between the persons who were, or became, the landlord and the tenant preceding or contemporaneous with that contract, disentitled the tenant to compensation.

(8) Subject to Article 39(1), a sum which a tenant is entitled to recover by way of compensation under this Article may be recovered by the tenant summarily as a civil debt due to him by the landlord.

Appendix Two

Pharmacy Case Studies

CASE STUDY ONE

A pharmacy business with an area of 289sqm. was purchased in 1999. At the time of purchase, the rent was approximately $36,000 per month, or $430,000 p.a.

In 2004 the lease was renegotiated as the centre was due to undergo a major renovation and expansion. At this renegotiation, the owner was offered premises of 500sqm. at a rent of $60,000 per month (or $730,000 p.a.). When the owner objected to the size and shape of the premises, he was told the conditions were not negotiable – take it or leave it. The owner had no option but to accept as he was not in a position to walk away with a large loan still owing.

In 2005 the pharmacy was relocated into temporary premises for six months, which subsequently turned out to be ten months.

In March 2006 the pharmacy moved into the new $500sqm. shop. At the same time the builders walked off the job and a court battle ensued between the builders and the shopping centre owners. The end of the centre where the pharmacy was relocated to remained half finished. Unfortunately, this meant that certain conditions that were promised were left incomplete. For instance, the pharmacy was to be positioned close to both a large medical centre within the shopping centre and access to a large medical centre on the street outside. Additionally, a significant number of unleased premises on the pharmacy level inside the centre ensured that traffic remained low.

A further sixteen months have now passed since that time. New builders have now been appointed. However, the pharmacist has still not received any news on when the centre will be finished and when the new medical centre will be opened.

To add further insult the only elevator at the pharmacy end end of the centre has been closed for the last two months for renovation. This elevator was the only practical means for the elderly moving between four levels of a major shopping centre.

In June 2006, the owner approached the centre management for rental relief. Initially this was declined and threats of immediate legal action were made. After a number of months it became apparent that the centre was in disarray. A number of tenants were forced to vacate. Therefore, the centre eventually agreed to provide rental relief on a four month basis. This was extended a further three months. Finally a further single month was offered.

When it became apparent that the problems of a half-finished centre were going to carry on indefinitely, the pharmacist approached the centre to try to renegotiate the lease as the centre could not provide the conditions that had been promised. Irreparable damage has been done to the business, and even once all works are completed, it is unlikely that it will be rebuilt to where it once was – or, for that matter, where it should have been. The shopping centre refused to renegotiate or offer an option on the lease. Instead, they offered a further two months rental relief at a significantly reduced rate. However, in order obtain this relief, the shopping centre required the pharmacist to sign a letter that agreed to finalise all issues with respect to the lease, as well as all issues outlined in previous correspondence.

At this point, the pharmacist had no choice but to engage the services of a lease negotiator. Discussions have been continuing since that time, with still no final resolution, and without any indication of when the shopping centre will be complete or the medical centre operational.

CASE STUDY TWO

The Current renegotiation of a pharmacy lease began back in November 2006. The original proposal from the shopping centre management included a 20% increase in base rent with yearly increases of CPI plus 2%, as well as a complete shop fit (which requires a significant level of capital for pharmacies).

This proposal was made in a climate where the shopping centre has experienced continued decreases in traffic flow for the past three years – reaching a critical point in late 2006 where the decrease in traffic flow was over 10%. These decreases in traffic flow have been acknowledged by centre management. Consequently, the pharmacy has experienced a decrease in turnover – largely due to these traffic decreases. The pharmacy annual turnover is down on where it was in 2004, and yet there have been 3 rent increases of CPI plus 1.5% since that time. Additionally, the future of the centre has been made even more uncertain by the news that a number of the local competing centres are currently planning major upgrades.

Following numerous meetings and discussions, the pharmacy put forward a proposal to the shopping centre that consisted of a 7% increase in base rent, a full shop fit with a 2 year deferral on start, as well as the request for a ten year lease to spread the cost of the shop fit over. The 7% figure was worked out to be the highest increase that could be afforded whilst still ensuring the viability of the business. This offer was rejected by the shopping centre, who indicated that they would not accept anything below a 10% increase.

Since this offer in May 2007, shopping centre management is no longer returning emails or phone calls to the pharmacy. The owner of the pharmacy suspects that the shopping centre is deliberately not negotiating in order to let the lease expire in September 07 – thus further weakening the pharmacy owner's negotiating position. They have clearly stated that if the pharmacy does not propose an offer of over 10%, they will simply offer the site to another pharmacy business – which would then enjoy the patronage and goodwill built up over many years by the existing pharmacy.

Appendix Three

Pharmacy Rentals Report 2007

The area of retail tenancy leases is one that The Pharmacy Guild of Australia takes a great deal of interest in. Pharmacists wish to remain the most accessible health providers in Australia; this can only be achieved if it remains viable to locate in shopping centres. On 20 June 2007, the Guild held the Pharmacy Rentals Symposium specifically to discuss these issues – with both tenants and landlords present. At the Symposium, the Guild also launched the inaugural Pharmacy Rentals Report, which will become an annual publication.

The report was specifically designed to help pharmacists to better prepare for rentals negotiations. It was also intended that it serve to improve landlords' understanding of the pharmacy industry, with particular regard to issues such as prescription pricing, which makes up the majority of pharmacy turnover. Currently, landlords receive turnover data from pharmacy tenants which, on its own, can give the false impression that pharmacy profitability is rising with drug inflation. In reality, over the past three years, profitability has been flat and the rents being imposed on pharmacy tenants are strangling them. The report also makes mention of the fact that costs are increasing in pharmacy at a faster rate than earnings. However, unlike in other industries, whilst costs may increase, pharmacists cannot pass these costs on to consumers.