THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

PRODUCTIVITY COMMISSION PUBLIC INQUIRY

SUBMISSION - WESTFIELD GROUP

22 FEBRUARY 2008

This Submission is made by Westfield in response to the draft report of the Productivity Commission ("Commission") in relation to the market for retail tenancy leases in Australia ("Draft Commission Report").

Westfield considers that the Draft Commission Report generally provides a fair and balanced analysis of the market for retail tenancies in Australia. Except as indicated otherwise in this Submission, Westfield supports most of the draft findings and draft recommendations contained in the Draft Commission Report.

Westfield agrees with the Commission's view that those aspects of retail tenancy legislation that have improved the operation of the retail tenancy market (such as measures to improve transparency, disclosure and dispute resolution and to reduce information imbalances and unwind constraints on efficient decision making) should be further improved. Westfield also agrees with the Commission's view that the market is working reasonably well and further prescriptive legislation would not achieve improved outcomes and, where appropriate, should be wound back. Finally, Westfield agrees that any move to a nationally consistent retail and commercial lease framework aimed at increasing efficiency and reducing costs would be a welcome development although, in Westfield's view, it is important that the method adopted to achieve such an outcome should be one that does not run the risk of achieving the opposite effect.

In this Submission, Westfield will focus on those aspects of the Draft Commission Report where Westfield's view differs to that of the Commission and those aspects which, in Westfield's view, warrant further comment. Except as indicated otherwise, Westfield is to be taken to agree with the draft findings and draft recommendations contained in the Draft Commission Report. In this Submission Westfield also briefly comments upon a number of matters that have been canvassed before the Commission at the public hearings conducted during February 2008.

1. Lease Registration

In the Draft Commission Report the Commission has invited comments on the feasibility and benefits of more widespread lease registration and facilitation of this process by landlords.

This matter has also been the subject of some discussion during the Commission's public hearings.

In its Submission to the Commission dated 27 July 2007 ("First Westfield Submission"), Westfield indicated that it would not be opposed to those States and Territories (where lease registration was not the prevalent practice in relation to retail tenancies) adopting registration requirements similar to those applicable in New South Wales, Queensland and the Australian Capital Territory. This, in Westfield's view, was an acceptable proposal to address perceptions regarding information imbalances between landlord and tenant. Westfield considers that the arguments that have been put forward in opposition to this proposal are not

compelling and do not detract from the overall utility of this measure in providing a generally accessible information data base regarding prevailing rents and lease terms that would be of assistance to retailers in retail lease negotiations.

The argument that tenancy information available from a State based register would not necessarily reflect true or current rents as it would not include information regarding rental incentives, in our view, unduly exaggerates this issue. In the first place the number of tenancies that are the subject of rent relief or rental incentive arrangements at any given point of time is likely to be a relatively small proportion of the overall number of tenancies in shopping centres. Whilst that proportion will necessarily be higher in the case of a shopping centre that is undergoing development, the majority of shopping centres at a given point of time will be stabilised shopping centres (that is no development is taking place). In any event, even in the case of shopping centres that are undergoing redevelopment, reputable and informed tenant advisers with access to a national retail lease registration data base are capable of estimating the value of applicable lease incentives and are thus able to make appropriate adjustment to face rents in order to establish market rents.

The establishment of a national accessible data base from which the terms and details of all retail leases could be ascertained would, notwithstanding any perceived shortcomings in the information provided by such data base, be a significant advance on the current situation where no such national data base exists. This measure would, in Westfield's view, contribute in a major way to minimising any perceived information imbalance currently considered to exist between landlords and retailers.

Westfield endorses the views of the Shopping Centre Council of Australia ("SCCA") on this matter as expressed in Section 2 of the SCCA's submission to the Productivity Commission dated 22 February 2008 ("SCCA Second Submission").

2. Voluntary National Code of Conduct for Shopping Centre Leases

In its draft report the Commission has invited comments on the feasibility and benefits associated with the introduction of a voluntary national code of conduct for shopping centre leases enforceable by the Australian Competition and Consumer Commission ("ACCC").

In the First Westfield Submission, Westfield noted that 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. Westfield supported the views of the SCCA in the SCCA's submission to the Productivity Commission dated 27 July 2007 ("First SCCA Submission") in that regard.

From its draft report it appears that the Commission considers that there are benefits to be achieved by the adoption of a voluntary national code of conduct which is applicable to shopping centres but not to other retail modes. As we understand it, the Commission considers that the frequency of complaints about market power imbalance between landlords and retailers and the perception that such an imbalance exists is concentrated at the shopping centre end of the retail spectrum. Accordingly, it appears to be the Commission's view that the adoption of a voluntary national code of conduct applicable to shopping centres would be a desirable step as part of a broader process whereby a new regulatory framework could be developed and where, over time, the more prescriptive aspects of

current State and Territory regulation would become redundant, the net result being potentially lower transaction, compliance and administrative costs of operating in the retail tenancy market.

Consistently with its policy of advocating a move towards national uniform retail tenancy laws, Westfield would welcome any nationally co-ordinated review of existing State and Territory retail tenancy laws that had as its objectives:

(a) the removal of the more prescriptive aspects of such laws (particularly in relation to minimum fixed lease terms, preferential rights of renewal, lease assignment and outgoings);

(b) the removal of existing inconsistencies between those aspects of current State and Territory retail tenancy legislation that deal with the same subject matter; and

(c) the adoption of a uniform national law regulating retail tenancies in substitution for the existing statutory framework which comprises a series of separate State and Territory statutes applicable in each State and Territory jurisdiction.

However, consistently with the First Westfield Submission, Westfield considers that the appropriate way to proceed towards these objectives is through a consultative process involving all relevant stakeholders (including State and Territory governments) such as that which led to the adoption of uniform corporations law throughout Australia under the auspices of the Council of Australian Governments ("COAG") having as its objective the adoption (with agreement of the States and Territories) of a uniform retail tenancy law in substitution for the existing series of States and Territories statutes that regulate this field.

Westfield prefers this approach to the attempted development of a uniform voluntary national retail tenancy code that would be confined in its application to the shopping centre segment of the retail tenancy market. The reasons for this are well summarised in the SCCA Second Submission which Westfield supports but in brief:

(i) in Westfield's view the establishment of a national retail tenancy code applicable to the shopping centre segment of the retail tenancy market would be unduly broad in its application as it would include all shopping centres, not just those super regional and regional shopping centres where the perception of an imbalance of bargaining power is more prevalent. Westfield agrees with the views put forward in Section 2 of the SCCA Second Submission that conditions applying in smaller shopping centres, such as "neighbourhood" centres, are more like the conditions that are applicable to retail tenancies located outside shopping centres such, as in retail strips, and that there is no good reason to include such shopping centres within the ambit of operation of a national uniform retail tenancy code.

(ii) more significantly, it is Westfield's view that the adoption of a national uniform retail tenancy code could only be supported if there was certainty that the States and Territories would repeal existing State and Territory based legislation regulating the retail tenancy market to the extent that such legislation applied to shopping centre landlords and tenants in respect of

matters that were the subject of the code. In Westfield's view, assuming agreement was reached between relevant industry participants in relation to the adoption of a voluntary national retail tenancy code, such a code would nevertheless be likely to have statutory force and be binding on industry participants (for so long as they elected to be bound by it) as an applicable code for the purposes of the Trade Practices Act. As such, the code would be likely to regulate with statutory force areas of conduct and practice in relation to retail leases which are currently the subject of State and Territory based legislation. If the two statutory systems were permitted to operate side by side the net result would merely be an increased layer of regulation in an already over regulated industry. In addition, there would be scope for potentially significant litigation arising in relation to issues regarding alleged inconsistency between the two systems with respect to their coverage of similar subject matter. Such an outcome would run counter to the recommendations in the Draft Commission Report that the industry progressively move to less prescriptive regulation. The co-operative approach between all interested stakeholders to develop uniform national legislation under the auspices of COAG is, in Westfield's view, likely to be a more effective way to advance towards uniformity and consistency of regulation (with, hopefully, less prescription) within the retail tenancy area (with the necessary ingredient of voluntary withdrawal from the field by the States and Territories) than an attempt to develop a uniform national code which is applicable only to the shopping centre segment of the retail tenancy market.

3. Planning and Zoning Controls

Draft recommendation 5 contained in the Draft Commission Report states:

"*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.*"

Westfield does not agree with this draft recommendation.

In the First Westfield Submission, whilst acknowledging the theoretical constraining impact that planning laws have on the supply of retail space, Westfield supported the "centres policies" approach to Australian planning laws which, by agreement between the various States, underpins those laws and brings benefits to the community through the concentration of commercial and retail activities in designated urban centres served by public transport, thereby creating an orderly and sustainable system of urban development that is environmentally sound and that minimises unnecessary car use and traffic congestion whilst optimising the conditions for sound investment in private and public infrastructure.

Westfield pointed out in the First Westfield Submission that the planning framework in place within Australia has not, in practice, posed any significant or undue impediment to the growth of the supply of retail space and the increased variety of retail formats. In Section 2 of the First Westfield Submission, Westfield provided examples of those new retail formats pointing out that this development had resulted in an ever increasing supply of retail premises across a wide area and an increasing diversity of retail formats. Westfield noted in the First Westfield Submission that these trends could, over time, be expected to exert a moderating influence on rent increases for retail premises generally, although this outcome

currently is, and would continue to be balanced by the ongoing demand for retail space. Westfield also pointed out that the additional supply of retail space from a variety of new ownership sources is also an influence over time for increasing diversity in the overall ownership of retail premises and other retail formats.

Westfield also pointed out in the First Westfield Submission that an obvious constraint affecting the supply of shopping centre space is the relatively small number of anchor tenant businesses within the Australian retail leasing market, such as department stores and discount department stores.

In Westfield's view this is a far more significant factor in the availability of retail space than the operation of planning laws and, of course, operates quite independently of planning laws. Westfield endorses the comments regarding this issue contained in the SCCA Second Submission (Section 5).

In Westfield's view, the fact that in practice there has been no significant impediment to the supply of new retail space brought about as a consequence of the operation of planning laws in Australia, the fact that the centres policy underpinning these planning laws has obvious public benefits and the fact that no compelling evidence has been produced to the contrary does not suggest that there is a need for a further review of these planning laws by the States and Territories with a view to relaxing controls that limit competition and restrict retail space and its utilisation. Westfield also agrees with the observation of the SCCA that in New Zealand where the planning regime is less rigorous than in Australia there is nonetheless less retail space per capita than in Australia. If Australian planning laws had such a significant impact on the availability of retail space, in practice it could be anticipated that in Australia there would be less available retail space per capita than in New Zealand.

4. Other Matters raised during Productivity Commission Public Hearings

(a) Unconscionable Conduct

During the course of the Commission's public hearings submissions have been made that the statutory laws concerning unconscionable conduct (Section 51AC of the Trade Practices Act and corresponding provisions of State and Territory retail lease legislation) has not worked effectively. Suggested measures to address this have included the introduction of a new statutory definition of unethical conduct, the statutory codification of an implied term of good faith into retail leases and the statutory prohibition of "unfair" contractual terms in retail leases coupled with a contractual pre-vetting process in relation to "unfair" contractual terms administered by a regulatory body. The advocates of these measures consider that the current statutory concept of unconscionable conduct, as it has been interpreted by the courts, is unduly narrow thereby setting an unreasonably high threshold with regard to the types of unethical or unfair business dealing that might otherwise come within its ambit.

These submissions are, in Westfield's view, misguided.

In Westfield's view, the proper starting point for a debate about the adequacy or otherwise of a particular statutory concept such as unconscionable conduct (and for that matter about the need for any form of regulatory intervention into private business dealings) should be an analysis of whether there is as a matter of fact such a high incidence of the

type of behaviour considered to require statutory redress that such intervention is warranted. The statistics supplied to the Commission regarding the incidence of claims and complaints (eg. Section 4, First SCCA Submission and pages 20 – 23 of the submission of the Australian Competition and Consumer Commission dated 14 November 2007 in fact demonstrate that the opposite is the case. Indeed, the Commission's own analysis of the level of disputation within the industry has led it to conclude in the Draft Commission Report that the number of retail tenancy disputes (which of course includes all disputes and not just those where there is a claim of unconscionable conduct) is very low relative to the size of the market (see Draft Commission Report, page 173). Some retailer associations and retailers have sought to dismiss statistics demonstrating the relatively low incidence of claims and disputation within the industry by asserting that retailers are too fearful to pursue complaints against more powerful landlords. However that assertion is obviously self serving and not backed up by evidence and should be treated as lacking credibility. In Westfield's view, it amounts to a disingenuous way of evading the conclusion to be drawn from the clear statistical evidence regarding claims and complaints. That evidence simply does not support the case that there is a significant problem regarding misconduct or malpractice in landlord/tenant dealings that requires further or amended statutory redress.

As Westfield pointed out in the Westfield First Submission the compliance programs that most large landlords have in place for their operational executives (particularly leasing executives) together with the retailer awareness and publicity campaigns undertaken by the ACCC provide a more plausible explanation for the low incidence of unconscionable conduct claims within the retail leasing market.

In Westfield's view, those proponents for the legislative change which originally led to the enactment of Section 51AC of the Trade Practices Act who now advocate further reform (because they believe the statutory concept of unconscionable conduct then introduced has not operated to their satisfaction) have never been able to demonstrate a case (based on proper statistics and rigorous factual analysis as opposed to unsubstantiated anecdote and allegation) that there was an endemic behavioural problem in the retail tenancy industry that required statutory intervention. All reliable evidence regarding the prevalence of disputation and complaint contradicts the notion that there should be any further change to regulation in this area.

Further, whilst there is some inherent degree of uncertainty as to the range of circumstances and situations in which unconscionable conduct within the current statutory expression of that term can be said to apply, it could be expected that as the courts progressively deal with unconscionable conduct cases that are brought under Section 51AC or the equivalent provision in State and Territory retail leasing legislation that a body of law will develop over time which provides greater clarity and certainty as to the range of circumstances and situations within the retail leasing business context where redress will be provided. Further, In Westfield's view, 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 doctrine of unconscionable conduct as some commentators have suggested based on their analysis of the cases that have occurred to date. Whilst each case has been, and will continue to be

assessed on the basis of its own particular facts, there is certainly no statutory warrant for the courts to adopt such a narrow interpretation and no compelling reason to believe that they necessarily will do so.

Inasmuch as the advocates for further reform in this area consider that the current statutory concepts of unconscionable conduct have proved inadequate to deal with instances of business malpractice within the industry that they believe are prevalent, they have not made any case that suggests that any alternative subjective statutory concept or notion (whether defined or not) such as "unfair" or "unethical" would more adequately deal with the issue or remove any perception of uncertainty regarding the operation of the law that is claimed to exist.

In short, these proposals for reform, particularly proposals such as the introduction of a contractual pre-vetting agency that would review contracts from the perspective of "fairness" are not supported by any demonstrated need for statutory intervention in the area, run counter to the Commission's views in the Draft Commission Report with which Westfield agrees regarding the need for less rather than more regulatory prescription in the industry and, if implemented, would only add further regulation and cost to an already overregulated industry with no demonstrated offsetting benefit.

(b) **Outgoings**

During the course of the Commission's public hearings it has been claimed that there is a need for further statutory intervention to regulate the charging of shopping centre outgoings to tenants on the basis of claimed instances of abuse by landlords in the charging and allocation of centre outgoings. It has also been submitted that outgoings charges made by landlords should be independently audited, that the area of outgoings charges should be regulated by a code of conduct and that all retail leases in shopping centres should be required to be in the form of gross leases.

Westfield supports and adopts the views of the SCCA in relation to these submissions (see SCCA Second Submission, Section 7). In particular, and despite claims to the contrary in submissions made to the Commission during its public inquiry, it is Westfield's view that:

(i) the administration and charging of outgoings is already extensively regulated through State and Territory retail leasing laws. Accordingly where claimed instances of landlord abuse in this area occur, there are already more than adequate avenues for statutory redress available to tenants through recourse to the low cost dispute resolution procedures which those statutes generally provide. Most of the instances of abuse cited in the public hearings, if they occurred within the context of a retail tenancy relationship to which the existing retail tenancy laws applied, would have involved a breach of the relevant statutory provisions. In instances where claims of excess charging relate to shopping centre leases which are not covered by retail tenancy legislation such as major supermarket or department store leases, it is Westfield's view that tenants under those leases are sufficiently sophisticated and have sufficient commercial leverage to ensure that their leases incorporate adequate contractual protection in relation to the area of outgoings charges at the time when the relevant lease contracts are negotiated. These major tenants do not,

and should not need to have their commercial interests protected by statutory intervention.

(ii) outgoings charges rendered by landlords in respect of retail tenancies to which retail tenancy legislation applies are already required to be independently audited.

(iii) shopping centre landlords have a compelling incentive to ensure that those outgoings charges covering services rendered by third parties such as contractors, cleaners and the like are kept as low as possible as generally around 40% of such outgoings charges are borne by such landlords and are unable to be recovered from tenants.

(iv) shopping centre landlords do not have any incentive to maximise the proportion of total occupancy costs comprising outgoings recoveries because landlords do not receive the benefit of outgoings (they are merely recovering costs) and to do so would be to reduce the capacity of the tenant to pay increased rental. Such an outcome would not be in the landlord's commercial interests.

(v) there is no compelling case for a code of conduct governing outgoings as the area is already sufficiently (indeed exhaustively) regulated through State and Territory retail lease legislation.

(vi) there is no compelling argument favouring from a tenant's perspective a gross lease arrangement over a net lease (where rent and outgoings are separately charged). Inasmuch as it is said that a gross lease confers advantage on a tenant (as the tenant could calculate with greater certainty total occupancy costs over the period of a lease) it could equally be said that a gross lease creates the potential for a landlord to charge excessive gross rent in order to compensate for future increases in outgoings charges that may never materialise. Further, a gross lease could be said to create the potential for a shopping centre landlord to reduce the level of shopping centre services to which outgoings charges relate with a view to maximising the landlord's return. Westfield agrees with the SCCA's argument that the selection of the retail lease model suitable for a particular retail tenancy is best left to commercial negotiation between the parties to the lease. It is not desirable that any particular commercial model should be mandated through legislation.

(c) **Turnover Information**

At the Commission's public hearings a number of submissions have been made on behalf of retailer associations and retailers to the effect that shopping centre landlords should not be permitted to include provisions in retail leases requiring tenants to provide to the landlord turnover information concerning the tenant's business. Alternative suggestions have been put to the effect that such turnover information should be collected by an independent third party (instead of landlords) and then made available upon request to landlords and tenants on a basis where the turnover data specific to particular tenants cannot be identified.

The basis for these proposals is a belief that the receipt by shopping centre landlords of such turnover information from tenants confers upon landlords

an unfair advantage by creating an information imbalance between landlord and tenant particularly in relation to negotiations regarding new leases or renewal leases.

Westfield observes that much of the debate that has surrounded the turnover collection issue has been misinformed.

In the first place it is not the case, despite submissions to the contrary, that landlords do not collect turnover information in other jurisdictions such as the United Kingdom or the United States of America. As pointed out in the SCCA Second Submission (Section 6) such information is in fact collected in the United States and the United Kingdom and further there is no legislative prohibition on the collection of turnover information in either of those jurisdictions.

Further, in the case of Westfield shopping centres, it is not the case that turnover data collected is unavailable to tenants in a form in which appropriate benchmarking can be done without identifying individual tenants. As pointed out in the SCCA Second Submission (Section 6) such information is made available to retailers by Westfield on request and a significant number of retailers already take advantage of that facility. It is Westfield's understanding that other large shopping centre landlords provide a similar facility to retailers.

Accordingly, in Westfield's view, there is no demonstrated justification for these particular reform measures in relation to the collection of turnover 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.

Insofar as the submissions made advocate that an independent third party or regulatory agency should be empowered to collect such turnover data in lieu of shopping centre landlords, Westfield notes that this would serve to create yet a further regulatory structure and create additional cost (some or all of which would be borne by the tenants) when the relevant information in an appropriate form is already available at no cost, certainly in Westfield shopping centres and shopping centres owned by other major landlords. Again, Westfield observes that the tenor of these submissions, which is to advocate further regulatory intervention and the establishment of regulatory structures in an already over regulated industry in circumstances where no need for such regulatory intervention has been substantiated, runs counter to the Commission's views as expressed in the Draft Commission Report that the industry should progressively move to less prescriptive regulation.

Westfield fully supports the position of the SCCA in relation to this issue (see Section 6 of the SCCA Second Submission).

In conclusion, Westfield records its appreciation for the opportunity that this inquiry has presented for it and other participants in the retail leasing market to put forward their views in relation to an industry which has great economic significance not only to its many different stakeholders ranging from institutional investors, superannuation funds, small investors, landlords and retail tenants but also to the consuming public and the nation as a whole. Westfield is pleased that unlike many of the previous inquiries and reviews that have taken place in relation to this industry, in making its draft recommendations and findings the Commission has approached its task with objectivity, proper economic analysis and rigour based on ascertainable fact and evidence in preference to unsubstantiated allegation and anecdote.