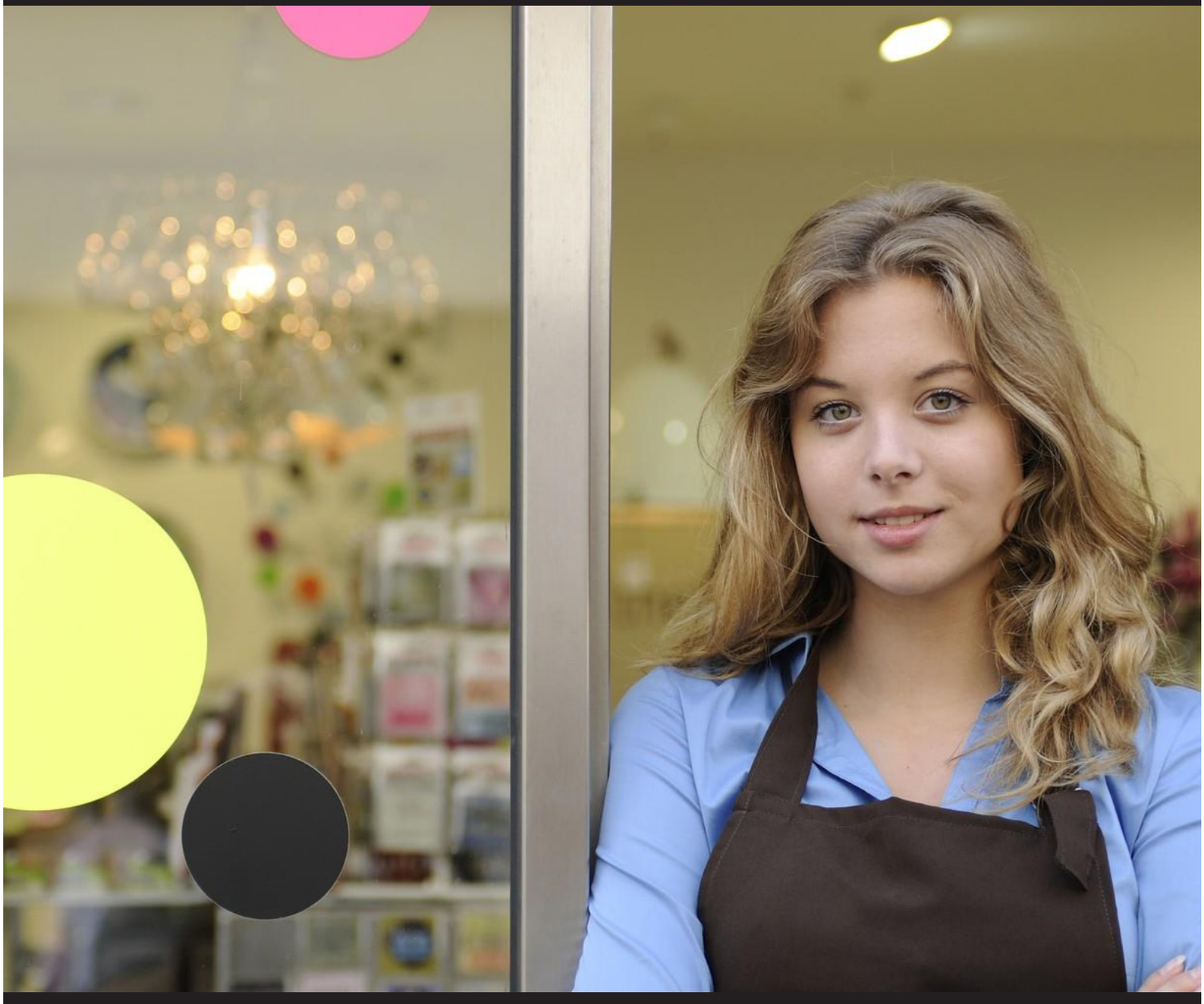
Australian Retailers Association

Ensuring retail success since 1903



Extending Unfair Contract Term Protections to Small Business – Retail Shop Leases

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Extending Unfair Contract Term Protections to Small Business – Retail Shop Leases

The Australian Retailers Association (ARA) is urging the Government to use the Unfair Contract Term Protections to Small Business to assist retailers in Australia who face a difficult operating environment. In the last ten years, the structure of the retail sector has shifted and evolved as a result of globalisation, advances in the digital economy and changes to business practice policies (such as employment and tenancy frameworks). In addition, the retail sector has experienced varying economic environments with the Global Financial Crisis (GFC), an inflexible wages system, lack of consumer/business confidence and the high Australian dollar having a significant effect on the performance of the industry and increasing trade exposure from overseas.

The ARA continues to advocate for greater harmonisation across jurisdictions. While not harming competitive federalism being advocated by many State Governments, the cost benefits from standardisation to national retailers are significant.

The ARA offers support, information and representation to over 5,500 member retailers representing over 50,000 retail outlets across every State and Territory and works closely with the Government and other industry participants to ensure the long-term viability and position of the retail sector as a leading contributor to the Australian economy. The ARA delivers training, tenancy advice, consumer law advice and employment relations advice (registered with the Fair Work Commission) in every State and Territory, which makes the ARA the only body undertaking these activities for the retail sector in every State. We believe reform of regulation and reduction in tax along with duties as well a reduction in compliance burden for business and consumers will see the Australian economy and Australian retailers return to their traditional strength.

Sources: ABS Labour Force, Australia, detailed quarterly 6291.0.55.003; ABS State National Accounts, 5220.0; ABS Count of Australian Businesses, 8165.0

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Unfair Contract Terms and Small Business Consultation Paper
Small Business, Competition and Consumer Division
The Treasury
Langton Crescent
PARKES ACT 2600

Key issues:

Extending Unfair Contract Term Protections to Small Business – Retail Shop Leases

This year represents the twentieth year since specific and extensive retail lease legislation began to be introduced by State and Territory Governments. This has been driven by the concentration of retail into major centres and has caused rental distortions, including an oligopolistic market place which has allowed in some cases unfair behaviour to appear whether that be unintended or not.

The legislation included development of dispute resolution systems specific to the retail shop commercial property industry. However, there remains a significant imbalance in the bargaining power between small retailers and large landlord's portfolio managers.

Even after an in-depth and substantial 'Productivity Commission Report – The Market for Retail Tenancy Leases in Australia 2008' which proposed nine specific recommendations to promote transparency towards a more informed market with the view to addressing directly these imbalances, no positive action nor steps have taken place to date.

Even though the then-Government openly supported the Productivity Commissions Report recommendations and noting a reasonably high level of bipartisan support from industry stakeholders, six years have gone by with no improvements to the problems.

Certain areas of the contractual relationships between landlord/lessor and tenant/lessee need to be explored under the Australian Consumer Law (ACL).

The areas of imbalance under a retail tenancy shop lease contract that need addressing are;

i. Procedural unfairness
ii. Unconscionable conduct
iii. False, misleading and deceptive conduct
iv. Information disclosure arrangements

Due largely to the nature, structure and resources of small retail business in these transactions there remains a potential for under-reporting of a problem as most feel powerless in the face of a contract or lease they see as non-negotiable particularly in light of the huge resource advantage of most landlords.

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i. Procedural unfairness

In either entering into a new lease for the first time or the renewing of an existing lease the most contentious issue will always be the amount of rent the landlord seeks under the lease contract.

Market forces will clearly always be the major factor in negotiations. There is evidence to suggest that there remains concern around the circumstances surrounding or the processes leading up to the formation of a retail lease which includes the amount of rent contract and available information.

The huge amount of data available to the larger landlords since the inception of shopping centres has created an enormous imbalance in these circumstances.

Noting that the majority of this information is in fact provided to the landlord by the lessee, in the form of sales and performance outcomes under the guise of "turnover rental", or other such contractual clauses contained in the lease, this has grossly compounded the significance of this imbalance.

Any active industry operative will confess to the reliance upon "portfolio averages", "category occupancy costs" or such third party resources as 'URBIS industry averages", when seeking to set the terms and conditions of a lease contract.

Examples and a fuller understanding of these circumstances and processes can be presented at the stakeholders meetings.

An area of substantive unfairness is the issue surrounding the level or standard of fit out or capital required.

This is more pronounced at the end of a lease where the lessee has not realised the investment of the capital applied to the fit out and where the landlord either:

i. Does not seek to renew the lease; or
ii. Seeks to renew the lease with a substantial rental increase; or
iii. Seeks to renew the lease with further onerous and substantive fit out requirements.

The compelling case is the end of a lease where the lessee was unfairly contracted to install a fit out usually in the hundreds of thousands and the landlord promotes a rental level to renew the term with the full knowledge the lessee is in no financial position to walk away.

(Specific case examples can be provided at a stakeholders meeting on the basis of the possible ramifications upon lessees providing such evidence.)

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ii. Unconscionable conduct

Unconscionable conduct is noted in most States and Territory retail tenancy legislation and is referred to the Australian Competition and Consumer Commission (ACCC) as the applicable industry code.

The meaning of unfair and the test for unfairness under Schedule 2, 5.24(1) of the Act and Schedule 128G of the ASIC Act are in essence similar, it is more clearly set out in plain English "A guide to the unfair contract terms law" than the varying provisions about unconscionable conduct.

It is our view that encompassing small business via extending the unfair contract term protections to small business will provide a better understanding to small retailers when seeking to interpret such terms as 'significant imbalance', 'not reasonably necessary', 'detriment' and 'a transparent term'.

(Actual case examples of landlord, lessors agents acting unconscionably can be made available at a stakeholders meeting.)

iii. False, misleading and deceptive conduct

The issues can vary significantly, and from our experiences are grossly under-reported, noting again the feeling of powerlessness when faced with the non-negotiable and resource rich advantage of the landlord.

Many examples of false, misleading or deceptive conduct can be described as unconscionable conduct in whole or at least in part.

The majority of instances are derived from the significant imbalance in resources and information between landlord and lessee when addressing a lease contract event.

The common result is an unfair negotiation leveraged by the relatively superior strength of the landlord.

The outcomes can further be described across the process as representing substantive and procedural unfairness.

(Case examples available at stakeholder meeting)

iv. Information disclosure arrangements

Although there remains varying formats of lease contract disclosure arrangements between the

parties to the lease contract, these do vary between the States and Territories.

It would be ideal to seek a standard form contract for all retail tenancy leases, however given the nature, structure and commercial diversification of the landlord stakeholders and the legislative road blocks the States and Territories have evidenced in the past, achieving such a standardisation is not realistic.

However, the promotion of a national standard form lease disclosure document has the very real potential to resolve a major portion of the issues covered in this submission.

Having such a single format disclosure to the lease contract publicly accessible would transform the significant imbalances over time and would result in a major reduction in red tape.

The concept of a national standard form lease disclosure has bipartisan support from industry stakeholders including landlords and the ARA.

A draft example has been prepared in readiness for presenting to the Small Business Commissioner and the stakeholder meeting for consideration of adoption in lieu of a standard form lease contract.

Further, we see that the introduction of a national standard form lease disclosure as being the catalyst to the harmonisation of minimum retail tenancy lease standards nationally.

There has been some interim discussion amongst stakeholders as to the costs and benefits of the standard form disclosure being publicly accessible and such submissions on this subject should best be addressed more specifically under separate cover.

Summary

This submission does not seek to introduce more proscriptive retail lease legislation as the current separate State and Territory legislations are already in place.

This submission does seek to address the failures or lack of action to address the inherent imbalance in the contractual arrangement between the parties when processing a retail tenancy lease negotiation.

We have deliberately sought not to seek Government input into the quantum of the rent, this must remain commercial between the parties but there must be adopted more transparent and open processes in the negotiation of such commercial considerations.

Otherwise there will remain the current culture of unfair contractual lease outcomes.

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Retail tenancy and planning reform

The ARA has historically worked with interest groups in the tenancy space and is the only national retail body with coverage in every State and Territory. The ARA is also not compromised unlike other groups purporting to represent the retail sector who are financed by landlord groups.

The ARA has also outlined below our historic position on various areas of market failure. While we do not believe the unfair contract proposal will relieve all of these pressures, it is important for any consultation to understand the context of the current position retailers find themselves in.

The dependency on securing tenancies within shopping centres poses a significant structural challenge for the ongoing viability of the retail sector. The oligopolistic nature of shopping centre ownership and a retail tenancy regime which is skewed in favour of these large-scale landlords both present an inherent disadvantage to Australian domestic bricks and mortar retailers in terms of equitable competition.

In practice, while there may appear to be a market of competing shopping centre owners, these are in fact shared ventures where centres may be 25 or 50 percent joint-owned by consortium. The sharing of turnover figures relevant to individual retailers, leading to greater inequity in the marketplace for retailers attempting to negotiate with these consortium landlords, has become one of the industry's most significant issues.

The ARA has agreed with the overall intent of Productivity Commission reports that all the current national Tenancy Working Group projects overseen by COAG must achieve a more equal framework for retailers negotiating leases; however this needs real Federal Government support to drive change. The ARA does recognise some State Governments have identified transparency of information and level playing field issues and commends those governments for taking action to rectify problems.

There are four distinct issues retailers within shopping centres are currently facing in relation to retail tenancies that the ARA would see as needing to be addressed.

Objectives

In addition to the base rental cost, significant additional rental expenditure is imposed through "turnover rent" whereby, built into the rental agreement, the landlord is entitled to a percentage of takings in addition to the minimum rent.

A retailer conducting business in a rental premise has little long-term certainty, significant costs associated with set-up, and relocation is heavily leveraged at the point of re-negotiation. Due to the standard terms of a lease, which is usually five or seven years, a retailer has no security and can be told to leave the premises for the simple reason of "not fitting" with the centre's image, notwithstanding the investment into the retail space. Retailers are subject to the perceived threat that an alternative tenant is prepared to pay more for the same tenancy.

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- The ARA believes there should be a first and last right of refusal by a sitting tenant on any rental offering
- The ARA seeks to require that a sitting tenant must be offered both first and last right of refusal to release the premises prior to the landlord executing a lease for another tenant. We believe that such a mechanism will force the landlord to meet the real market value for the demised premises and not take advantage of a veiled threat or misrepresentation of the true facts as to an alternative tenant for the tenancy. We also believe this mechanism will create an environment conducive to bargaining in good faith, fair disclosure and transparent undertakings
- The ARA also see this mechanism as being a solution to the problem experienced by a retailer whereby a sitting tenant effectively gives up a large percentage of goodwill of the business to the landlord (via increased rent) as a defence to the threat that a third party will take over the lease at a higher rent without having to purchase the goodwill of the existing business
- Abuse of the "turnover rent" provisions by landlords where they are able to determine rent increases which are geared within what a retailer "can afford to pay" rather than a common and transparent market rate mechanism thanks to accrued data provided under the turnover rent clauses needs removing
- The structure of such a term is usually based around financial requirement within the lease to pay a percentage of turnover rent as an additional rent component. Almost without fail, this financial requirement to pay turnover rent is set at such an unrealistic level of turnover which would most likely never be achievable by the tenant
- The ARA believes the retailer's monthly turnover figures should be reported by the tenant to a third party aggregator, and not directly to the landlord. These figures can then be advised from the third party to the shopping centre on an aggregated category basis, rather than individual figures being reported to the landlord directly which would allow landlords access to the statistics they require to run a centre and retailers a level playing field. An exception could apply if the rent paid by the retailer was based solely as a percentage of tenants' turnover figures
- In the period after the current lease term is expired, but prior to a new lease being agreed to, the tenant is regarded as being the occupant month-to-month under a "lease hold over prevision" period. If, and when, a new lease is signed at a different rate, the retailer is obliged to pay back the difference and this is obviously an unbudgeted and unexpected financial burden to the individual retailers.

For these reasons ARA would require these changes to protect tenants' turnover and any other commercial in-confidence information which could impact on negotiations with landlords.

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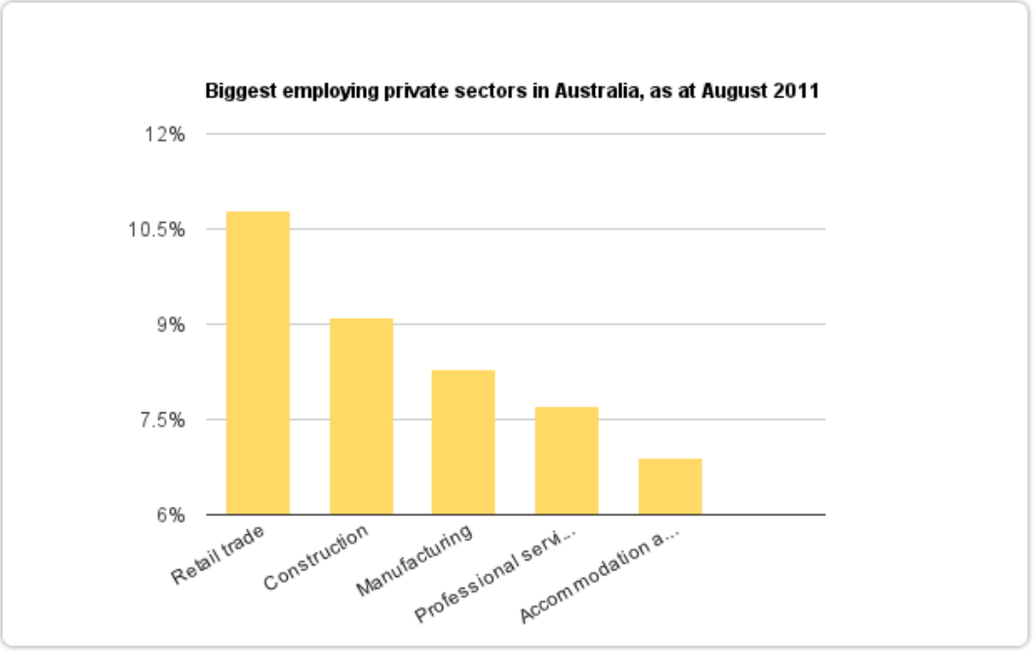
Almost 140,000 retail businesses in Australia



Source: ABS Labour Force, Australia, detailed quarterly 6291.0.55.003

Planning

The Council of Australian Governments (COAG) should be the recommended body used to facilitate a national approach which will create a greater availability of retail space in retail activity areas driven by the Federal Government.

The ARA supports any move to create a greater competitive environment allowing retail development to be a positive outcome, and the ARA would like to see a mechanism facilitated by the Federal Government through COAG to achieve this outcome.

- Take into consideration the social and economic impacts of "dead centres," when local government undertakes assessment of new "out-of-centre" planning proposals. The ARA would support this if part of that assessment would be to still allow rejuvenation projects in existing retail areas. It is also important to consider "out-of-centre" developments which are beneficial to the community such as outlying areas
- Costs being awarded against vexatious planning appeals would, in all reason, reduce compliance costs, time and funding costs for retail developments. As with a number of these matters, the Commonwealth would need to look at ways of facilitating this move through mechanisms such as COAG
- ARA will support moves which reduce unnecessary regulatory development costs
- With improving technology, local Government could undertake large parts of the approval processes electronically using methods such as process application interfaces meaning as an application went through an applicant could instantly see what was wrong before trying to continue and address the issue immediately. This would limit the appeals process, improve the

ability of council staff to understand the commercial implications of any delays and gain an understanding of how significant any delays can be for developers and retail tenants.

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