Productivity Commission Inquiry

The market for retail tenancy leases in Australia

Submission No.2

THE SECRET MARKET

OF RETAIL LEASES IN AUSTRALIA.

Non-confidential

We request that this submission be published on the PC website

Southern Sydney Retailers Association

Contact : Craig Kelly 0413 433 288

July 2007

THE SECRET MARKET OF RETAIL LEASES IN AUSTRALIA.

In 1999, Senator Andrew Murray noted the following[1]

> *I am concerned at the existence of secret markets in Australia, namely secrecy of the pricing of retail space made available by landlords, particularly in shopping centres. Landlords, who may also be described as `retailers of space', often have absolute market knowledge as sellers, in contrast to the buyers of their products, who are generally in the dark.*
>
> *A prospective consumer of almost any product can take himself or herself to the market place for the goods they are considering purchasing, and easily obtain the different prices of the various different products or services that are on offer. A customer in a shoe shop is made aware of every price of all the shoes in the shop. In contrast, a retailer customer wanting to rent a shop almost always has no idea at all of the prices at which space has been sold to other retailers in the centre.*
>
> *Landlords are in fact simply retailers of space. Their goods are square metres and the services that go with them. Landlords are just one more supplier to tenants, but a supplier with unusual power.*
>
> *Open access to pricing information does not exist in the market place for retail space. That market is the very antithesis of an open and transparent market place, and the consequences are typical of closed and controlled markets – high returns to the sellers, and inequitable pricing practices.*
>
> *As a principle, secret pricing is generally a stratagem which allows the vendor (in this instance the landlord), and those with unusual or exaggerated market power, to maximise their returns and to unjustifiably discriminate between similar buyers with similar needs, but differing abilities to negotiate or pay. If those same pricing stratagems were used against customers buying houses, cars, financial services, white goods, consumables and so on – there would be political, social and regulatory uproar.*
>
> *The prices of such goods and services is rightly non-discriminatory and public. The market badly needs the methodology of rent pricing to also become open and widely understood.*
>
> ***It needs an end to secret pricing.***

[1] http://www.aph.gov.au/SEnate/committee/retail_ctte/report/d01.htm

2.1 The Need for Transparency in Prices of Retail Rents.

We agree that is most circumstances there should be a provision that allows for secrecy in contracts. However, there are certain circumstances when this basic principle should not apply.

1. Where the secrecy has the potential to distort markets and result in inefficient outcomes for the economy as a whole.
2. Where the seller is protected from the normal forces of free market competition through government regulation.
3. When the secrecy is practiced by a seller with market power.
4. When the secrecy involves the supply of a business input, to firms in competition with each other, whereby the secrecy has the potential to place one or more of the 'competing purchasers' unknowingly at a competitive disadvantage.
5. Where the secrecy operates against the public interest.

It is our view that ***all*** the above circumstances apply to retail leases in shopping centres and therefore a set of rules need to be introduced to ensure the market for retail leases in Australia is fully open and transparent. Further secret rebates are not the "Australian way" of doing business, and should be discouraged as they not only distort the market, but also have the tendency to breed corruption.[2]

It is time for secret pricing to end for retail leases.

2.2 The Registration of Leases – A System to End Secrecy ??

We are aware of various suggestions made to the Productivity Commission calling for the mandatory registration of leases in all states (as they currently are in NSW & QLD) with the spurious claim that this is the "most efficient way to ensure access to this information".

We are also aware of other claims from the 'existing retailing hierarchy' that there is in fact, "no secret market" and that in NSW & Qld "all leases are available for inspection by anyone for the payment of a small fee."

We hope that the Productivity Commission will not be deceived by these claims, and they recall that such claims come from the same order of men behind previous deceptions too numerous to list here.[3]

The registering of leases at the Land & Titles Office in various states is ***not*** a method that can be used to bring to and end the secret market of retail rents in Australia.

[2] For example, the Australian Wheat Boards secret rebate to Saddam Hussein.

[3] See http://sunday.ninemsn.com.au/sunday/cover_stories/transcript_437.asp which is most likely just the tip of the ice-berg.

To the contrary, the mandatory registration of all leases in all states (as is current practiced in NSW & Qld) will not only entrench the current secrecy of prices, but even worse, it will lock in a system so open to manipulation that the "information" in the registered lease, will not become meaningless, but distorted in such a way to deliberately create an impression of higher "market" rents that actually do exist.

We hope that the Productivity Commission will be awake to this trick, as to recommend the mandatory registration of leases for all states are currently practiced in NSW & Qld, will result in a system more detrimental competition, than exists under the current system of secrecy and suppression.

2.3 "The Lease" and the "Agreement to Lease"

In many leases for retail premises, the Landlords use two separate and legally binding contracts.

One contract is "The Lease" and the other is known as the "Agreement to Lease" – however under the mandatory system that exists in NSW & Qld, ***only*** "The Lease" needs to be registered, while the "Agreement to Lease" remains secret.

The only information that "The Lease" needs to show, (and hence the only information that is registered) is the starting rent and the length of the lease term. Everything else such as; secret rebates, kickbacks, escalation clauses, 'incentive' payments, rent free periods, unearned commissions, exemption on outgoings, etc, etc, etc. are contained in the "Agreement to Lease", which does ***not*** have to be registered.

Therefore, the "Agreement to Lease", can become an anti-competitive tool, used to create a false and inflated impression of what the "market" rent is.

For example, "The Lease" may show a starting rent at $180,000 p.a, and assuming the Lease also shows that the shop size is 100m2 (which is not mandatory) the starting rent is $1,800 per m2. This creates the impression for anyone looking at the register (which is described by some as "the most efficient way to access this information") that $1,800 per m2 was the market price for this shop or one similar at the time the lease was signed.

However, the separate "Agreement to Lease" which does ***not*** have to be registered, could contain a wide range of secret terms – such as; a hidden kickback of $600 per m2, a 50% secret rebate on the outgoings payable, a one off cash 'incentive' payment of $100,000, a rent free period of 6 months, and virtually anything else.

These secret and hidden terms, not disclosed in "The Lease" make the $1,800 per m2 recorded in "The Lease" and registered at the Land & Titles offices in various states not only irrelevant, but misleading, as the ***true market price*** of the rent paid could be $1000 per m2 once all the secret terms are

included – yet the figure in the register "that is available for inspection by everyone" is showing the higher figure of $1800 per m2

If such practices were used by white-shoed salesmen which had the effect of creating a false impression of the market price for Gold Coast apartments, there would be regulatory uproar – but this is the current system in NSW and Qld, and it is likely those representing the interests of the "existing retail hierarchy", will recommend to the Productivity Commission that such a system, so open to exploitation and manipulation be adopted for retail leases in Australia.

2.4 Secrecy & Suppression or Openness & Transparency ?

Clearly there two options – either allow the market to continue with the current practices of secrecy and suppression, were undisclosed hidden kickbacks are standard practice, which has resulted in the current market failure - or to end the secrecy and distortions by introducing a set of rules to ensure that the price of retail rents is an open and transparent market.

In considering which option is best for Australia, we would like the Productivity Commission to consider Section 17045 of the *California Business and Professional Code*, which states;

> "*The secret payment or allowance of rebates, refunds, commissions, or unearned discounts, whether in the form of money or otherwise, or secretly extending to certain purchasers special services or privileges not extended to all purchasers purchasing upon like terms and conditions, to the injury of a competitor and where such payment or allowance tends to destroy competition, is unlawful."* [4]

Penalties for breach of section 17045 in California include jail, fines or both.

When home of free market capitalism, the economic powerhouse of the State of California, outlaws the practice of secret rebates – it hi-lights that such a law can only be beneficial to competition and consumers, and is long overdue in Australia, ***especially in the market for retail rents***, which has been so corrupted and distorted by the use of secret rebates.

2.5 Previous Arguments to Support Secrecy & Suppression

In the previous Senate Inquiry - the poorly named *"The effectiveness of the Trade Practices Act in protecting small business"* [5] - The Shopping Centre

[4] http://www.leginfo.ca.gov/cgi-bin/displaycode?section=bpc&group=17001-18000&file=17040-17051

[5] Small business does not want or need any "protection" and this is not the purpose of the Trade Practices Act – what small business wants is equality of opportunity – and that includes equality of opportunity to access market information and the right to operate in free and fair market where information is transparent and openly available on a level playing field. The only group seeking "protection" is the existing retail hierarchy – whom are seeking to protect their ability to engage in

Council expressed the rather bizarre view that under some circumstances, secret pricing could have "benefits".

> Assuming for the moment you have done a special deal with that tenant where because of his difficulties you have rebated the rent, you may be worried as the owner that that will have a tremendous knock-one effect if you do it for every one else. The problem the owner has is; what does he do in the circumstance ? From the owners point of view he might say, 'I'm prepared to give you a discount but I'm not prepared to give it to anyone else because I know that I'll have everyone complaining of it' In that circumstances I think that is quite fair. You could have another set of circumstances where it would be totally unfair to have such a clause in there – unfair and obnoxious" [6]

A closer analysis of what the SSC are actually saying here, is that if a tenant has "difficulties" – most likely because he is paying an inflated and uneconomic rent, (the resulted of secret prices in the first place) and this unsustainable rent is threatening to drive him to ruin and bankruptcy - then the landlord should be able to keep secret from the market any information that a rent at this level, is unsustainable and uneconomic.

Further, given that regional shopping centres boast 99% occupancies, and that tenants are ***locked in*** to leases, with bank guarantees, and often personal guarantees - what sort of nonsense are the SSC arguing claiming that reducing an unsustainable rent for one tenant may some how have a "tremendous knock-on effect" for everyone else.

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 faced ruin and bankruptcy - can be represented by the landlords as the "market rent", through a system of undisclosed secret rebates and secret kickbacks.

In fact in California, under Governor Schwarzenegger, such practices of secret rebates are not only considered "unfair and obnoxious" – they are considered a criminal offence.

2.6 Outgoings – Non Discloser of Secret Rebates

Not only do secret rebates in rents threatens competition by unknowing placing some retailers at a competitive disadvantage – secret rebates in outgoings also threaten competition.

---

practices of secrecy and suppression of information to distort the operation of an efficient market for retail leasing.

[6] http://www.aph.gov.au/senate/committee/economics_ctte/completed_inquiries/200204/trade_practices_1974/report/report.pdf

The entire concept of outgoings is that they are calculated on the space occupied and every pays there fair share of land taxes, water rates, council fees, cleaning, etc – or do they ?

On page 821 of the transcript of evidence to the Senate Enquiry "*Finding a Balance – Towards Fair Trading in Australia"* an executive of one of the leading shopping centre landlords is recorded as stating that this major landlord may *"pick up the bill"* for a component of the outgoings for larger retailers.

The evidence seems clear that Shopping Centre Landlords secretly extend the payment or allowance of rebates or refunds for outgoing to certain large retailers, but do not extended these privileges all small retailers, and this discrimination distorts competition, by unknowingly placing small retailers at a competitive disadvantage forced to pay outgoings including certain taxes, that large retailers are exempt from.

Does any Shopping Centre Landlord disclose that the fact, that some retailers don't pay for outgoings – or is this yet another "material fact", kept as a secret by the landlords to hide the extent of the competitive disadvantage small retailers face ?

2.7 Shopping Centre landlords have forfeited their right to secrecy.

If the market were fair, free and open, without the current exploitation of market power by SS landlords, and the market was working efficiently, then maybe there could be an argument not to support compulsory disclosure of **ALL** rental terms for leases in shopping centres.

The market for residential rents, industrial rents, and office rents are transparent with market prices - but retail rents are not.

This is because retail leasing is not a free market, its protected by government regulation that places artificial limitations on retail space, which has handed shopping centre landlords market power, which they have ruthless exploited including the practice of maintaining secrecy of pricing, that would simply not occur in a normal free and open market.

This secrecy and suppression has resulted in the current broken market of retail leasing in Australia - and at the end of the day, this market failure is paid for by the Australian consumers in higher prices.

The shopping landlords through their exploitation of the current system, have simply forfeited their rights to maintain the current secrecy - it is time for secret pricing to end.

2.8 The need for Transparency – Is there a level playing field, or will the rent place the retail business at a competitive disadvantage ?

Every business needs to try and develop some type of competitive advantage to survive, or at least a 'level playing field' to enable the business to get a foot-hold in the market.

When a small business is entering into lease for a retail shop in a shopping centre, often they will have family homes and life savings all on the line – they accept the risk – but doing so, they are going to "live or die" depending upon their ability to compete against other retailers in the centre.

Therefore, they are simply entitled to information that if the price they are paying for rent has the potential to place them at competitive disadvantage against other competitors in the same shopping centre.

It is therefore completely 'unfair and obnoxious' when the existence of any competitive disadvantage is hidden from a potential market entrant by the use of secret rebates, secret kickbacks, subsidized outgoings and the like – whereby such suppression and secrecy, has the potential to drive the new retailer to ruin and bankruptcy.

If the level playing field does not exist, and a potential new market entrant is going to be placed at a competitive disadvantage, through Price Discrimination in rents and other terms by the shopping centre landlord, it is complete untenable for the shopping centre landlord to able to continue to engage in practices of not only failing to disclose this competitive disadvantage, but activity taking steps to keep the information hidden.

2.9 Secret Pricing in Retail Leases – Against the National Interest.

To ensure productivity growth and future prosperity, it is essential that Australia's limited financial and entrepreneurial resources are used in their most efficient way.

It is only through open and transparent markets that investors have the information to enable them to direct limited financial and entrepreneurial resources into their most efficient uses. Simply the more open and informed the market is, the more efficiently it operates to the benefit of the Australian economy, competition and consumers.

The operation of secret markets, with secret pricing and the non-disclosure of competitive disadvantages, which results in wasted financial and entrepreneurial resources, can only lead to lower productivity growth, and is a clear a present danger to the nation's future prosperity – and this is exactly the situation facing Australia with the secret market of retail leases.

If a business enters a market where it has a competitive disadvantage and cannot compete effectively, its resources will be wasted, and entire Australian nation is poorer as a result.

With the currently sickly state of Australia Productivity Growth, as a nation we can afford for even a single dollar of our limited financial and entrepreneur resources being put to inefficient uses.

It's time to end the secret market of retail leases.

2.10 Information Dissymmetry & Hypocrisy.

The secret pricing in retail rents is another example of the information dissymmetry that is currently preventing the efficient operation of the retail leasing market.

Landlords have precise knowledge of the sales performance for every tenant in a shopping centre, they know exactly what each tenant's occupancy costs are, and what ability each tenant has to absorb a rent increase - but through the secret market of retail rents, a tenant can't even find out what the "market rent" for other shops are in the centre, or even his own shop.

This is like playing Texas poker, where one player has to show all their cards, but the other player gets to keep his covered.

Shopping centre landlords argue they must have access to a retailer's sales figures for "benchmarking" and to enable them to "develop strategies" for "long term investments".

Therefore, surely retailers have a reciprocal right to access to what retail rents are for "benchmark", and to enable them to "develop strategies" for "long term investments" ?

But apparently not, according to the Shopping Centre Landlords.

But they can't have it both ways, it is completely untenable that Shopping centre landlords can keep secret from tenants information on market price of rents, while at the same time arguing that they are entitled to a tenants sales figures. But this is a very special industry sector, where such bald-face appalling hypocrisy is just an everyday practice.

Yet despite this glaring inequity and Information Dissymmetry, amazingly there have been submissions to this inquiry claiming there is *"sufficient information symmetry between owners and tenants".* When a submission contains such blatant falsehoods, it can only cast of shadow of doubt over the legitimacy of the entire submission, and whether it has actually been submitted in good faith, or instead is an attempt to deceive this inquiry.

Such gross hypocrisy should send "alarm bells" ringing for the Productivity Commission, to remind them to treat every utterance from that comes from this order, with the highest level of suspicion.

2.11 Recommendations

Recommendations to end the secret pricing for retail rents and to bring openness and transparency to the market will be made by the Southern Sydney Retailers Association in a supplementary submission.

2.15 CASE STUDY -

Is a Failure to Disclose the Existence of a Competitive Disadvantage - Unconscionable Conduct ?

> *"There are…laws that* [redacted] *(a leading shopping centre owner) and every other landlord must obey. These laws…require landlords to disclose to tenants any material facts which they know that might affect the future of the business of those tenants"*[7]
>
> Mr. [redacted] (Chairman of a leading shopping centre developer) Nov 2004

Is a ***"material fact"*** known by Shopping Landlords (that might affect the future of the business of a new tenant) the existence of massive Price Discrimination in rents that places a new tenant at a competitive disadvantage against existing tenants ?

If a prospective tenant is considering to lease space in regional shopping centre, and is offered a rent of $1200 per m2, plus outgoings of $150 per m2, which if the tenant reaches industry average sales for his category, would have an occupancy costs of 25% - is it unreasonable for the Landlord to fail to disclose to this prospective tenant, that he shall competing directly against another retailer whom the landlords has only charged just $150 per m2 with no outgoings, whom has an occupancy costs of just 5% ?

Under current law, can a landlord keep secret the existence of such a massive competitive disadvantage from a prospective new tenant ??

Regardless of whether or not such practice is "fair" or "unfair", is the existence of this massive competitive disadvantage, not a "material fact" that might affect the interests the new tenant?

Is failure to unreasonably disclose the massive competitive disadvantage (clearly a material fact and a potential risk) to the prospective new tenant unconscionable conduct ?

The above questions are the basis of a current dispute that is before the Administrative Decisions Tribunal in NSW, where a small retailer has alleged that its landlord breached s62B of the NSW Retailing Leases Act. "Unconscionable conduct in retail shop lease transactions."

[7] Mr. [redacted] transcript of evidence, Inquiry into the [redacted] 29th Nov 2004

Section 62B states in part;

> *"A lessor must not, in connection with a retail shop lease, engage in conduct that is, in all the circumstances, unconscionable.*
>
> *Without in any way limiting the matters to which the Tribunal may have regard for the purpose of determining whether a lessor has contravened subsection (1) in connection with a retail shop lease, the Tribunal may have regard to:*
>
> *(I) the extent to which the lessor* ***unreasonably failed to disclose*** *to the lessee:*
>
> *(i) any intended conduct of the lessor* ***that might affect the interests*** *of the lessee, and*
>
> *(ii)* ***any risks*** *to the lessee arising from the lessor's intended conduct (being risks that the lessor should have foreseen would not be apparent to the lessee)*

Is a *"risk"* or something *"that might affect the interests of"* any business, if the business obtains a significant business input from a supplier, at a substantially higher price as compared to what his direct competitors are paying for the same input, whereby the price differential will place the business at a distinct competitive disadvantage ?

There is no question that a buyer, obtaining a smaller quantity of any goods or services, (including retail space) expects to pay a higher price as opposed to a buyer obtaining a larger quantity. If the premium paid in the higher price by the smaller buyer is 10%, 20% or even 50% extra it ***may not*** be "unreasonable" if the seller did not disclose existence of such difference, as such price discrimination, may not necessarily place the smaller buyer at a competitive disadvantage.

However when the discrimination is in the range of 1000% and given such extreme magnitudes in price are unnatural, and without any true economic cost justification, is it unreasonable for the landlord not to disclose these facts.?

This current case before the NSW ADT, may set a precedent that brings to an end the secret market in retail rents.