
1 Introduction

The market for retail tenancies involves dynamic and complex interactions of small and large businesses participating in the market as retail tenants and landlords. Depending on the format and the range of facilities offered, retail tenancies can be broadly divided into shopping strips (or high streets), neighbourhood centres and regional centres. There are also specialist centres that handle ‘bulky goods’ or act as ‘direct factory outlets’.

The State and Territory governments have regulatory responsibility for this market, and all (with the exception of Tasmania) have specific retail tenancy legislation. In Tasmania, a regulated code of practice applies.

This inquiry examines the effectiveness of this regulation, and whether changes that could be introduced would lead to improvements in the operation of the market and benefit the Australian community as a whole.

The terms of reference for this inquiry were released on 21 June 2007, in a joint press release from the Treasurer and the Minister for Small Business. In brief, the Commission has been asked to:

- make recommendations for improving the retail tenancy market in Australia; and
- identify and, where practicable, quantify the likely benefits and costs of those recommendations for retail tenants, landlords, investors and the community generally.

The detailed terms of reference are on page IV.

1.1 Background and recent regulatory developments

Retail tenancy leases are the most common means to provide access to premises for the conduct of a ‘retail’ business alongside commercial leases and owner occupation of retail premises. Retail (and commercial) leases are legally binding documents that set out the terms of a contractual agreement between a lessor (the landlord) and a lessee (the retailer or tenant). They cover a wide range of matters including lettable space, rent, lease terms, relocation, redevelopment, quality and maintenance of premises, rent reviews and fit-outs. In signing a retail lease, the tenant is

contracting to pay the agreed rent and the landlord agrees to provide access and ‘quiet enjoyment’ of the premises for the full term of the lease, subject to the specific details in the lease.

Retail tenancy leases are a form of business contract that have attracted specific legislative and regulatory arrangements. Retail tenancy legislation was first introduced in Queensland (1984), followed by Western Australia (1985), Victoria and South Australia (both in 1986) (table 1.1). Legislation in New South Wales came into force in 1994, after the perceived failure of a voluntary code of conduct, followed by the Australian Capital Territory in 2001. The Northern Territory is the most recent jurisdiction to introduce legislation (in 2003). Prior to the introduction of specific retail tenancy legislation, retail leases were treated under law as standard commercial leases, as occurs in other countries such as New Zealand and the United States.

Table 1.1 **Retail tenancy legislation by State**

<i>State/Territory</i>	<i>Legislation</i>	<i>Original date commenced</i>	<i>Number of amendments^a</i>	<i>Date last amendment commenced</i>
New South Wales	<i>Retail Leases Act 1994</i>	1 August 1994	5	1 Jan 2006
Victoria	<i>Retail Tenancies Act 1986</i> replaced by the <i>Retail Leases Act 2003</i>	21 Sept 1987	7	23 Nov 2005
Queensland	<i>Retail Shop Leases Act 1984</i> replaced by the <i>Retail Shop Leases Act 1994</i>	12 March 1984	8	3 April 2006
South Australia ^b	<i>Retail and Commercial Leases Act 1995</i>	30 June 1995	3	6 Dec 2001
Western Australia	<i>Commercial Tenancy (Retail Shops) Agreements Act 1985</i> incorporating the <i>Retail Shops and Fair Trading Legislation Amendment Act (2006)</i>	1 Sept 1985	3	11 May 2007
Tasmania	<i>Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998</i>	1 Sept 1998	1	–
Australian Capital Territory	<i>Leases (Commercial and Retail) Act 2001</i>	1 July 2002	..	–
Northern Territory	<i>Business Tenancies (Fair Dealings) Act 2003</i>	1 July 2004	..	–

^a Includes either direct amendment acts or replacement acts, but excludes trading hour amendments. ^b South Australia introduced a commercial tenancy component to its *Landlord and Tenant Act 1936* in 1986.

The intention of specific retail tenancy regulation was to address perceived imbalances in bargaining power between shopping centre landlords and small retail

tenants. With the emergence of shopping centres as a preferred format of retail activity, concerns over this imbalance heightened. For example, the second reading of the Queensland *Retail Shop Leases Act Amendment Bill 1985* (a year after the original was introduced) spoke of ‘unacceptable power vested in the landlord’. Similarly, the stated objective of the New South Wales *Retail Leases Act 1994* was to ‘provide protection for small and medium size retailers operating in shopping centres’ (Independent Pricing and Regulatory Tribunal 2006, p. 241).

In most States and Territories, retail tenancy regulation includes dispute resolution processes. These generally enable disputes between landlords and tenants to be referred to mediation or conciliation before proceeding (if unresolved) to a tribunal or court.

While the Australian Government has no retail tenancy legislation, the *Trade Practices Act 1974* (TPA) contains provisions relevant to retail tenancy arrangements. Part IVA of the TPA contains laws prohibiting unconscionable conduct, including unconscionable conduct in business transactions (section 51AC). Part IVB enables the establishment of industry codes and prohibits the contravention of any applicable industry code.

To date, numerous reviews at both the State and Commonwealth level have sought to alter the legislation in response to stakeholder concerns. For example, the House of Representatives’ Standing Committee on Industry, Science and Resources (SCISR 1997) report *Finding a Balance: Towards Fair Trading in Australia* (the ‘Reid Committee’ report — box 1.1) led to the introduction of ‘unconscionable conduct’ in the TPA after findings that small businesses were often disadvantaged in their dealings with big businesses. Subsequently, States and Territories have drawn-down the unconscionable conduct provisions of the TPA (or similar provisions) into their respective legislation.

At the State and Territory level, there have been a total of 27 amendments (including replacement Acts) since the legislation was first introduced (see table 1.1). Some amendments arose from reviews which were conducted in response to mandatory sunset and review provisions. Others were driven by stakeholder concerns that the legislation did not adequately deal with the imbalances in negotiating power in the retail tenancy market. There has been a presumption that increasingly complex and prescriptive regulation could effectively and appropriately deal with such concerns.

These reviews and initiatives were accompanied by numerous changes to the retail tenancy Acts themselves. In New South Wales, for example, along with five direct changes to the *Retail Leases Act 1994* since 1996, a further 11 changes were brought about by the establishment of other pieces of legislation.

Box 1.1 **The Reid Committee report**

In May 1997, the House of Representatives' Standing Committee on Industry, Science and Resources released a report on fair trading in Australia called *Finding a Balance: Towards Fair Trading in Australia*. The report examined:

- business conduct issues arising out of commercial dealings between firms including, but not limited to, franchising and retail tenancy; and
- the economic and social implications of major business conduct issues particularly whether certain commercial practices might lead to sub-optimal economic outcomes.

The committee was also asked to examine whether the issues identified warranted intervention and to suggest options if intervention was found to be justified.

In total, 30 recommendations for change were put forward by the committee, including 12 specifically relating to the market for retail tenancies.

The legislative changes have led to increasingly complex and prescriptive legislation. However, concerns continue to be expressed about the adequacy and extent of the current legislative and regulatory arrangements. For example, the Franchise Council of Australia (FCA) stated that:

... monopolies like shopping centres operate with inordinate power knowing the turnover of all tenants and thus knowing what a retailer can afford to pay. They use this knowledge to manipulate the market. (FCA 2007, p. 1)

The Council of Small Business of Australia (COSBOA) added concerns over the 'fairness' of the market:

It is important that market power is not used unconscionably in retail leasing negotiations. The best result would be a fair and more efficient market place for retail tenants and their customers. (COSBOA 2007, p. 1)

Similarly, the Australian National Retailers Association (ANRA) said:

... it is not just small businesses facing challenges when entering into commercial leases. ANRA's members, many of whom are considered 'anchor tenants', are also experiencing ongoing difficulties when entering into or renegotiating retail tenancy agreements ... In the current environment, retail tenants are forced to accept leases with a range of charges, terms and conditions without being able to assess their impact upon their businesses. Competition and opportunities to negotiate on a level platform do not exist. (submission no. 92, p. 3)

The Shopping Centre Council of Australia (SCCA) raised different concerns over the heightened level of retail tenancy legislation in Australia, stating:

As a result of this intervention the market for retail tenancy leases in Australia is now heavily regulated. We are unaware of any other country in the world with such a highly

regulated retail tenancy market. In all States and Territories there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease. (submission no. 83, p. 7)

Allegations about excessive red tape were expressed by smaller landlords. For example, one small landlord stated:

The NSW Government 2006 legislation for retail leases, whilst being drawn up with good intentions, is excessive in its rulings and counter productive. We are led to believe that governments want to minimise red tape, yet I find that with this legislation, the opposite occurs. (confidential submission)

When announcing the inquiry, the Australian Government Minister for Small Business and Tourism and the Treasurer at the time highlighted issues of bargaining power and consistency of legislation in explaining the motivation behind the call for the inquiry:

Small business tenants are telling me that they are worried about the difficulties they face when presented with commercial leases over which they feel they have little or no control....Other concerns include the range of disparate retail tenancy laws between states and territories... (Bailey 2007, p.1)

In assessing these concerns, consideration should be given to whether there are constraints on the efficient operation of the market and what possible changes by industry and government may be pursued to address them.

The Commission has been asked to make recommendations to improve the operation of the retail tenancy market.

1.2 Recognising constraints on economic efficiency in retail tenancy

It is apparent from evidence tendered to this inquiry that major shopping centre owners, in particular, have strong negotiating power (and hence influence over contract terms) in their dealings with retail tenants, particularly the small and/or inexperienced. However, the existence of a strong negotiating position by some market participants, does not itself provide evidence of inefficiency in the operation of the retail tenancy market (see box 1.2 for details on efficient markets).

It also needs to be recognised that the market for retail tenancies extends to a much broader set of tenant-landlord relations than those that occur in shopping centres (such as those that occur on shopping strips and commercial tenancies more generally). Thus, retail tenancy regulation must be evaluated in this broader context.

Box 1.2 When are markets efficient?

The 'market' is the term used to describe the mechanism that allocates resources between competing uses. Given competing uses for resources, a number of combinations of use exist that generate a range of different payoffs. An efficient market is one which allocates these resources so that the community receives the highest possible net return.

To arrive at an efficient outcome, firms within the market must make the best use of available labour, financial and other resources. That is, the least amount of resources are used to produce the greatest amount of goods and services possible in accordance with economically-feasible technological and management standards. Also, firms in an efficient market will have a strong incentive to maintain, and improve on, the best possible use of resources over time.

More generally, it needs to be recognised that considerable differences in negotiating power are not a unique feature of the retail tenancy market. Such imbalances are common in many other markets, with firms large and small, and with a range of negotiating power, trading efficiently without industry-specific regulation prescribing the terms of their relationship. Accordingly, it is not readily evident that differences in size or negotiating power constrain the efficient operation of the retail tenancy market, or indeed of other markets.

It is therefore important to look beyond firm size and negotiating power to assess efficient market operation. This should encompass factors which might arise from market or regulatory failure.

In the case of the retail tenancy market, constraints to the economically efficient operation of the retail tenancy market could possibly stem from:

- unjustified restrictions on the supply of retail space;
- asymmetries in information available to the parties to a lease;
- differences in the capacity or motivation of market participants to analyse available information or seek advice;
- 'rigidities' in legislation and the market that lead to terms and conditions in retail leases that systematically and substantially favour one party over another or that create undue complexity and compliance costs;
- inconsistencies between legislation in different jurisdictions adding to compliance costs for business; and
- impediments to the cost-effective resolution of disputes.

It needs to be established that such potential impediments to the efficient operation of the market create actual inefficiencies, and that these can be corrected. Information gaps, for example, can be a significant constraint to efficient market operation (one party to a transaction may have greater knowledge than the other), but this is a common feature in markets and such information gaps will not necessarily be corrected by government intervention.

It is also important to note that evidence of impediments to efficient market operation, does not necessarily imply market failure or a need for government intervention. For government intervention to be justified, it must be established that the net benefit of government action is positive. That is, the benefit from government action, less the regulatory and compliance costs incurred to achieve that benefit, is larger than the cost to the community of the original perceived market failure.

This latter assessment needs to take account of possible ‘perverse’ outcomes from unwarranted or poorly designed interventions by well intentioned governments. For example, there could be a ‘moral hazard’ if small tenants were led to believe the government would protect their business, and this, in turn, resulted in parties being less cautious and diligent about their contracts than otherwise.

1.3 Relation to other inquiries

The inquiry into the market for retail tenancies has links with the Commission’s current inquiry into Australia’s consumer policy framework (PC 2007). For example, both inquiries explore the notion of unconscionable conduct that exists within the TPA to protect business (in this case, those with retail tenancies) and consumers (the focus of the consumer policy framework inquiry) from unconscionable behaviour.

This inquiry examines the market for retail tenancies and investigates, amongst other things, unconscionable conduct provisions and how these specifically relate to the interactions of businesses with other businesses. The case for change and the relative costs and benefits may well differ from those proposed in regard to reforming Australia’s consumer policy framework, where the focus is on the interactions not just between businesses, but between businesses and consumers.

The findings of the retail tenancy inquiry will also provide input into the Commission’s annual review of regulatory burdens on business which, in 2008, will focus on manufacturing and distributive trades (PC 2008).

1.4 Study procedures

The Commission received the terms of reference for this inquiry on 21 June 2007 and issued a circular on 29 June 2007 detailing the terms of reference and information sought from industry participants. A draft report was released in December 2007 to allow interested parties to comment on the Commission's preliminary analysis and findings. Public hearings were subsequently held in Canberra (4 participants), Sydney (17 participants), Brisbane (5 participants), Melbourne (14 participants), Perth (7 participants) and Adelaide (3 participants) during February 2008. The names of participants are listed in appendix A. This final report takes into consideration the views expressed at those hearings and those expressed in submissions received before and after the draft report.

In total, 211 submissions were received, including 69 in response to the draft report. Of these submissions, 75 were received from tenants (mainly operating from shopping centres), 57 were from organisations representing tenants, 20 were from owners/operators of large shopping centres and their representatives, and 3 were received from small landlords, with the remainder contributed by government agencies, real estate agencies and other interested parties (appendix A).

In preparing this report, the Commission also conducted visits to stakeholders across Australia and undertook relevant research. Apart from meeting with many individual traders and centre managers, the Commission consulted with: government agencies including the Australian Government's Office for Small Business, the Treasury, and the Australian Competition and Consumer Commission, State and Territory registrars and administering agencies; key industry/professional groups across jurisdictions; and academics specialising in small business and retail tenancy matters. Visits covered each jurisdiction, except Tasmania and the Northern Territory, for which telephone hook ups with relevant authorities were conducted in the course of the inquiry (appendix A).

Further, the Commission is grateful to the tenants and landlords who generously related their experiences and provided their perspective of the market and its operation. The Commission became acutely aware of the commitment required to be a successful retailer, the stiff competition for the consumer dollar and the commercial risk faced in retailing. The Commission heard that there are many traps for both new and more experienced participants in the sector, and that downsides can be financially and personally devastating.

1.5 Structure of the report

The remainder of this report is structured as follows. Chapter 2 provides an overview of the key characteristics and changes that have occurred in the retail tenancy market over recent decades. Chapters 3 and 4 explore the evolution of the current legislative and regulatory framework and the reasons for its development and the dispute resolution processes used by each jurisdiction, respectively. Principles for evaluating legislation and regulation in the retail tenancy market are developed in chapter 5. Participants' views about the operation of the retail tenancy market, supporting evidence and possibilities for change as suggested in the submissions to this inquiry are presented in chapters 6 to 9, while chapter 10 presents some alternative approaches considered by the Commission. Chapter 11 details the Commission's recommendations for improving the operation of the retail tenancy market.

