SHOPPING CENTRE
COUNCIL OF AUSTRALIA

Extending Unfair Contract Protections

To Small Businesses

Submission on the Consultation Paper May 2014

Submission by the

Shopping Centre Council of Australia

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Attachment A: **Minter Ellison 'Retail Tenancy Legislation Compendium**

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Consultation Paper - Extending Unfair Contract Term Protections to Small Businesses – May 2014 – Exemption of leases regulated by state/territory retail tenancy legislation

1. Executive Summary

The Shopping Centre Council of Australia is firmly of the view that the extension of the unfair contract terms (UCT) provisions of the *Competition and Consumer Act* to standard form contracts involving small businesses will result in business uncertainty; will increase business costs in Australia; and will place Australia at a significant disadvantage compared to the countries with which we compete.

We believe it is vital for the efficient operation of a market economy that business relationships are able to be formed and operate within a legal framework that provides certainty and instils business confidence. It is also vital that bargains that are struck will endure and be enforceable and are not lightly put aside by courts or tribunals. That is why comparable countries have not taken the radical step that Australia is about to take.

The relationship between business and consumer (for which the UCT regulation was conceived) is quite different to that between business and business. Businesses, whether large or small, must do their homework if they are to succeed and must take responsibility for the business decisions they make. The business to business contract, unlike the business to consumer contract, is commercial in nature and is one on which small businesses could be expected to obtain legal advice. Even if legal advice is not obtained businesses, including small businesses, have greater knowledge of contractual terms and have greater resources to enforce other legal and contractual remedies. In a competitive market, businesses (again including small businesses) also have greater opportunity to negotiate terms than do ordinary consumers.

We are also concerned that the extension of the UCT provisions to business contracts will put the focus on the individual terms of a contract and does not take into account the complexities and subtleties of commercial negotiations. There are many circumstances where businesses compromise and consciously accept less favourable contractual terms in one area in exchange for more favourable terms in another area. Examination of a contractual term by a court will fail to appreciate the overall commercial context and the nuances of commercial negotiations. Courts typically are not commercially experienced and judges generally do not have commercial training or commercial expertise.

We also note that the proposed extension of the UCT provisions to business contracts is inconsistent with '*The Australian Government Guide to Regulation*', released by the Parliamentary Secretary to the Prime Minister, the Hon. Josh Frydenberg MP, in March 2014. The first two of the 'Ten Principles for Australian Government Policy Makers' in that Guide state: 'Regulation should not be the default option for policy makers: the policy option offering the greatest net benefit should always be the recommended option'; and 'Regulation should be imposed only when it can be shown to offer an overall net benefit'.

Nevertheless the Federal Government has made clear on several occasions its determination to fulfil its election policy commitment to extend the UCT provisions to standard form contracts involving small businesses. According to a media release on 13 June 2014 the Federal Minister for Small Business, Mr Billson MP, said a meeting of Australian State and Territory Consumer Affairs Ministers "have thrown their support behind an extension of unfair contract term protections to small business."

Given the Federal Government's repeated determination to fulfil its election commitment, therefore, we see little point in addressing Option 1 (Status quo) and Option 2 (Light touch or non-regulatory responses) since these have already been ruled out by the Minister. Our submission therefore addresses only Option 3 (which the Consultation Paper notes is the 'Preferred Option') and Option 4. We understand, from discussions with the Business Council of Australia, it will be addressing Option 1 in detail in its submission. We note our disappointment, however, that only now, after the election policy commitment has been made, is the Federal Government seeking evidence that such an extension is justified and is only now seeking to assess the implications. It is worrying that such a radical and sweeping new law, which has the potential to seriously erode business confidence and certainty, can be pledged for no compelling reason and without proper and rigorous analysis.

We are firmly of the view that it is not appropriate to simply "extend" the existing UCT provisions to business contracts without modification of those provisions to take into account the very different business to business context.

The three major changes we **recommend** are made if the UCT provisions are extended are:

- The current exemption in section 26 (Part 2-3) of the Act, that the laws do not apply to "a term required, or expressly permitted, by a Commonwealth, State or Territory law" should be extended to include *"or which meets the minimum standards of a law of the Commonwealth, State or Territory".*
- The 'rebuttable presumption' in section 23 (that a contract is presumed to be a standard form contract) and in section 25 (that a term of a contract is presumed not to be reasonably necessary to protect the legitimate interests of the party) should be reversed so that the onus is on the party challenging the contract term.
- Guidance must be given in the legislation, or in the Explanatory Memorandum, on the degree of negotiation which must occur before a contract falls outside the scope of being a 'standard form contract'. In our view once a single term has been amended, this is sufficient evidence that a contract is no longer a standard form contract.

We also **recommend** the definition of a 'small business' for the purposes of extending the UCT provisions be consistent with the definition of a 'small business employer' in the *Fair Work Act* i.e. a business that employs fewer than 15 employees. If this is not accepted we **recommend** the definition of a small business entity in the *Income Tax Assessment Act* 1997 be adopted i.e. an aggregated turnover in the previous year of less than $2 million.

We strongly **recommend** that publicly listed companies, and subsidiaries and related body corporates of publicly listed companies, are excluded from the UCT provisions, irrespective of the definition of 'small business' that is adopted.

We also **recommend** that retail leases (contracts) which are regulated by state and territory retail tenancy legislation should be exempted from the new law.

In making this final recommendation we are responding to comments by Minister Billson, in his address to the Franchise Council of Australia on 21 October 2013, in which he stated he did not intend to create a "forum shopping extravaganza" and that, where satisfied there is "enforceable equivalence" through other mechanisms that provide protections for small business, "we won't go at these transactions twice". In *Business Spectator* on 5 February 2014 the Minister was paraphrased as saying "to be exempt from the proposed legislation organisations must show that the existing regulations achieve the same objective as the proposed legislation . . ."

Throughout Australia there exists extensive state and territory legislation regulating retail leases. This legislation is long-standing; is industry-specific; and contains detailed provisions regulating all aspects of retail leasing. The general approach of this legislation is to outline minimum conditions which must apply in the lease entered into by the landlord and tenant; to lay down detailed rules on key aspects of the retail tenancy relationship; and to seek to resolve retail tenancy disputes by easily-accessible and cost-efficient mediation. In other words the legislation exists in order to ensure there is a *fair* relationship between landlords and small (and, even, medium-sized) tenants. If mediation is not successful either party is able to refer the matter to specialist tribunals for prompt and objective arbitration. In serious cases involving allegations of unconscionable conduct, retail tenants have the opportunity of bringing applications under the *Competition and Consumer Act* ("the Act") via the Australian Competition and Consumer Commission or the relevant state tribunals under the unconscionable conduct provisions of state retail tenancy legislation.

There is, therefore, already in existence an extensive body of legislated rules about fair behaviour by retail property owners and their managers when dealing with their tenants and legislated rules about fair retail lease terms. If a lease term fails to meet the minimum standards in the legislation, the lease term is void. Where a tenant claims an owner or manager has breached one of the rules there is adequate redress by low cost mediation or, as a last resort, legal proceedings in specialist tribunals.

We understand Australia is unique among western countries in having such detailed legislation governing retail leasing. We also believe there are very few other areas of commerce in Australia where business to business contracts are already so highly regulated by governments.

We have demonstrated in section 4 of this submission that the existing state and territory retail tenancy legislation achieves the same objective as the proposed extension of UCT provisions but does so in a much more direct and more comprehensive manner and with much greater certainty for all parties. This legislation does not rely on vague and subjective notions about whether a lease term is 'unfair'; nor depend on the vagaries of judicial interpretation. State and territory retail tenancy legislation not only provides "enforceable equivalence" to the extension of the UCT provisions; the legislation is far superior in providing protections for small retail businesses, not only in negotiating the terms of leases but in the day-to-day administration of the lease.

Without an exemption for those retail leases already regulated by state and territory governments, the Federal Government's proposed extension of the UCT provisions to business to business contracts will impose an additional layer of business regulation. This will mean 'double regulation' of these contracts. It will also mean regulation which is inconsistent with, and which potentially undermines, state and territory legislation (as explained in section 2.11 of this submission). This will also counteract the Government's objective of reducing unnecessary business red tape by an amount of $ 1 billion a year.

2. Option 3 – Legislative Amendment To Extend The Existing Unfair Contract Term Provisions To Small Business Contracts (Preferred Option)

2.1 Definition of small business

It is important that the new law applies only to those small businesses considered to need the protection of Parliament in their business dealings. As the Consultation Paper notes, the more businesses that are covered, the higher the compliance costs imposed on Australian industry. It is also the case that the more businesses that are covered, the more likely that 'moral hazard' will become a feature of Australian commerce.

The most common definition of a 'small business' is one which employs fewer than 20 employees. As noted on page 63, however, this is a very generous definition since, according to ABS data, approximately two million businesses, or around 97% of total businesses in Australia, would be covered by this definition. We therefore **recommend**, on the grounds of consistency, the definition of a 'small business employer' in the *Fair Work Act* also be adopted for the purposes of this law i.e. a business that employs fewer than 15 employees at a particular time.

If this recommendation is not adopted then we **recommend** the definition be based on annual turnover. Again, on the grounds of consistency, we recommend the definition of a 'small business entity' in the *Income Tax Assessment Act 1997* be adopted for the purposes of the new law i.e. an aggregated turnover in the previous year of less than $2 million.

We do not believe a transaction threshold is appropriate for this purpose since this would also inadvertently permit large businesses to challenge a contractual term since not all transactions of large businesses are themselves large. A transaction threshold is also likely to come under pressure from small business organisations to be increased on a regular basis. The unconscionable conduct provisions in the (former) *Trade Practices Act*, for example, originally had a transaction threshold of $3 million. After lobbying this was increased to $10 million and was ultimately abolished.

An exclusion of publicly listed companies by itself is not a sufficient definition of a 'small business'. In retailing there are many examples of unlisted companies (such as BB Retail Group and the Cotton On Group) which own hundreds of retail stores, which obviously give them a bargaining strength far in excess of any single landlord. This would also permit some international retailers, such as Zara, to be covered. The grocery chain Aldi, for example, with more than 300 stores in Australia (and further growth planned), is an unlisted company and it would obviously be absurd for Aldi to have the protection of the UCT provisions.

We strongly **recommend** that publicly listed companies, and subsidiaries and related body corporates of publicly listed companies, be excluded from being able to rely on the UCT provisions, irrespective of the definition of 'small business' that is adopted. While such an exemption would probably be unnecessary if our recommendations above for a definition of 'small business' were adopted, it is important this exclusion be established from the outset, particularly if a different definition of a 'small business' is adopted. We note that publicly listed companies are excluded from actions for unconscionable conduct under section 22 (Part 2-2) of the Act. It would be anomalous if they are not also excluded from the UCT provisions.

2.2 Large business to small business contracts

The Consultation Paper raises the issue of whether to extend the UCT provisions only to large business contracts with small business or to also include small business to small business contracts. Any notion that small business to small business contracts should be regulated should be emphatically ruled out. The only justification for regulating business to business contracts is an assessment that there is some aspect of market failure, such as an imbalance in bargaining power. We are unaware of any evidence that suggests there is a market failure in markets where small businesses are dealing with small businesses.

2.3 Acquisition versus supply

The Consultation Paper also raises the issue of whether the UCT provisions to all contracts involving either supply or acquisition of goods and services by small businesses or only contracts involving acquisition of goods and services by small businesses. We strongly believe any extension should be limited to small business contracts involving the acquisition of goods and services from another business (option B2 on page 65). Buying and selling are very different concepts. Where a small business is the seller of goods or services, they may decide to participate in a competitive tender or an RFP process where the purchasing company uses standard terms for the acquisition of goods or services. This process allows the purchaser of the goods or services to compare 'apples with apples'. If the UCT provisions are extended to include the supply of goods or services by a small business, a company looking to acquire goods or services may elect to only seek tenders from, or contract with, exempt entities seeking to avoid the potential contractual uncertainty associated with a small business supplier as against an exempt supplier.

2.4 Standard form contracts

One of the problems in "extending" the existing UCT provisions to business contracts is the implicit assumption in the ACL provisions that a 'standard form contract' is inherently 'bad'. This can be seen from the list of matters which a court must take into account in deciding whether a contract is a standard form contract. The guidance currently given to courts include "whether another party was, in effect, required to accept or reject the terms of the contract . . . in the form in which they were presented" and "whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties." These matters carry overtones of being commercial behaviours that should be discouraged.

This is faulty thinking, however. Standard form contracts which are clear in their terms; are disclosed well in advance of exchange; and have been crafted by industry associations and their lawyers/experts with due regard to the legitimate interests of all sides; are obviously beneficial. Such beneficial standard form contracts should be encouraged by governments, not discouraged. For small businesses, in particular, beneficial standard form contracts minimise legal and other costs, minimise risks and encourage consistency of treatment. They are particularly useful where the subject matter of the relevant contract is of relatively little value (having regard to the time and costs likely to be involved for the parties negotiating each time the contract from scratch) or where little time is typically afforded to the prospective parties to enter into contract.

In business transactions there are many instances where standard form contracts are beneficial. (There are also many beneficial standard form consumer contracts, such as the Law Society of NSW's widely used 'Contract for the Sale of Land,' which is also sometimes used by businesses.) 'Standard' retail leases, for example, are produced by bodies such as the Law Society and the use of such leases is often encouraged by State Governments. This is because such leases considerably reduce business transaction costs for small businesses. A tenant can enter into such a lease with the knowledge that, since it has the imprimatur of an independent body such as a Law Society, it is a 'fair' lease and is therefore likely to include all necessary protections. The use of such leases is often common, for example, in 'retail strips' (which do not have the leasing complexity of a shopping centre) and such strips usually have a higher proportion of small business tenants than in a shopping centre. It is anomalous, and borders on the absurd, that the terms of such leases (which are designed to reduce legal costs on small business and to simplify business transactions) will now be open to challenge because they are clearly 'standard form contracts' and because one party (for example, the tenant) is not prepared to incur the legal costs involved in, and taking the risks associated with, negotiating the terms of that industry accepted lease.

Most large businesses operate on the basis of 'standard leases' or 'precedent leases'. This is obviously the most efficient way of doing business. Such standard leases have often been compiled and refined as a result of years of experience having regard to the legitimate interests of both lessors and lessees. These leases are obviously prepared by one party before any discussion has occurred with the actual other party, notwithstanding that they generally take into account the interests of the other party. This is standard commercial behaviour. Indeed, in the case of shopping centres, retail tenancy legislation requires that a copy of the standard lease be provided to prospective tenants at the commencement of negotiations. It would obviously be absurd if such standard leases were deemed by courts to be a 'standard form contract', and the terms of which are liable to be declared void, simply because they are required by legislation to be prepared in advance of negotiations beginning over the terms of the contract.

2.5 'Rebuttable presumptions'

In a business to business context there is no justification for reversing the usual onus of proof and including a presumption that all contracts are 'standard form contracts', thus putting the onus on the party seeking to enforce the contract to prove that it is not a standard form contract. This would have the effect of encouraging businesses to seek to avoid their contractual obligations and to contest litigation, something the Government has said it wants to avoid.

The onus should be on the party challenging the contract term to prove that the contract is a standard form contract rather than the party seeking to rely on it. The contract should be assumed to be binding unless shown to be otherwise.

Similarly, in the current UCT provisions, a term of a consumer contract is presumed not to be reasonably necessary to protect the legitimate interests of the business and it is up to the party who would be advantaged by the term to rebut the presumption. Whilst this may make sense in a business to consumer contract it makes little sense in a business to business contract. Executives of public companies, in particular, have a duty to take every action they can to protect their shareholders' investments. It should not be a function of a court, with little business experience in business, to make such a judgment without an understanding of the general commercial context which may require such a term.

Where a landlord, for example, seeks to rely on a term of a lease which was originally drafted and approved by the Law Society (with every intention of representing a fair balance between the legitimate interests of both lessors and lessees), there is no justification for that landlord having to bear the burden of proving that the compromise originally reached by the Law Society constitutes a compromise that was reasonably necessary in order to protect the landlord's interests.

At least where the terms of the proposed contract were available to both parties well in advance of exchange, or where the parties have a cooling off period, the rebuttable presumption should instead be that each term of a business to business contract is reasonably necessary to protect the legitimate interests of one or other of the parties to that contract.

Contract terms are not included in business contracts in order to make the document as complex or as thick as possible. Shopping centre lease terms, for example, are included because many years of legal and operational experience have found them necessary to protect both the property owner's and the lessee's legitimate interests. Once again the onus should be on the party challenging the contract term to demonstrate that the term is not reasonably necessary to protect the legitimate interest of the party advantaged by the term.

We **recommend**, if the UCT provisions are extended to business contracts, the current presumptions - that a contract is a standard form contract and that a contract term is not reasonably necessary to protect the legitimate interests of the business - are reversed.

2.6 Meaning of unfair

The concept of 'unfairness' is subjective. Because each party to a commercial transaction between businesses is obliged to protect its own interests, the concept provides no meaningful guide as to how one business is to act in a particular transaction with another business. Commercial parties require laws that, in any given situation, ensure both parties seeking legal advice as to their rights and obligations can expect clear, confident and consistent answers from their advisers. Those laws should ensure neither party is tempted to embark on lengthy and expensive litigation in the belief that victory depends on winning the sympathy of the court or winning the lottery of which judge may be sitting on the bench.

This is one of the reasons why successive governments in Australia, until now, have rejected the adoption of vague and subjective concepts such as 'fairness' as a legal norm or standard (rather than a desirable guiding principle) in transactions between businesses.

One of the key legal doctrines in Australia is the separation of powers doctrine which suggests that all regulation should set down clear standards which are capable of being interpreted and applied correctly and consistently by judges, without wide judicial discretion on matters of subjective merit which require arbitrary or prerogative judgment.

Section 24 (Meaning of unfair) and section 25 (Examples of unfair terms) of the UCT provisions ignore this doctrine by including vague terms which give considerable discretion to judges to make determinations on the basis of their own perceptions, rather than clear and consistent standards. Section 24, for example, affords a court an extraordinarily wide discretion in that it "may take into account such matters as it thinks relevant". While this might not be consequential in a business to consumer contract it can have profound consequences in the context of business to business regulation. It is not clear whether, and to what extent, this discretion may be read down so that it is confined to matters relevantly connected to the actual findings that the court is required to make in relation to the definitional elements of section 24.

This uncertainty is compounded by the fact that it is not clear that an appeal could lie against a decision of a court in such cases. Appeals normally lie only in matters of law. Decisions on whether a contract term is unfair will be a subjective decision, given the vagueness of these concepts. Provided a court does take into account the items listed in section 22(2) it is difficult to see how an appeal can lie against the court's exercise of its discretion of "such [other] matters it thinks relevant."

The fact that the individual subjective views of judges as to what, in a given set of circumstances, is fair will most likely not be able to be appealed against means that there will not be a 'rule of law' but rather the 'luck of the draw'. Without appellate overview there will also be no meaningful development of binding precedents and consequently no consistency of decision making. There is no prospect of a coherent and consistent body of case law being compiled.

We also question the relevance of 'transparency' as a criterion to be taken into consideration (section 24(3)) in deciding whether a lease term is unfair in a business to business contract. While this may be a relevant consideration in a consumer contract, business contracts are very complex, are drafted by lawyers and contain contractual terms that are well understood by legal practitioners but might not be "readily available to any party affected by the term".

2.7 Types of unfair contract terms

The UCT provisions include a non-exhaustive list of examples of the types of terms in a standard form contract that a court *may* regard as unfair. The provisions do not prohibit the use of these terms; nor do they create a legal presumption that the terms listed are unfair. Each of these examples therefore leaves the actual decision as to whether or not they are unfair open to the discretion of the court, depending on the particular circumstances. This creates significant uncertainty for businesses which are otherwise seeking reasonable certainty from a contract, at least for the period of the contract. After all this is the very reason for the existence of contracts.

This uncertainty also means any audit by a company of its standard contracts, to determine whether or not these include terms which might be considered 'unfair', will be impossible to undertake since there is no relevant case law and interpretation of these terms will ultimately depend on judicial interpretation and the lottery of which judge sits on a particular case.

When the previous Federal Government proposed in 2009 to extend the UCT provisions to business contracts, the legal firm Corrs noted: "*Although terms of the type identified are not automatically regarded as unfair, it is unclear what weight the courts will place upon these legislative examples and defendants to unfair contract claims may face significant challenges in establishing that terms included in this list are not unfair.*" This observation remains valid today.

To give one example, 'a term that limits, or has the effect of limiting, one party's right to sue another party' may be unfair as may be 'a term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract', may also be unfair. Many business contracts contain clauses which stipulate that the terms and conditions contained in the lease comprise the whole agreement between the parties, and that no further or other terms and conditions are implied in the lease or arise between the parties because of any promise, representation, warranty or undertaking given or made by any party to the lease on or before the lease execution. The purpose of such clauses is to ensure that parties enter into a lease in good faith and that the lease term will not be characterised by disputes that are unrelated to the observance of the lease terms once the lease has been entered into.

Such 'whole of agreement' clauses are not a contract term with the purpose of seeking to limit a party's rights to sue on the contract. In addition, it is a clause on which most lessors will not compromise or negotiate, because to do otherwise would make the lessor vulnerable to vexatious claims if the lessee subsequently wished to terminate the lease. It is unreasonable and unjustifiable to suggest that such clauses may now be held to be unfair on the whim of a court. That would now be the risk.

The uncertainty for businesses created by the vague nature of the list of examples of unfair terms is compounded by the provisions leaving it open to future governments by regulation to proscribe further unfair terms by regulation. At present the relevant minister must take into consideration the detriment that a term could cause; the impact on business generally; and the public interest. Such a major step of prescribing an additional unfair term should be done by legislation, where the full scrutiny of Parliament can be applied, not by means of subsidiary regulation.

2.8 'Upfront price' of the contract

The Consultation Paper makes no reference to how the 'upfront price' of the contract would be handled in the event of an extension of the UCT provisions to business contracts. The UCT provisions do not apply to the up-front price payable under the contract provided it was disclosed before the contract was entered into. The up-front price is the amount the consumer agrees to provide under the contract and covers a future payment or series of future payments provided these were disclosed at the time the contract was entered into. In considering whether a future payment, or a series of future payments, forms part of the up-front price, a court may take into account whether these payments were disclosed in a transparent way. A court may also consider whether the consumer was made aware of the basis on which such payments would be determined at or before the contract was made.

We assume, if the UCT provisions are extended to businesses, that the upfront price payable under the contract will also be exempted, provided the same disclosures and transparency applies. In the case of a lease, we also assume the up-front price includes the amount of rent payable over the period of the lease, inclusive of options periods, provided the lease discloses the amounts payable in future years or the basis on which the future year payments will be made. The Federal Parliament has taken the position that an ordinary consumer has sufficient commercial acumen to understand and to negotiate the amount the consumer will be paying under the contract. It would be very strange if Parliament was to legislate on the assumption that a small business person has less commercial acumen than an ordinary consumer when negotiating a contract.

2.9 Extent of negotiations

The current guidance given to the courts (s. 27(2)) states that, in determining whether a contract is a standard form contract, the court must take into account (among other matters) "whether another party was, in effect, required to either accept or reject the terms of the contract [other than the exclusions in s. 26(1)] in the form in which they were presented". The guidance also includes "whether another party was given an effective opportunity to negotiate the terms of the contract [other than those nominated in s. 26(1)."]

A reasonable interpretation of these provisions is that only a contract that was presented as a 'take-it-or-leave it' contract (as a whole) could be found to be a standard form contract. If the party receiving the contract negotiates changes to, say, only one clause, this would appear to mean that the contract is no longer a standard form contract since this is evidence that the party was not required to accept or reject the terms of the contract and evidence that the party was given an effective opportunity to negotiate the terms of the contract. This is not clear, however.

When the previous Federal Government was contemplating similar legislation in 2009, the law firm HWL Ebsworth noted that *"even if some of an agreement is negotiated, terms that a party imposes on a 'take it or leave it' basis may still be able to be challenged under the unfair contracts provisions".*

In the case of a shopping centre owner, if the lessor was not prepared to compromise on some particular clauses (such as, for example, the standard of presentation it requires in the fit-out of tenancies), but was prepared to compromise on others, does this mean that the contract could still be found to be a standard form contract? This is another example of the uncertainty in business that will be created by this new law.

This uncertainty is compounded by the guidance to the courts in section 27(2) which states that the court may also take into account "such matters as it thinks relevant". This wide discretion given to the courts adds further uncertainty. We noted earlier that it is vital for the efficient operation of a market economy that business relationships are able to be formed and operate within a legal framework that provides certainty and instils business confidence. It is also vital that bargains that are struck will endure and be enforceable and are not lightly put aside by courts.

We **recommend** if the UCT provisions are extended to business contracts that the legislation or the Explanatory Memorandum eliminates, or at least reduces, the uncertainties that will be created by providing guidance on the degree of negotiation that must occur before a contract falls outside the scope of being found to be a standard form contract. In our view once a single term of a lease is negotiated this means a contract can no longer be considered a standard form contract.

2.10 Unintended consequences

The Consultation Paper asks if there are any unintended consequences that might arise from Option 3 (see Question 36). We have already noted several such consequences. The Consultation Paper at no stage contemplates whether or not the regulation of unfair contract terms has a potential to introduce greater 'moral hazard' in business transactions. It is our strong view that the extension of UCT provisions to business contracts will inevitably lead to less consideration and assessment being given by small businesses to normal business risks, and will mean small businesses will be more inclined to take on additional business risks, because they now believe they are more insulated from the consequences of those risks or that the consequences will be borne or shared by the other party to the contract.

We also believe the Consultation Paper fails to consider the possibility that the UCT provisions will lead to active discrimination by large businesses against small businesses in the issuing of contracts. This is because a business may refuse to take the risk that a commercial bargain freely negotiated between the two parties will not endure and be enforceable since the other party is free to seek to have a key term of that contract set aside by a court. We can give a possible example in retail leasing, where two prospective tenants are competing for the same tenancy, one of which is a small business just starting out in retail while the other is a retail chain with a large number of similar stores. If we assume each is prepared to pay the same rent for that space, the lessor may well decide to 'play it safe' and enter into a lease with the larger retailer simply because the lessor knows the negotiated contract with that retailer will provide certainty, whereas there will always be an element of uncertainty about entering into a contract with a small retailer.

2.11 Exemptions

The existing UCT provisions include a number of exemptions, such as contracts for shipping (which are subject to a comprehensive legal framework) and insurance contracts which are regulated by the *Insurance Contracts Act).* In section 4 we present our reasons for excluding retail leases (which, like insurance contracts, are already regulated) from the extension of the UCT provisions.

Irrespective of whether this recommendation is accepted, the existing exemption for terms that are required or permitted by another law is drawn too narrowly to be covered by this exemption. A clause permitting the relocation of a tenant in a shopping centre in the event of a genuine redevelopment proposal, for example, is only valid if it meets the minimum protections for the tenant specified in the relevant retail tenancy legislation, such as adequate notice, relocation costs, option to end the contract etc. (Such a relocation can only occur if the tenant has agreed to a 'relocation clause' in its contract). While such a clause is contemplated by state and territory laws it would not appear to be a term that is "required" or "expressly permitted" by Commonwealth, State or Territory law.

We could therefore face a situation where a particular judge (without any commercial experience in retail leasing) at the federal level makes a ruling that cannot be appealed that a relocation clause is, in his or her subjective view, 'unfair'. This ruling would be despite the fact that experienced experts representing all parties to retail leases at the state level, following decades of reviews and debates (set out in section 4.1 of this submission), have recognised the need for such clauses in order to enable the orderly redevelopment and expansion of shopping centres (and retailing). This might also be despite the fact that the relevant clause at issue may have exceeded what those experts over several decades have agreed represent the 'fair' protections for tenants in the event of such relocations. Such a decision could create great uncertainty in the marketplace and thus impede the development or redevelopment of shopping centres in Australia and this would be to the ultimate detriment of retailers and consumers alike.

We therefore strongly **recommend,** if the UCT provisions are extended to business contracts, this general exemption be widened to also include the words: "*or which meets the minimum standards of a law of the Commonwealth, State or Territory".*

2.12 Cost burden on businesses

The Consultation Paper notes that there will be transition costs for Option 3, including "familiarisation costs"; "the costs of ensuring terms are compliant and revising terms (if necessary)"; and "the costs associated with change in business processes if costs are amended". While the first cost category is generally expected when laws are changed, we have no doubt that familiarisation costs will be higher in this case because of the vague nature of the laws and the difficulty that will be involved in training and educating staff.

We believe the Paper underestimates the costs of "ensuring terms are compliant and revising terms (if necessary)". This assumes that any such risk audit will readily establish and identify 'unfair contract terms'. We have noted in section 2.6 of this submission our view that this is almost an impossible task, which cannot be informed by relevant case law, and therefore the resources that will have to be directed at this task will need to be significant.

We stress that the identified costs will be additional costs on retail property landlords unless our recommendation for the exclusion of regulated retail leases is accepted. Retail property landlords already incur significant costs as a result of administering retail tenancy legislation (such as the costs of preparing and keeping up to date disclosure statements, cost of adhering to the regulation governing payment of operating expenses, cost of auditing outgoing statements etc.)

Some of the compliance costs of retail tenancy legislation have been identified by the Productivity Commission in its inquiry into the market for retail tenancy leases (discussed in section 4.10 of this submission below). These are outlined in Box 10.2 on page 221 of the Commission's report.

3. Option 4 – Legislation To Require Standard Form Contracts With Small Businesses To Be Negotiated On Request

We consider this Option to be unworkable and it would seem from the discussion in the Options Paper that Treasury has come to a similar conclusion.

The Option presupposes that a small business will know in advance, and will be able to recognise, an unfair contract term. There is no list of unfair contract terms, however. The UCT provisions include a non-exhaustive list of examples which may be unfair. As noted in section 2.7 of this submission, however, such terms are not prohibited and there is no legal presumption that they may be unfair. In order for this option to be workable, both the party issuing the contract, and the party receiving the contract, would need to be able to recognise such a term. This is ultimately in the hands of a court and would not be possible until a substantial consistent, reconcilable body of case law has been assembled (which, as we have noted in section 2.6 above, is unlikely ever to occur).

Any party to a contract such as a retail lease will regard some aspect of the contract as 'unfair' in the sense that they would prefer to have been able to negotiate, say, a lesser/greater rent (ignoring for the moment that the upfront price is not challengeable) or, say, a more favourable fit out allowance. This does not necessarily mean, however, that the contractual term is unfair in the statutory sense. (Nevertheless, this could subsequently be found by a judge to be unfair). This highlights not only the unworkability of this Option but the significant difficulties in attempting to legislate according to vague and subjective notions of fairness.

The Option does appear to acknowledge that once a single term is negotiated in the lease then the "*contract would no longer be a 'standard form contract' (as it is no longer offered on a 'take it or leave it' basis) and would become a negotiated contract".* This is not acknowledged in Option 3, however, particularly in the discussion of 'standard form contract'. This reinforces our recommendation in section 2.9 of this submission that, if the UCT provisions are extended, guidance must be given in the legislation or the Explanatory Memorandum that once a single lease clause is negotiated the contract is no longer a 'standard form contract'.

4. Exemption of Leases Already Regulated By State and Territory Retail Tenancy Legislation

The Options Paper asks the question (p.40): "Are there other options not considered in this paper that would effectively address the problem [of possible unfairness in business contracts]".

In the area of retail property leasing, there are industry-specific options which address the issue of fair contracting in an objective (rather than subjective) manner; which are easily understood; and which provide all parties with reasonable certainty in the contractual negotiations. One such example is the leasing of retail property space.

All states and territories extensively regulate retail leases. This legislation is long-standing; is industry-specific; and contains detailed provisions regulating all aspects of retail leasing. The general approach of this legislation is to outline minimum conditions which must apply in the lease entered into by the landlord and tenant; to lay down detailed rules on key aspects of the retail tenancy relationship; and to seek to resolve retail tenancy disputes by easily-accessible and cost-efficient mediation.

In other words, the legislation exists in order to ensure there is a *fair* relationship between landlords and small (and, even, medium-sized) tenants. In the event of a dispute, and if mediation is unsuccessful, either party is able to refer the matter to specialist tribunals for prompt and objective arbitration. In serious cases involving allegations of unconscionable conduct, retail tenants have the opportunity of bringing applications to the ACCC under the *Competition and Consumer Act* or to relevant state tribunals under the unconscionable conduct provisions of the relevant retail tenancy legislation.

There is, therefore, already in existence an extensive body of legislated rules about fair behaviour by retail property owners and their managers when dealing with their tenants and legislated rules about fair retail lease terms. These rules are quite specific and they do not rely on subjective interpretation by a judge as to whether they are 'fair' or 'unfair'. If a lease term fails to meet the minimum standards in the legislation, the lease term is void. Where a tenant claims an owner or manager has breached one of the rules there is adequate redress by low cost mediation or, as a last resort, legal proceedings in specialist tribunals.

We understand Australia is unique among western countries in having such detailed legislation governing retail leasing. We also believe there are very few other areas of commerce in Australia where business-to-business contracts are already so highly regulated by governments. Without an exemption for those retail leases already regulated by state and territory governments, the Federal Government's proposed extension of the UCT provisions to business to business contracts will impose an additional layer of business regulation. This will mean 'double regulation' of these contracts.

4.1 State and Territory retail tenancy legislation

There is throughout Australia extensive state and territory legislation regulating retail leases. Five of the six states, and both territories, have enacted specific retail tenancy legislation. The other state, Tasmania, regulates retail leasing by a compulsory code of practice adopted by regulation under the *Fair Trading Act*.

The industry specific legislation, and the date of introduction of the original retail tenancy legislation, is as follows:

- *Retail Shop Leases Act* (Queensland) (1984)
- *Commercial Tenancy (Retail Shops) Agreements Act* (Western Australia) *(1985)*
- *Retail Leases Act* (Victoria) (1986*)*
- *Retail Leases Act* (NSW) (1994)
- *Retail and Commercial Leases Act* (South Australia) (1995)
- *Fair Trading (Code of Practice for Retail Tenancies) Regulations* (Tasmania) (1998)
- *Leases (Commercial and Retail) Act* (ACT) (2002)
- *Business Tenancies (Fair Dealings) Act* (Northern Territory) (2002)

In the eastern mainland states, where retail leasing is the most competitive, this legislation has been in existence (in the case of Queensland and Victoria) for nearly three decades and, in NSW, for two decades. (Prior to 1994, retail leasing in NSW was governed by a voluntary code of practice.)

The legislation is now well-established and is reviewed at very regular intervals. The NSW *Retail Leases Act*, for example, was introduced in 1994; was reviewed in 1998, leading to amending legislation in 1999; was further reviewed in 2003-05, leading to amending legislation in 2006; was further reviewed in 2008, but the draft amending legislation did not proceed following the change of government in 2011; and is presently being reviewed again. We doubt that any other piece of legislation in NSW has been substantially reviewed four times in 20 years.

Each review leads to the introduction of amending legislation which inevitably increases the amount of regulation. To give one example, the original *Retail Tenancies Act* in Victoria, in 1986, had 26 sections and was 37 pages; the *Retail Tenancies Reform Act,* in 1998, had 52 sections and was 50 pages; the current *Retail Leases Act,* in 2003, has 121 sections and 128 pages. This is a near quadrupling of regulation in Victoria in less than two decades.

4.2 Coverage of retail tenancy legislation

Retail tenancy legislation was originally conceived to be a protection for small retailers who were considered to be at a disadvantage compared to the superior bargaining power of landlords. The legislation was therefore meant to apply to 'small' retailers and to exclude 'large' retailers who were considered not to require the protections of Parliament in their dealings with their landlords.

The retail tenancy legislation of each state therefore includes a 'threshold' for determining whether or not leases of retail premises are regulated by the legislation. The most common threshold – in Queensland, NSW, the ACT, Tasmania, the Northern Territory and Western Australia is the '1,000 square metres' rule which means that retail premises which have a lettable area which is larger than 1,000 square metres are excluded from coverage of the Act. (In Queensland and the ACT such premises have to be larger than 1,000 square metres *and* be leased to a public company or subsidiary to be excluded.) To give some idea of the generosity of this 1,000 square metre threshold, the average speciality store inside a shopping centre is usually only around 100 square metres.

In Victoria and South Australia the threshold is a monetary one. In Victoria, the Act applies unless the total occupancy cost of the premises (i.e. rent and marketing and operating expenses) exceeds $1 million a year. In SA the Act applies unless the rent for the premises exceeds $400,000 each year. These monetary thresholds, which are set by regulation, are subject to regular review when the regulations are due to expire and are to be renewed. Again these are generous thresholds. A recent regulatory impact statement in Victoria estimated that 97% of shops in Victoria are covered by the *Retail Leases Act*.

In addition, and absurdly, premises in Queensland, NSW, the Northern Territory and the ACT are covered by the relevant Act, even if they are leased to a public company or the subsidiary of a public company.

While the Acts in most States apply only to leases of retail premises (as opposed to other commercial premises), in some States the legislation also applies to commercial offices. Inside shopping centres, however, all premises are covered by the Acts, whether retail or non-retail premises, unless the premises exceed the specified thresholds.

It can therefore be said with some confidence that all small retail businesses are protected by retail tenancy legislation. If there are anomalies whereby small retail businesses do not have the protection of retail tenancy legislation then these would be few in number. In any event, we are not arguing that any such small businesses would not have the protection of the unfair contract terms legislation. We are seeking exemptions only for those small businesses whose leases are regulated by state and territory retail tenancy legislation.

4.3 Detailed provisions of retail tenancy legislation

We have supplied (separately) with this submission a copy of each of the pieces of legislation referred to in section 4.1 of this submission so Treasury can understand the volume and comprehensiveness of the regulation that applies to the retail tenancy relationship. We have, however, **attached** to this submission a copy of the latest Minter Ellison '*Retail tenancy legislation compendium'* which provides an overview of retail leasing regulation in each state and territory (**Attachment A**). This gives an appreciation of just how detailed is this regulation and an indication of the existing micromanagement of the retail leasing industry. The fact that this compendium is in its sixth edition (having only commenced in 1999) gives some indication of how regularly retail tenancy legislation is reviewed and updated.

Regulation begins even before a retail tenant enters into a lease with a landlord with legislation specifying what documentation must be provided to a prospective tenant. This includes a draft copy of the lease. The legislation also specifies the specific information that must be disclosed to a prospective tenant (in the lessor's disclosure statement) and even lays down a timetable as to when the prospective tenant must receive this information. Retail tenants are therefore well informed of the key provisions of their lease.

The regulation continues throughout the entire period of operation of the lease, specifying minimum protections in the event of matters such as tenant relocations in the event of shopping centre redevelopments, market rent reviews, disturbances to tenancies etc. Regulation also governs matters to do with end-of-lease issues with legislated protections for the tenant in the exercise of options, notification of landlord's intentions in relation to new leases etc.

Some of the key areas of regulation are listed below:

- Lease must be in writing;
- Copy of proposed lease must be given to tenant;
- Disclosure statement, and what must be included in the disclosure statement, to be given to the tenant by landlord;
- Termination rights arising from failure to deliver a disclosure statement or delivery of a defective disclosure statement;
- Further documents to be provided to tenant;
- Notification/registration of lease;
- Prohibition on payment of key money;
- Procedures and limitations on rent reviews;
- Limitations on turnover rent;
- Prohibition on early termination of lease for failure to achieve turnover;
- Minimum term of lease;

- Option clauses;
- Notice of last date for exercising option;
- Procedures for notification of intentions at end of lease term;
- Liability for costs associated with lease;
- Limitations on liability for outgoings (i.e. operating expenditures);
- Outgoings which may not be recovered from tenants;
- Recovery of land tax (prohibited in most states);
- Regulation of management fees;
- Estimate and statement of outgoings to be provided to tenants;
- Adjustment of contributions to outgoings at end of year;
- Regulation of promotion and advertising funds;
- Procedures for assignment, subletting;
- Requirements for fit out;
- Notice of works;
- Landlord's repair obligations;
- Urgent repairs;
- Damaged premises;
- Refurbishment;
- Compensation for disturbances etc.;
- Obligations of landlord to franchisees and subtenants;
- Unconscionable conduct;
- Misleading and deceptive conduct;
- Protections for tenants in event of relocation;
- Protections for tenants in event of demolition;
- Regulation of 'core' trading hours;
- Regulation of security deposits;
- Regulation of guarantees.

We stress that we are unaware of any other country which has such detailed and sophisticated protections for retail tenants. As an example New Zealand, which has a number of Australian shopping centre companies and many Australian retailers, has no retail tenancy legislation and nor does it have the equivalent of the unconscionable conduct law applying in its competition law.

Where identifiable gaps have occurred in retail tenancy legislation, the relevant parties have also negotiated codes of conduct in order to ensure harmonisation of regulation throughout Australia. An example is the *Casual Mall Licensing Code of Practice,* negotiated between the SCCA and the major retailer associations, and which has been authorised by the ACCC. Discussions are also taking place at present between the SCCA and major retailer associations over a possible code of conduct on sales and occupancy cost reporting in shopping centres.

4.4 Consultative nature of retail tenancy legislation reviews

It is important to stress the consultative nature of the retail tenancy legislation reviews and the fact that retailer associations have had plenty of opportunity to identify areas where protections of small retailers are necessary and to formulate those protections.

The current review of the Queensland *Retail Shop Leases Act* is an example of this. First, a Discussion Paper on the Act's provisions was publicly released by the Queensland Government and submissions were invited from the public. On the basis of the submissions received, an Options Paper was prepared and released by the Government and further submissions were sought. Once these submissions had been received, the Government established a Reference Group which met on six occasions to consider all proposals in the submissions. This Reference Group included four retailer associations and one body which represented small businesses generally. The number of retailer representatives was double the number of landlord representatives.

When its work was concluded a report of the Reference Group was prepared and submitted to the Government. In many areas (but obviously not all) consensus was reached between retailer and landlord representatives. We anticipate the next step in the process will be draft legislation which, again, will be subject to consultation with relevant stakeholders. This review, and similar reviews in other jurisdictions, was thorough, detailed and consultative. Undoubtedly this provides a much more detailed and focused protection for small retail tenants (both within shopping centres and without) than could be provided by the extension of the UCT provisions.

4.5 Disclosure requirements of retail tenancy legislation

In addition, as briefly noted in section 4.3 of this submission, landlords are required to make extensive disclosures to prospective tenants prior to the retailers entering into a lease. These disclosures cover not just key items of the lease (such as rent, operating expenses, promotion and marketing costs, term of the lease, commencement date of the lease; handover date of the premises; options and whether or not exclusivity is given in the use of premises). In addition landlords are required to disclose a range of other matters including alteration works; relocation and demolition; relevant details of the shopping centre; core trading hours. The relevant details of the shopping centre include the number of shops; gross lettable area; annual turnover (broken down into categories); expiry dates of major/anchor tenants leases; customer traffic flow; and casual mall licensing.

The lessor's disclosure statement in NSW (Schedule 2 of the *Retail Leases Act),* before it is populated, runs to 12 pages, excluding attachments. It is not uncommon for disclosure statements by major landlords to be much longer than this after all material information is included. We have **attached** to this submission **(Attachment B**) an actual NSW disclosure statement, issued by one of our members (with confidential material removed) to give Treasury an idea of how detailed is the information supplied to prospective tenants before they enter into a retail lease.

In addition to providing a prospective retail tenant with a disclosure statement, some states also require lessors to provide the tenant with a copy of the authorised retail tenancy guide which serves to educate the tenant about the major obligations and possible risks of entering into a retail lease.

We note that paragraphs 104-117 of the Consultation Paper raises the prospect of the extension of UCT provisions being a measure to reduce information failures in markets. The extensiveness of the information currently supplied in the disclosure statement, and the fact that the detailed information to be supplied to tenants is under regular review in retail tenancy legislation reviews, suggests this is unlikely to be applicable in relation to retail tenancy leases. The constant review of the provisions of the disclosure statement reduces the risk of tenants entering into retail tenancy leases being unaware of key contractual obligations.

4.6 Negotiation of retail leases

A typical negotiation process for a shopping centre lease begins with discussions between the leasing executive acting on behalf of the owner and the retail tenant. This is then followed by a brief confirmation letter setting out the major lease terms. If negotiations proceed, the lessor usually then provides a formal letter of offer and, at the same time, is required by law to provide a copy of the standard lease. Usually the lessor supplies the disclosure statement at the same time (and retail tenancy legislation requires the disclosure statement to be supplied at least seven days before the lease is entered into). If the prospective tenant decides to proceed with the tenancy it is then required to return the lessee's disclosure statement, generally acknowledging the receipt of the disclosure statement and confirming that the tenant has not relied on any additional representations by the lessor in deciding to

enter into the lease. Only once this process is completed is a detailed draft lease prepared.

Negotiations between both parties then begin in earnest over the terms of that lease. In reality these negotiations are between the legal representatives of the parties. It is unusual in business negotiations, unlike consumer negotiations, for the parties not to have legal representation. We are not aware of any examples of a 'take it or leave it' approach to lease negotiations and think it is unlikely that this has occurred in the shopping centre industry since the introduction of unconscionable conduct legislation in 1998. This has been reinforced by the difficult leasing conditions that have prevailed in the retail property industry in the last few years. Nevertheless, as noted previously in this submission (section 2.9), there may be particular clauses on which a lessor may not be prepared to compromise.

In the light of this negotiation process, it is difficult to envisage a retail tenancy lease being found to be a 'standard form contract' and, therefore, difficult to envisage an extension of the UCT provisions being a substantial protection for small retail tenants. Nevertheless this can't be said with certainty given the vagaries of judicial interpretation (see sections 2.6 and 2.7 of this submission). Nor will it prevent retail property landlords being loaded up with additional costs given they will be required to commission a legal audit of their existing leases (as well as contracts with service providers) to seek to determine whether or not they would fall foul of the new law.

4.7 Enforcement of retail tenancy legislation provisions

Many of the key provisions of retail tenancy legislation contain penalty provisions. The penalty provisions are usually attached to obligations on landlords. There are very few penalty provisions attached to obligations on tenants. These penalty provisions are reviewed on each occasion the retail tenancy legislation is reviewed.

Other provisions have natural consequences which flow from the failure to observe legislative requirements. If a landlord fails to provide a disclosure statement, for example, or if a landlord provides a disclosure statement which contains information that was incomplete or materially false or misleading, the tenant may terminate the lease at any time within 6 months of the lease being entered into.

The state and territory legislation also provides mechanisms to resolve retail tenancy disputes by easily accessible and low cost mediation. As an example, Part 10 of the Victorian *Retail Leases Act* ('Dispute Resolution') provides that any party to a retail lease may refer a dispute to the Small Business Commissioner for mediation and the Act also provides powers for the Commissioner in such mediations. Generally more than 80% of disputes referred to the SBC are successfully resolved. If the SBC certifies that mediation has failed, or is unlikely to resolve the dispute, the dispute is referred to the Victorian Civil and Administrative Tribunal (VCAT) which has jurisdiction to hear and determine a dispute and can make a variety of orders, including requiring a party to pay money by way of restitution or compensation.

The Productivity Commission found in its inquiry into the market for retail tenancy leases in 2008: *"The number of retail tenancy disputes lodged with State or Territory authorities is very low relative to the size of the market. . . The vast majority of disputes, once registered, are settled before escalation to a tribunal or court."* (Report, pp. 194-195.)

Contrast these enforcement provisions with the consequences of the UCT provisions where the ACCC, state or territory consumer agencies or private parties are required to apply to a court for a declaration that a term of a contract is unfair (p.124). The enforcement provisions of retail tenancy legislation are far superior to the relief provided by an extension of the UCT provisions.

4.8 Unconscionable conduct and misleading conduct provisions of the Competition and Consumer Act and retail tenancy legislation

In addition to the penalty provisions in retail tenancy legislation, retail leasing is also subject to the 'unconscionable conduct' and 'misleading and deceptive conduct' provisions now contained in Schedule 2 of the *Competition and Consumer Act*. A law extending the unconscionable conduct provisions to small businesses was incorporated in the (then) *Trade Practices Act* in 1997 and became operative in July 1998. It was introduced following a Report in May 1997 by the House of Representatives Standing Committee on Industry, Science and Technology "*Finding a balance: towards fair trading in Australia*" (widely known as the Reid Report). The then Federal Minister for Workplace Relations and Small Business, the Hon Peter Reith MP, said this section would "*provide a new avenue for small and specialist retailers to pursue remedies against unconscionable conduct in the retail tenancy relationship*" (House of Representatives, 30 September 1997).

Following the introduction of section 51AC into the *Trade Practices Act*, the Federal Government subsequently passed the *Trade Practices Amendment (Operation of State and Territory Laws) Act 2001*. This enabled states and territories to extend the jurisdiction of their retail tenancy tribunals to ensure they could also consider matters of unconscionable conduct. This was done in order to provide retail tenants with a lower cost and more easily accessible tribunal to deal with allegations of unconscionable conduct. Most states and territories have now 'drawn down' this legislation into their own retail tenancy legislation. Despite assurances given to the SCCA at the time that this would involve no lessening of the standard of judicial administration of unconscionable conduct claims that applies at the federal level, these assurances have been watered down over time.

In determining whether conduct is unconscionable, courts and tribunals can take into account a range of matters and some of these overlap with matters a court may take into account in determining whether or not a contract is a standard form contract and whether or not a contract term is unfair. These include the relative bargaining strengths of the parties; the extent to which one party was prepared to negotiate the terms of the contract; and whether a party was required to comply with conditions not reasonably necessary for the protections of the interests of the other party.

In addition, all retail property lessors are subject to the federal misleading and deceptive conduct provisions, which are now contained in Part 2-1 of the *Competition and Consumer Act*. This is also replicated in some retail tenancy legislation. For example, section 62D of the NSW *Retail Leases Act* provides that "a party to a retail shop lease must not, in connection with the lease, engage in conduct that is misleading and deceptive to another party to the lease or that is likely to mislead or deceive another party to the lease". A party who suffers loss or damage by reason of misleading or deceptive conduct may lodge a claim for recovery. The NSW *Retail Leases Act* also has a provision (section 10) which provides for a right to compensation for damages suffered as a result of a false or misleading statement or representation prior to entering into a lease.

It could be said that these provisions of the *Competition and Consumer Act* already represent a second layer of regulation of retail leases and that if the UCT provisions are extended to retail leases then this would actually be a third layer of regulation.

4.9 Rent reviews

In the *Business Spectator* article of 5 February 2014, which appears to be based on an interview with the Minister, it is reported the Minister wants to see "*how existing regulations [governing retail tenancy leases] achieve the same objective [as the proposed unfair contract terms regulation], including matters like rights in rent review procedures".*

It is not clear what the Minister (or the journalist) is referring to here. Rents are 'reviewed' during the term of a retail shop lease according to two distinct procedures: by means of an automatic 'rent escalation' clause agreed by the parties when the lease is entered into; or by means of a 'market rent review' at an agreed time during the period of the lease. The method chosen is specified in the lease, having been agreed by both parties, and both methodologies are highly regulated by retail tenancy legislation. Without a rent review clause, agreed by the parties, the rent under the lease cannot be changed.

Under the first method the rent is escalated, usually each year, according to a rent formula agreed by the parties. Retail tenancy legislation is quite specific about how the rent can be escalated and the frequency with which it can be escalated. Section 18 of the NSW *Retail Leases Act*, for example, provides that a lease cannot apply an increase in rent more than once in 12 months, unless the increase is by a specified amount or a specified percentage. The same section also outlaws 'ratchet clauses' in leases, which are clauses which would prevent a rent decrease occurring if the methodology adopted had the potential to cause that rent to decrease. Section 17 of the same Act also provides that a tenant can't be charged rent if the tenant's obligation to pay rent commences when the tenant takes possession of the premises but the landlord has not completed its fit out obligations under the lease.

Under the second method the rent to apply for the remaining period of the lease is determined by a specialist retail valuer as the "current market rent" that would reasonably be expected to be paid for the shop if it was unoccupied and offered for rent for the same or a substantially similar use. Retail tenancy legislation specifies, among other things, the matters that the valuer must take into account or exclude in reaching the determination; the information that must be supplied to the valuer; and how a determination by a specialist valuer can be reviewed if there is disagreement. See, for example, sections 19 and 19A of the NSW *Retail Leases Act* for an example of this regulation.

In our view this conforms fully to the requirements concerning disclosure and transparency referred to earlier when discussing the exclusion of the 'upfront price' of the contract (see section 2.8 of this submission).

In addition, if the lease provides for the payment of rent by reference to turnover (i.e. 'percentage rent' or 'turnover rent'), this is also regulated by retail tenancy legislation. For example, section 20 of the NSW *Retail Leases Act* lists items that cannot be included in 'turnover' for the purposes of the payment of rent.

Incidentally the payment of outgoings (operating expenses) by tenants is also heavily regulated under retail tenancy legislation. Sections 22, 22A, 23, 24, 24A, 24B, 26, 27, 28, 28A, 29 and 30 of the NSW *Retail Leases Act* all ensure the payment of operating expenses by tenants is fair and reasonable.

4.10 Productivity Commission inquiry into the market for retail tenancy leases

The retail property industry is one of the few industries in Australia which has been the subject of a detailed investigation by the Productivity Commission. In 2007-2008 the Commission conducted an inquiry into the market for retail tenancy leases in Australia (*Productivity Commission Inquiry Report No. 43, 31 March 2008*). A major aspect of this inquiry was the 'fairness' of the market for retail tenancy leases. The terms of reference addressed such matters as "competition, regulatory and access constraints" on the efficient operation of the market; "any information asymmetry between landlord and tenants"; "the appropriateness and transparency of the key factors" in rent determination and rights when the lease ends; and any measures to "improve the overall transparency and competitiveness" of the market.

The Productivity Commission's assessment was that overall "*the retail tenancy market is operating well*" and that "*there is not a strong case for further detailed regulation of the retail tenancy market*". The Commission further found that "*it is unlikely that market tensions will be resolved or eliminated by government intervention into contracts through retail tenancy or other regulation. Regulation is not a good substitute for due diligence, the appropriate use of commercial lease advisory services and lease information – and sound business judgment".*

This is further justification for the exclusion from the UCT provisions of retail leases already regulated by state and territory legislation.

The Productivity Commission went further and recommended introducing a national code of conduct for shopping centre leases, in lieu of the existing detailed retail tenancy legislation. The Commission argued that "*less prescriptive legislation and greater harmony in legislation between jurisdictions could improve the efficiency of the retail tenancy market and lower compliance and administrative costs".*

There has been no movement by the Federal Government or by State Governments on this central recommendation by the Productivity Commission. The Shopping Centre Council considers it unlikely that the states and territories will surrender their powers to legislate in this area. Nevertheless we note that the Senate Economics References Committee has commenced an inquiry into "the need for a national approach to retail leasing arrangements to create a fairer system and reduce the burden on small to medium businesses with associated benefits to landlords".

5. Shopping Centre Council of Australia

The Shopping Centre Council of Australia represents Australia's major shopping centre owners, managers and developers. Our members are AMP Capital Investors, Brookfield Office Properties, CFS Retail Property Trust Group, Charter Hall Retail REIT, DEXUS Property Group, Eureka Funds Management, Federation Centres, GPT Group, Ipoh Management Services, ISPT, Jen Retail Properties, JLL, Lend Lease Retail, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, Scentre Group (formerly Westfield Group and Westfield Retail Trust) and Stockland.

Contact

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