

Ref: D2007/12743

Commissioner Neil Byron  
Retail Tenancy Inquiry  
Productivity Commission  
PO Box 80  
BELCONNEN ACT 2616

Dear Commissioner

## **INQUIRY INTO RETAIL TENANCY MARKET**

Thank you for the opportunity to provide an initial submission to the Productivity Commission's Inquiry into the Market for Retail Tenancy Leases in Australia.

As Minister for Small Business, I have broad responsibility for the development of the retail sector and also for regulating the commercial arrangements between small business retail tenants and landlords in Victoria.

The Commission's inquiry provides an opportunity to assess the functioning of retail tenancy markets across Australia. The Victorian Government intends to make a substantive submission to the Productivity Commission's inquiry at a later stage. However, in the interim, I am writing to you to provide the attached brief overview of the context and current experience of certain aspects of Victoria's approach to retail tenancy policy and regulation, to assist your preliminary investigations.

Victoria's retail tenancy regulatory framework is the result of a comprehensive process involving a rigorous policy development approach and extensive consultation with the key industry participants, leading to the Victorian *Retail Leases Act 2003* and associated regulations, as well as the *Small Business Commissioner Act 2003*. I have enclosed copies of this legislation for the Commission's information.

I consider Victoria's retail tenancy framework to be the most contemporary, fair and balanced in Australia. Its approach focuses on providing certainty, clarity and fairness to landlords and tenants through information, education, dispute resolution, and protections for small businesses from unconscionable conduct in retail leasing arrangements.

Although a regulatory framework is in place, disputes between tenants and landlords naturally still arise. This is not necessarily evidence of a regulatory failure. Indeed, the Victorian Small Business Commissioner's high rate of success in mediating retail leasing disputes would indicate that the mechanisms Victoria has in place are working in a 'light handed' manner to facilitate a competitive and fair retail tenancy market.

Thank you again for the opportunity to comment on this matter. If you have any enquiries regarding the Victorian Government's involvement in this inquiry, please contact Mr David Latina, Executive Director, Office of Small Business on (03) 9651 9768.

Yours sincerely

**JOE HELPER MP**  
**Minister for Small Business**

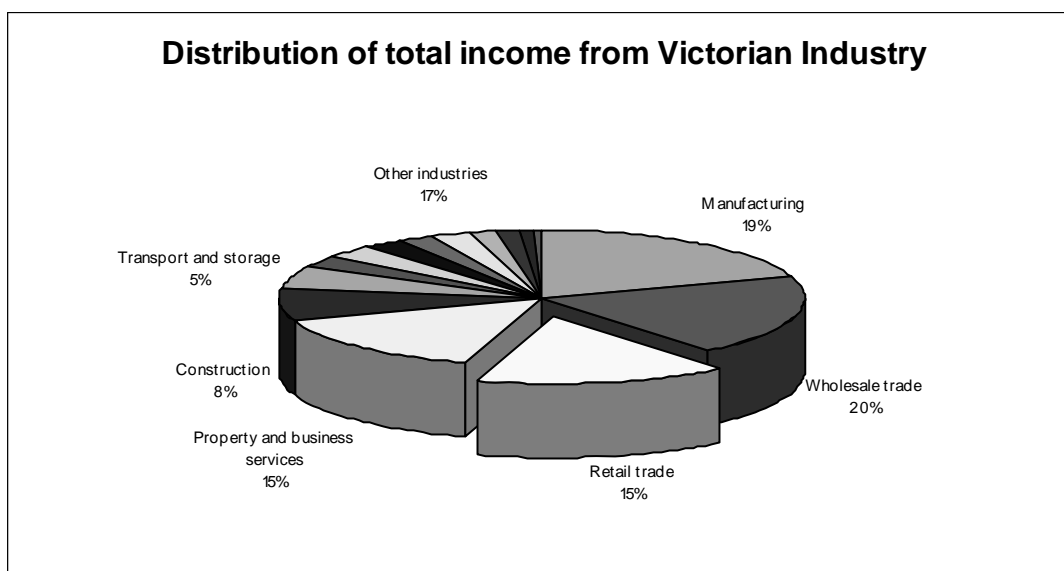
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## **INITIAL VICTORIAN GOVERNMENT SUBMISSION TO THE INQUIRY INTO THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA**

This initial submission provides preliminary background information on the retail tenancy market in Victoria. It begins by outlining the role of the retail sector in the Victorian economy and the policy approach adopted by the Victorian Government to regulate the retail tenancy market. It provides an overview of the current retail tenancy market in Victoria and its existing regulatory framework. This includes factual information on performance of the market and information on retail tenancy disputes handled by the Victorian Small Business Commissioner. Further, the submission identifies important policy areas from a Victorian perspective that warrant investigation by the Productivity Commission in its inquiry.

### **The importance of the retail sector to Victoria**

The retail sector is an important part of the Victorian economy. The sector is estimated to employ an average of 364,950<sup>1</sup> people annually. It accounts for 11%<sup>2</sup> of all Victorian businesses and around 15%<sup>3</sup> of total income from Victorian industry. Importantly, the retail sector provides many young Victorians with their first experiences in the workforce. A thriving and competitive retail sector is thus an important part of Victoria's economic success.



Australian Bureau of Statistics Cat 8155.0, Australian Industry 2004/05

More broadly, a wide range of economic factors contribute to the market for retail tenancies, including planning and land use matters, property development and investment, land tax and other duties, the efficiency and competitiveness of markets and regulations, and dispute resolution. Ongoing investment in the commercial property sector is partly affected by the retail tenancy market. Therefore, the regulation of retail tenancy leases by government can have a significant economic impact.

<sup>1</sup> Department of Innovation, Industry and Regional Development estimate, May Qtr 2005 – February Qtr 2006.

<sup>2</sup> Australian Bureau of Statistics Cat. 8165.0, Counts of Australian Businesses, including Entries and Exits, June 2003 to June 2006

<sup>3</sup> Australian Bureau of Statistics Cat 8155.0, Australian Industry 2004/05

## **Selected characteristics of the retail tenancy market in Victoria**

The retail environment presents many potential opportunities for innovation and entrepreneurship. Relatively low barriers to entry encourage start-up businesses and the development of small businesses in the retail sector. However, strong competition and the dynamic nature of the sector provide challenges for retail business. These challenges are often underestimated by new and inexperienced business operators who may lack the appropriate management skills to operate effectively in the retail sector and, in particular, to fully understand the importance of their retail lease to their overall business success. A critical factor to the viability of any retail business, especially for small retailers, is the lease or tenancy agreement.

The commercial relationship between a landlord and retail tenant is in many ways unique. While the relationship exists for the mutual pursuit of profit, as with any commercial relationship, retail tenancy relationships have particular characteristics that lead to market power imbalances and information asymmetry. Regulatory intervention in the retail tenancy market is necessary to help balance inequalities in the landlord/tenant relationship and address market failures.

Victoria's retail tenancy market is characterised by a combination of shopping centres and strip shopping centres. While shopping centres comprise a significant component of the market, the majority of retail tenancies are located in strip shopping centres. It can be argued that the market for retail tenancies differs substantially between strip shopping areas (characterised by a number of independent landlords and a relatively unmanaged mix of retail outlets) and large shopping centres (characterised by one large, sophisticated landlord/property owner, often with a clear strategy to manage the overall mix and performance of the centre).

The measures of success for property owners (in terms of financial return) may also differ substantially depending on the nature of the shopping area and the level of investment in overheads like parking and the overall amenity of the shopping centre. It is important to note that both landlords and tenants of strip shopping centres are often small businesses who may be equally inexperienced in managing a retail lease arrangement.

Further, the different characteristics of strip shopping centres and large retail shopping malls, along with the apparent trend for many consumers to prefer the convenience of large retail centres, may contribute to an imbalance in the competitive market for retail leases. The degree of choice (or substitutability) for small retailers between strip shopping centres and large malls is not always free and fair. The importance of passing trade (foot traffic), especially for small retailers, can be the difference between business success and failure. Thus small retailers may be explicitly or implicitly forced into shopping malls where rents may be higher and lease terms and conditions more restrictive than in strip centres.

### **Suggested issue for Commission to examine**

This inquiry provides an opportunity for the Commission to undertake some research on the definition of the market and the degree of substitutability between retail shopping centres and strip shops for prospective tenants, and the effect this may be having on competition and market behaviour.

## Victoria's policy approach to retail tenancy regulation

The current regulatory framework for retail tenancies in Victoria was established following a comprehensive inquiry and review in 2001, including extensive consultation across the State. This resulted in complete reform of Victoria's retail tenancies regulation and led to the enactment of the *Retail Leases Act 2003* (the Act) and its associated regulations. It is worth noting the first specific retail tenancy legislation was enacted in Victoria in 1986.

In developing its regulatory framework, the Victorian Government has sought to regulate only to the minimum extent necessary. The Government has adopted the following policy principals<sup>4</sup>:

1. Government regulation of retail tenancies should focus on addressing information imbalances and the misuse of market power.

Misconceived regulatory intervention can have drawbacks, in terms of compliance costs on the parties, discouraging investment, stifling innovation and distorting the behaviour of businesses. Therefore, the Victorian Government has sought to regulate to the minimum extent necessary to address market failures and achieve its policy objectives.

2. Retail tenancies legislation should only protect small and medium sized retail businesses.

Small to medium sized retail businesses are the most likely parties to be at a negotiating disadvantage and find it costly to access professional advice to overcome the information imbalance.

3. Government involvement in retail tenancies matters should aim at ensuring that prospective tenants have sufficient knowledge to make an informed business decision.

Prospective small business tenants often face difficulties in accessing details necessary to make an informed decision about entering a lease. The presentation of accurate and relevant documentation is a relatively inexpensive means of overcoming the information imbalance. Mandatory disclosure requirements, complemented by educational campaigns aimed at informing tenants of the implications of signing a lease, facilitate informed decision making without imposing onerous compliance burdens or unduly distorting business decisions.

4. While a landlord has a fundamental right of control over the use of its property, this right does not extend to engaging in unfair business practices.

It is not unreasonable for a landlord to benefit from a successful tenancy, given their investment in the property. However, there is the potential for a landlord to exploit its superior negotiating power when a lease is expiring to seek excessive rent increases in renegotiations or choose not to renew a lease even though the tenant has invested in the fit-out of the property, which cannot be recouped in the term of the lease. Such actions are considered to go beyond the fundamental right of a landlord to manage its property as it thinks fit and breaches the notions of fairness and proper business conduct.

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<sup>4</sup> Victorian Government *Review of Victorian Retail Tenancies Legislation Discussion Paper* October 2001

5. Landlords and tenants should be able to access a low cost informal dispute resolution forum prior to any grievances proceeding to formal litigation.

The consultation process to develop Victoria's retail tenancy framework identified general support for an independent body to deal with grievances in an informal and accessible manner.

## **Victoria's retail tenancy regulatory framework**

A copy of the Act and associated regulations is enclosed. An overview of the key features of the principal legislation for regulating retail tenancy is provided below.

### ***Coverage***

An appropriate definition of "retail premises" is important to ensuring that the regulatory framework matches the policy principles described above, and that the protections offered to retail tenants and landlords are available only to those who most need them.

Section 4 of the Act provides a broad definition of retail, and states that the Act is applicable to premises used wholly or predominantly for the sale or hire of goods by retail or the provision of services. However, the application of the Act is refined through particular exclusions either in the Act itself, in regulations, or at the discretion of the Minister.

For example, the Act does not apply to retail leases where the total value of occupancy costs exceeds \$1 million a year. Other exemptions are also in place for premises deemed by the Minister to be outside the scope of the legislation for varying reasons. The number of tenancies falling under these exemptions is relatively few.

One of the functions of the Victorian Small Business Commissioner under the Act is to publish guidelines about retail leases, which include an explanation of what constitutes a retail premises under the Act. These guidelines are written for non-legal readers, and are available for download from [www.sbc.vic.gov.au](http://www.sbc.vic.gov.au).

For landlords and tenants covered by the broad definition and not exempted from the Act by any of the above means, the Act aims to achieve **certainty, fairness, clarity, education** and **dispute resolution**. These objectives are embodied in several ways throughout the Act and its regulations.

### ***Certainty***

The Act provides certainty to all parties of a tenancy agreement by stipulating certain conditions and obligations on the landlord and tenant. It provides for a minimum five year term for a lease, including options for renewal, and restricts the ability of landlords to pass on certain costs to a tenant, such as land tax, depreciation, and capital costs. This in turn helps to balance the landlord/tenant relationship and provides both parties with certainty over aspects of the tenancy agreement that are not negotiable. In addition, provisions are made in the Act to provide a degree of certainty for tenants at the end of a lease period. For example, if a tenant does not have an option to renew the lease for a further term, the landlord must provide written notice either offering a renewal of the lease or informing the tenant that the landlord does not propose to offer a renewal of the lease. This provision allows tenants to plan the future of their business with greater certainty.

### ***Clarity***

Disclosure of information is a significant feature of the Act. Appropriate availability of information helps to ensure both parties are aware of their rights and obligations under the tenancy agreement and allows small business tenants in particular to make informed business decisions about their lease. The Act requires the landlord to provide a tenant with a Disclosure Statement at least seven days prior to signing a new lease or 21 days prior to a lease renewal. Sanctions are applicable if disclosure requirements are not fulfilled. The contents of the Disclosure Statement are prescribed by regulation and include information about the term of the lease, permitted use of the premises, occupancy costs, rent payable, outgoings and, if applicable, information on the shopping centre in which the premises is located.

### ***Fairness***

In addition to disclosure provisions and sanctions, the Act has drawn down unconscionable conduct provisions of the Commonwealth *Trade Practices Act 1974* (TPA) to offer both parties protection from unfair practices. Additional matters that a Tribunal can consider when determining whether action has been unconscionable have been added to the Act. This is to reflect particular aspects of the retail tenant/landlord relationship that may arise, such as the relative strength of bargaining positions, the ability to understand documents relating to the lease, and the extent to which a lease could be negotiated under similar circumstances with a landlord or tenant.

In the past, the ability to prove unconscionable activity has been an area of certainty for small businesses. Evidence of how the TPA interacts with the retail market and whether its existing protections are adequate would be of value to regulators and stakeholders.

### **Suggested issue for Commission to examine**

The inquiry provides an opportunity to assess the effectiveness of section 51AC of the *Trade Practices Act 1974* in dealing with unconscionable conduct activity in the retail tenancy market.

### ***Education***

The 2001 inquiry identified a significant lack of awareness and understanding by both parties of the rights and obligations under a tenancy agreement. Raising awareness about retail tenancy has been a focus of work by the Small Business Commissioner and the Office of Small Business (within the Victorian Department of Innovation, Industry and Regional Development).

One of the key functions of the Small Business Commissioner is to educate small businesses about the Act. The Small Business Commissioner produces a range of publications to help small businesses understand how the Act applies to retail businesses. The education program helps to raise awareness about disclosure requirements for landlords and provides prospective tenants with the skills to identify possible tenancy risks and seek appropriate advice.

The Office of Small Business also runs an extensive education program for new and established small businesses. The program helps to educate businesses about the risks and obligations when entering into a retail tenancy agreement. Generally, retail tenancy information is incorporated into workshops for people establishing or operating a small business. In addition, the Office of Small Business offers one workshop dedicated entirely to providing an overview of the Act. The Office of Small Business has run 52 workshops with a focus on retail tenancy since the beginning of 2007, attracting attendance of 665 people. Workshop attendance is consistently good and indicates the continuing need and interest among businesses for retail tenancy information. Additional information for current and prospective tenants is published online at the Business Victoria website ([www.business.vic.gov.au](http://www.business.vic.gov.au)).

### ***Dispute Resolution***

Access to a low cost dispute resolution service is a key feature of Victoria's retail tenancy framework. It is important that even if a dispute does arise between landlord and tenant, this does not compromise the ongoing business relationship between the parties. Victoria's Small Business Commissioner plays a major role in the mediation of disputes and alternative dispute resolution. It provides an accessible and informal avenue for both landlords and tenants to seek guidance and assistance in the resolution of disputes arising from retail tenancy matters. Victoria is the only jurisdiction in Australia to have a Small Business Commissioner.

The number of retail tenancy applications received by the Commissioner reflects use of these services. In 2006-07, the Commissioner received 874 retail tenancy applications, mostly comprising of retail tenancy disputes. Since establishment of the Small Business Commissioner in 2003 the number of retail dispute applications has increased annually. This appears to reflect the increasing awareness of these services amongst business over this time. Generally, the Commissioner successfully resolves around 75% of retail tenancy disputes through the use of mediation or pre-mediation services.

### **Function and performance of Victoria's retail tenancies market under the Act**

Many stakeholders in the retail sector consider Victoria to have the most competitive and fair regulatory environment for the retail sector. This applies not only to the regulation of retail tenancy arrangements, but also to Victoria's relatively deregulated shop trading laws. Under the *Shop Trading Reform Act 1996*, there are only three and a half restricted trading days in Victoria each year (Good Friday, Easter Sunday, Christmas Day, and between 12.01am and 1pm on ANZAC Day). Even on these days the majority of retail shops are allowed to open, either by virtue of having fewer than 20 persons employed at the shop, or through one of several exemptions for certain types of retailers or in certain locations.

Victoria's legislative framework for retail tenancies has been in place for just over four years and is the newest amongst states and territories. However, as most leases run for a five year term the full effects of the Act may not yet be apparent.

A good indication of the current performance of the Act can be ascertained from the number of enquiries generated and use of dispute resolution mechanisms. The Victorian Business Line (VBL) is a Victoria Government telephone service providing Victorian businesses with information and referrals to relevant government bodies. Many Victorian businesses use the VBL as a central access point for all government resources and support, with the service answering enquiries over a range of areas including business licences, permits and registrations, shop trading laws, industry codes of practice, eBusiness assistance, intellectual property issues, business mentoring and counselling, export and import information, innovation initiatives, and business development and support. The service provides a good indicator of the areas over which Victoria businesses seek support and assistance. In 2006-07, enquires related to retail tenancy accounted for only 4% of all calls received by the VBL. The low percentage of these calls indicates retail tenancy concerns are a relatively small part of overall business issues.

Since the establishment of the Small Business Commissioner, the number of retail tenancy disputes handled by the Victorian Civil and Administrative Tribunal (VCAT) has declined, while the total number of disputes mediated by the Commissioner and VCAT (combined) has increased. This trend reflects the policy intent of the Victorian Government in establishing the

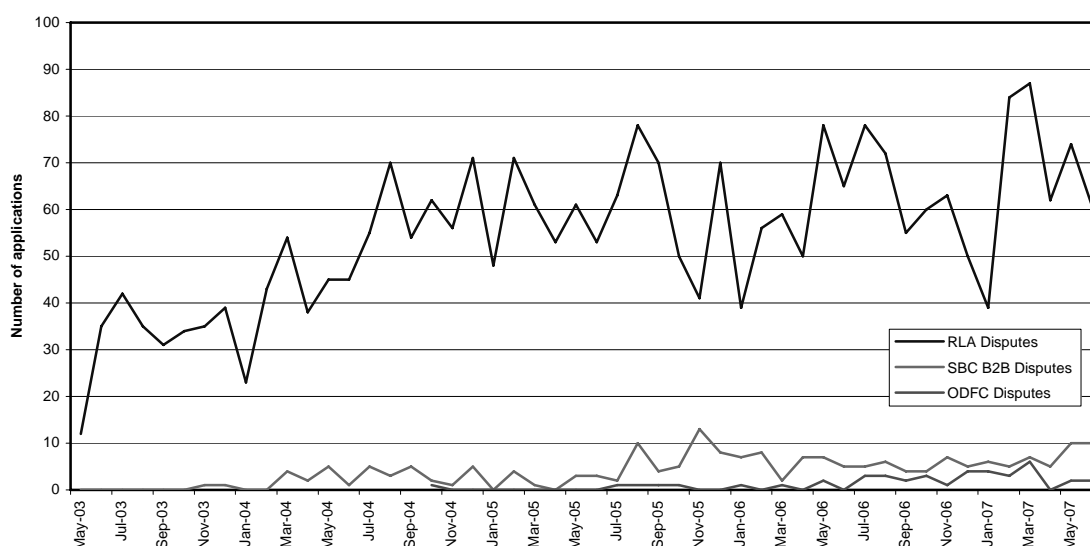


Small Business Commissioner – to allow parties to resolve their problems and maintain business relationships in a low-cost non-adversarial environment, and to take relatively small disputes out of the formal tribunal and court system. The data shown below suggests that this policy has been effective in allowing greater numbers of businesses access to dispute resolution services, while taking some load off VCAT. The data indicates that the introduction of the Small Business Commissioner has resulted in more than 500 additional cases per year being resolved, which in the past may not have been resolved due to the lack of a low-cost non-adversarial service for small businesses.

Year	VCAT Retail Tenancies List <sup>5</sup>	VSBC Retail Tenancies disputes handled <sup>6</sup>	Total
1999-00	199	0	199
2000-01	203	0	203
2001-02	215	0	215
2002-03	222	44	266
2003-04	161	378	539
2004-05	184	614	798
2005-06	171	599	770

Following a rapid increase in awareness of the functions and services of the Small Business Commissioner in 2003-04, the number of applications for assistance in retail tenancy disputes has remained relatively steady at around 60 applications per month (see chart below). The Commissioner’s role in handling disputes between businesses not related to retail tenancies generates fewer applications, reflecting the Commission’s priority on fulfilling its roles under the *Retail Leases Act 2003*.

VSBC Dispute Applications



RLA = retail tenancy dispute applications under the *Retail Leases Act 2003*

SBC B2B = business to business dispute applications under the *Small Business Commissioner Act 2003*

ODFC = dispute applications relating to owner drivers and forestry contractors

<sup>5</sup> Source: VCAT annual reports, Jaguar Consulting report for 1999-00 to 2003-04

<sup>6</sup> Source: Victorian Small Business Commissioner

Source: Victorian Small Business Commissioner

Notably, of the 2730 disputes handled by the Victorian Small Business Commissioner between May 2003 and June 2007, only 476 (17%) involved a large shopping centre landlord, and of these about 70% were complaints brought by a tenant against the shopping centre. Where the shopping centre was the respondent to a dispute application, a successful mediation was reached in over 80% of cases. This indicates that despite the often high public profile of disputes between small tenants and big shopping centre landlords, in terms of numbers of reported disputes the majority arise in strip shopping centres, and where large centres are involved in disputes, the parties are able to reach agreed settlements in the majority of cases.

This may be interpreted in a number of ways. For example, it could be attributed to a general reluctance by shopping centre tenants to raise issues with their landlord due to perceived potential consequences from the landlord. Alternatively, it could indicate that disputes tend to arise in strip shopping centres where both the tenant and landlord may be relatively inexperienced and may not understand their rights and obligations.

Overall, the retail tenancy market appears to be functioning relatively well. The existence of enquiries and mediated disputes between landlords and tenants is evidence of a robust regulatory system where parties are able to access the information and advice they need, and can seek low-cost mediation assistance when required.

Clearly, persistent problems or inefficiencies in the market would need to be identified and substantiated before a change to the policy settings could be seriously considered.

**Suggested issue for Commission to examine**

This inquiry provides an opportunity for the Commission to investigate and clarify the existence and underlying cause of systemic unfair market practices by retail landlords and tenants.

**Current priorities for Victoria**

The Victorian Government has committed to reduce the regulatory burden on business through its *Reducing the Regulatory Burden* initiative. The relevance and performance of all regulations will be assessed on an ongoing basis as part of this initiative. In this context, retail lease disclosure provisions have been identified as an area of priority review.

Current disclosure requirements and forms will be examined to identify opportunities to reduce administrative and compliance burdens on business. This will include clarifying and streamlining information disclosure requirements, particularly in cases where businesses must also comply with additional disclosure requirements (such as under the Franchising Code of Conduct or the Sale of a Small Business vendor's statement under section 52 of the *Estate Agents Act 1980*).

## **Conclusion**

The retail leasing commercial relationship requires some government intervention to ensure fair, competitive outcomes for market participants. This paper provides an overview of the current approach adopted in Victoria and its performance over the last few years.

At this point in time there does not appear to be fundamental problems with the retail tenancy market in Victoria that require a substantial change in the regulation of the market. The Victorian Government considers that its approach helps to balance the retail tenancy relationship by dealing with information imbalances and imperfect competition arising from varying degrees of bargaining power between players.

It is hoped the information will assist the inquiry in its initial investigations and contribute to better understanding of the retail tenancy market.

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