

Submission to the Productivity Commission Inquiry into the Market for Retail Tenancy Leases

**Prepared by the Franchise Council of Australia
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Executive Summary

In an efficient market, consumers (tenants) and producers (landlords) take decisions that reflect all possible, relevant information, prices reflect all costs, and firms cannot profitably charge prices in excess of “marginal” cost. When a market lacks these characteristics, society suffers a welfare loss which regulation may be able, and required, to address.¹

The Franchise Council of Australia (FCA), as the peak industry body for the franchise sector, has developed this submission to the Productivity Commission to seek regulatory intervention in the market for retail tenancy leases, particularly in regional shopping centres (defined as a major retail facility within one integrated building structure, incorporating at least one major department store as well as a wide range of other facilities) and discount department store (DDS) based centres (typically sub-regional facilities built around one or two major DDSs).² Feedback from FCA members indicates that there is market failure in this sector of the market due to:

- **Imperfect and asymmetric information.** Tenants often have limited knowledge about price (rent paid by other tenants) and quality (landlord plans for centre extensions, changes in the tenancy mix) of the premises, whilst landlords have access to turnover information of tenants across all centres by the same owner, effectively having knowledge of a tenant’s ability to pay.
- **Excessive market power and bargaining power in negotiations.** Prices are often charged solely by the decision and discretion of the few players who dominate the shopping centre industry, with limited regard to customers or competitors. This market power arises due to weak competitive pressures (continued industry consolidation and the virtual monopoly afforded to many centres in their region) and the strong bargaining power of the dominant players places small tenants in particular at an economic disadvantage.

There is substantial evidence that the market failure is material:

- **The Australian shopping centre industry has consistently achieved high profits, above those achieved by other commercial and retail properties.** These profits are arguably “excessive” as rental income has increased even during periods of downturn in consumer spending. The rent charged to specialty shops is much higher than the rent charged to anchor tenants, indicating that the rent paid by specialty shops are above the marginal cost of providing the premises, and shopping centres are able to achieve high economic rents from these shops.

¹ Financial Services Authority, A Guide to Market Failure Analysis and High Level Cost Benefit Analysis, 2006

² Urbis JHD, Australian Shopping Centre Industry, March 2007

- **Proposed rent increases at renewal by shopping centre landlords average between 30 – 50%, and sometimes over 100%.³** Over the last decade, occupancy costs have increased from less than 10% to over 16% of turnover, which is a significant erosion of profit margin for most franchisees, and shopping centre rent increases in some 5-10% of cases have led to the closure of shops.

There is a strong case for regulatory intervention to address the market failure. The cost benefit analysis of any proposed reform must consider the high baseline cost of inaction by Government:

- **In the absence of regulatory action, the market failure will not correct by itself.** The problems in the retail tenancy have been well documented since the 1990s, however despite numerous calls for action, including the comprehensive 1997 Reid Report, there has been no effective government action or the implementation of a national code for retail tenancy, as recommended. Inconsistent state legislation and ineffective prohibitions on unconscionable conduct have had a very limited effect on addressing the failures of the market identified more than a decade ago.
- **Changing technology / market behaviour in the future will only serve to increase the market failure.** The societal trends that have led to the rise of shopping centres, namely lack of parking spaces, increased suburbanisation and consumer preferences for convenience all serve to increase the demand for shopping centre floor space and leads to even higher bargaining powers for landlords.

The franchise sector is a substantial contributor to the Australian economy. However, over 95% of franchisors, and almost all franchisees, are small businesses. Franchising enables small businesses to compete very effectively against large corporations, but at the same time small businesses are particularly vulnerable to any structural inefficiencies in markets or anti-competitive or inappropriate conduct by larger market participants such as shopping centre owners.

The franchise sector generated gross revenue of \$111.5 billion in 2004/05, which contributed to 3.2 per cent of the total Australian GDP. Franchise systems employ 600,000 Australians across 55,000 franchised outlets. Retail trade franchises form the largest industry sector (around 52 per cent of all franchises), with over fifty per cent of these retail franchises operating in regional and major shopping centres and malls.⁴ As a result, this inquiry is a critical issue to approximately 26,000 franchisees and perhaps 300,000 working Australians.

The typical structure of a franchise in the context of a shopping centre tenancy adds further vulnerability. Landlords typically insist upon the franchisor signing the lease, with a licence or sub-lease to the franchisee. The franchisee will own the business assets such as fixtures, fittings, equipment and stock. The landlord therefore has the best of both worlds – the security and administrative efficiency of the franchisor as tenant, but the

³ This statistic is supported by the Review of Market Trends for Retail Tenancy Leases conducted by PricewaterhouseCoopers dated August 2007 which accompanies this submission.

⁴ Ibid.

added pressure point of having a franchisee with substantial assets on the line at that particular location. The franchisee’s position makes it much more difficult for a franchisor to take a robust attitude to negotiations, as the franchisee is locked in to the premises, and the landlord knows it.

The economic impact of the market distortions noted in this submission is that above economic rental costs are passed on to consumers in higher prices, absorbed by small business as lower profits or cause business failure with the inherent economic and social costs. If trends continue and shopping centre proprietors achieve their stated objectives in terms of rental returns as a percentage of turnover, the whole viability of small business tenancy in shopping centres is at risk. The franchise sector is particularly vulnerable due to the nature of the franchise relationship.

The FCA is not looking to create artificial barriers to shield the franchise sector from competition. Rather the FCA is simply seeking to remove market distortions and regulate inappropriate market conduct so that markets function more effectively. As the problems are market distortions it is highly appropriate that the matter be addressed under the auspices of the Trade Practices Act and administered by the ACCC. The FCA considers a mandatory industry code conceptually similar to the highly successful Franchising Code of Conduct and Oilcode should be enacted.

The following table summarises the key points in this submission.

Terms of Reference	Key Points in this Submission
<p>The structure and functioning of the retail tenancy market in Australia, including the role of retail tenancies as a source of income for landlords, investors and tenants, and the relationships with the broader market for commercial tenancies</p>	<p>The growth in rent, and hence profits, in shopping centres is higher than the growth in retail turnover and has come at the expense of franchises and small retailers. Rent increases proposed at renewal average between 30 - 50%, and can be as high as over 100%.⁵</p> <p>The fact that retail landlords in major shopping centres have consistently enjoyed above market financial returns and outperformed comparable international benchmarks is clear evidence of market distortion. The profit margins of major shopping centre owners ranged from 43 - 74% in 2005/06, more than double the average profit margin for small businesses operating in the shopping centres.</p>
<p>Any competition, regulatory and access constraints on the economically efficient operation of the market</p>	<p>A lack of effective competition and regulation has resulted in the market not operating efficiently:</p> <ul style="list-style-type: none"> ▪ Shopping centres, in particular regional shopping centres, are increasingly dominating the Australian retail market. Consumer preference for convenience and the growing demand for parking is fuelling further growth in shopping centres and the decline of strip shopping ▪ A small number of shopping centre owners dominate the market, and over the years there has been a decrease in the number of players in the market due to industry consolidation ▪ Renewal of similar size and style leases in shopping centres rarely

⁵ More information on rental increases can be found in the Review of Market Trends for Retail Tenancy Leases conducted by PricewaterhouseCoopers dated August 2007 which accompanies this submission.

Terms of Reference	Key Points in this Submission
	<p>occur simultaneously, reducing the number of competing shopping centres a tenant can choose from</p> <ul style="list-style-type: none"> ▪ Council zoning laws, town planning issues and long lease terms for anchor tenants has constrained competition and led to shopping centres operating as a virtual monopoly in many areas <p>Due to this inefficient operation of the market, there is excessive market power to shopping centre landlords. There is little bargaining power for franchisees (who are essentially small businesses) and other small, independent retailers. This is due to:</p> <ul style="list-style-type: none"> ▪ intense competition between small retailers and franchises for space within shopping centres; ▪ collective bargaining arrangements are difficult to establish and practically utilise as tenants compete, and do not wish to be seen as an activist by the landlord; ▪ the fear by tenants of being forced out of the shopping centre (which is a captive market) and losing the goodwill of their customers which is area specific.
<p>The extent of any information asymmetry between landlords and retail tenants, and the impacts on business operation</p>	<p>Shopping centre landlords have access to turnover information of all tenants in centres operated by the same owner.</p> <p>However, tenants have no reliable, timely sources of information on net effective market rent levels. Although lease registration information exists in NSW and Queensland, they are not up to date and are costly to access. As a result, tenants have no means of determining what is the net effective rent paid by other tenants, and hence the fair market rental value. Confidential deals and rebates also further restrict the free flow of information.⁶</p> <p>The information asymmetry leads to a risk of abuse of market power by the shopping centre landlords, as tenants find it hard to compare rent levels between shopping centres, and the landlord has an unfair advantage in rent negotiations as they know the tenant's ability to pay.</p>
<p>Scope for reform of retail tenancy regulation to improve economic performance, including:</p> <ul style="list-style-type: none"> ▪ differences in retail tenancy regulation between States and Territories, and the scope for nationally agreed regulations and approach ▪ the extent and adequacy of dispute 	<p>ACCC efforts to use unconscionable conduct provisions of the Trade Practices Act on major shopping centre landlords have been unsuccessful.</p> <p>Access to dispute resolution systems such as Tribunals are often not pursued because:</p> <ul style="list-style-type: none"> ▪ the process is time consuming and a matter can take many months to be resolved; ▪ legal costs are prohibitively high for small franchises and other retailers; and ▪ the tenant is afraid of punitive actions by the landlord, such as lease withdrawal.

⁶ More information on information asymmetry can be found in the Review of Market Trends for Retail Tenancy Leases conducted by PricewaterhouseCoopers dated August 2007 which accompanies this submission.

Terms of Reference	Key Points in this Submission
<p>resolution systems for landlords and retail tenants, including differences in dispute resolution frameworks between the States and Territories</p>	
<p>The appropriateness and transparency of the key factors that are taken into account in:</p> <ul style="list-style-type: none"> ▪ determining retail tenancy rents ▪ determining rights when the lease ends 	<p>Due to high sunk costs, a desire to retain goodwill in the business, and the negative impact of relocation on revenue, tenants are in a captive economic relationship with shopping centres and have little defence to:</p> <ul style="list-style-type: none"> ▪ excessive rent increases at renewal, which results in a significant number of franchisees having to close their business and lose the goodwill they have built up; ▪ changes by the shopping centre to the tenancy mix, which means the landlords have control over the level of competition tenants face; and ▪ demands by the shopping centre to relocate / renovate, as well as rising management and marketing costs.⁷ <p>In particular, the sitting tenant has little rights at lease end, including:</p> <ul style="list-style-type: none"> ▪ no guaranteed right of renewal; and ▪ unfair disclosure of their turnover information by the shopping centre to other prospective tenants.
<p>Any measures to improve overall transparency and competitiveness of the market for retail tenancy leases</p>	<p>The problems in retail tenancy are well documented and relate fundamentally to market place distortions. Proposed solutions have either not been implemented or have not worked, and small business and consumers have suffered as shopping centre owners have exacted above fair economic returns.</p> <p>National legislation, such as the enactment of a mandatory industry code pursuant to section 51AE of the Trade Practices Act to be administered by the ACCC, is essential.</p> <p>Although some level of industry input and consultation is appropriate in the development of the Code the ACCC should have a strong stewardship role to ensure the exercise is completed within a relatively short time frame. Critical issues must be addressed in order to improve the efficient operation of the market, notably:</p> <ul style="list-style-type: none"> ▪ tenants should have longer guaranteed tenure. In this respect we note that Oilcode and previous legislation in the petroleum industry addressing a similar issue mandated 9 year minimum terms. In the UK sitting tenants have preferential rights of renewal; ▪ sitting tenants must be protected from excessive end of term rental increases; ▪ the level and quality of free information available to tenants must

⁷ This argument is supported by findings in the Review of Market Trends for Retail Tenancy Leases conducted by PricewaterhouseCoopers dated August 2007 which accompanies this submission.

Terms of Reference	Key Points in this Submission
	<p>be improved, preferably via the establishment of a national tenancy register;</p> <ul style="list-style-type: none"> ▪ the efficiency and effectiveness of dispute resolution systems must be improved, possibly using an expert panel of mediators similar to that which has operated so successfully as part of the mandatory mediation process in the Franchising Code of Conduct; ▪ landlords should be banned from taking any action that discourages tenants from using the collective bargaining provisions of the TPA, and any retributive conduct (such as not renewing a tenant that has taken collective bargaining action or sought dispute resolution through regulators); ▪ clear justification required for rental increases at renewal, and protection from excessive rental reviews, particularly at or near lease end; ▪ greater transparency and strict controls and audit requirements on fees such as management fees, promotional contributions and levies which are often simply disguised rent; ▪ all incentives granted to tenants must be grossed up and included in rent to ensure integrity of reported rental figures; and ▪ banning of landlord practices which harm exiting tenants. <p>Overall simplification of State laws with legislative consistency, common disclosure documentation and requirements and streamlined processes should result in significant reductions in compliance costs.</p> <p>The disclosure of turnover to landlords leads to abuse of this knowledge during rent renewals. Information should only be disclosed to independent third parties and disclosed in aggregate form.</p> <p>The capacity of employee bodies such as the NSW Industrial Relations Commission to have any jurisdiction over business transactions such as leases and franchise agreements should be removed.</p> <p>The public company exemption from legislative protections provided to tenants where a franchisee or other sub-tenant is also involved should be removed.</p>

1 The growing dominance of shopping centres in the Australian retail tenancy market

Summary Points:

- Regional shopping centres are increasingly dominating the Australian retail market
- The rise in occupancy costs in regional shopping centres has not been accompanied by an equal rise in tenant profit or consumer spending

Australia's retail leasing market has become dominated by shopping centres

Franchises form a critical part of the Australian economy. The sector generated gross revenue of \$111.5 billion in 2004/05, which contributed to 3.2 per cent of the total Australian GDP and currently employs 600,000 Australians across 55,000 franchised outlets, making it the most franchised nation per head of population in the world. Franchising is forecast to continue to grow in its contribution to the Australian economy, with an average annual growth rate between 2007 and 2010 of 5.1 per cent in revenue, and 5.0 per cent in its contribution to GDP; a rate higher than the predicted growth in Australian GDP over the same period.⁸

Retail trade franchises form the largest industry sector (around 52 per cent of all franchises), with over 50 per cent of these retail franchises operating in regional and major shopping centres and malls. As a result, this inquiry is a critical issue to approximately 26,000 franchisees and perhaps 300,000 working Australians. Despite their significant contribution to the economy, over 95 per cent of franchisors, and almost all franchisees, are small businesses. As small businesses, franchisors and franchisees are particularly vulnerable to any structural inefficiencies in markets or anti-competitive or inappropriate conduct by larger market participants such as shopping centre owners.

Over the past 25 years, the retail tenancy market has shifted progressively from shops in street strips and CBD department stores to expansions of suburban shopping centres.⁹ This trend has continued and over the period 1999 and 2006, shopping centres steadily increased their share of Australian retail sales from 41 per cent to over 50 per cent.¹⁰ **Table 1** below shows the growth of shopping centres as a dominant player in the retail market.

⁸ PricewaterhouseCoopers, Review of market trends for retail tenancy leases, 2007

⁹ IBISWorld Industry Report, Retail Property Operators in Australia, L7714. p6.

¹⁰ Ibid.

Table 1 The growth of shopping centres in the retail market

	1999	2006	CAGR
No. of shopping centres	879	1,388	6.7%
Floor space in shopping centres (m ²)	11.5 million	15.5 million	4.4%
% of Australian retail sales in shopping centres	41%	50%	2.9%

Source: IBISWorld Industry Report, Retail Property Operators in Australia, L7714. p6.

In addition, there has been some recent consolidation among listed property trusts and ownership of shopping centres. IBISWorld estimates that the largest four operators generate around 19 per cent of total retail property industry revenue. However, concentration varies within industry sectors (and by location). For example, large real estate investment trusts have a greater market share in terms of large regional shopping centres. This issue is further discussed in Chapter 2 of this submission.

The table above shows that growth in both the number of shopping centres and the amount of floor space in shopping centres has consistently outpaced Australian retail sales turnover, which only increased at a CAGR of 3.7 per cent¹¹ during the same period. This shows that the growth in shopping centres is not just a result of rises in consumer spending, but has also been at the expense of strip shopping.

Shopping centres are particularly dominant in NSW, Queensland and Victoria, with over \$13.2 billion in annual retail sales from shopping centres in those states.¹² The relative concentration of shopping centres across the states is summarised in **Table 2** below.

Table 2: Shopping centres in NSW, Victoria and Queensland

State	Number of regional and DDS-based shopping centres	Share of retail sales by regional and DDS-based shopping centres
New South Wales	107	28.1%
Victoria	75	23.7%
Queensland	76	28.5%

Source: UrbisJHD, Australian Shopping Centre Industry, p3 – 6

Note: Information based on 2005/06 data

Since 1998/99 retail sales at shopping centres has grown \$33.4 billion, or 52 per cent of the total retail sales growth in Australia.¹³ Within the Australian shopping centre industry, there are:

- 63 regional shopping centres (defined as a major retail facility with one integrated building structure, incorporating at least one major department store as well as a wide range of other facilities);

¹¹ ABS

¹² IBISWorld Industry Report, Retail Property Operators in Australia, L7714. p9.

¹³ Australian Shopping Centre Industry Report March 2007 update, UrbisJHD

- 268 discount department store based centres (defined as smaller, typically sub-regional facilities built around one or two major discount department stores and one or more supermarkets);
- 759 supermarket centres (defined as comprising one or two major supermarkets and a collection of food and non-food specialty shops and services); and
- 12 are CBD based shopping centres anchored by a major retail tenant located in the core retail periphery of Australian capital cities.

The breakdown of shopping centres by type in **Figure 1** and **Figure 2** below show that despite neighbourhood shopping centres accounting for a large proportion of shopping centre facilities, the vast majority of floor space is let to regional shopping centres.

Figure 1: Shopping centre segments as a percentage of total shopping centres¹⁴

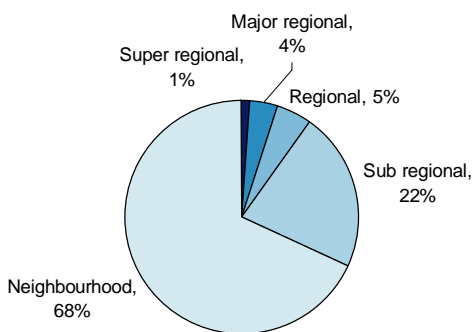
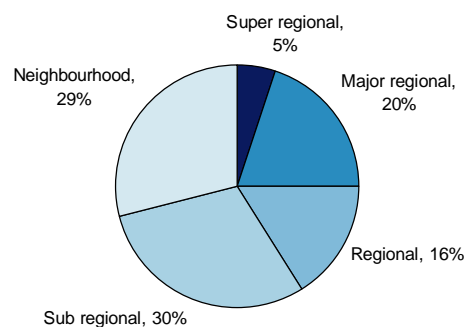


Figure 2: Shopping centre segments as a percentage of total floor space¹⁵



Sources: IBISWorld Industry Report, Retail Property Operators in Australia, L7714. p9

The above graphs show that regional and DDS-based shopping centres account for over 70 per cent of total floor space in shopping centres. This shows that, despite numerous claims by the shopping centre industry that their level of control over the market is low because the number of shopping centres is low, this sector of the market is characterised by major centres representing a majority of retail floor space in their regions.

The dominance of shopping centres in the retail sphere has also effectively devalued strip retail locations. Simon Fonteyn, the director of leaseinfo.com.au, when interviewed by *The Sydney Morning Herald* in April 2007, stated that "high street retail strips have been hit harder, such as Oxford Street in Sydney's east, where rents have come down as much as 15-20 per cent over the last two years, due to the [inability of retailers to pay higher rents as a result of higher interest rates, petrol prices and other economic factors] and market cannibalisation from bigger centres. Prime retail shops are renting at about \$1000-\$1275 per square metre gross face [before incentives], whereas two years ago, they were worth \$1500 per

¹⁴ Shopping Centre Council of Australia

¹⁵ Ibid

square metre gross face."¹⁶ Therefore, the consolidation of the industry dominance of shopping centres is placing increasing upward pressure on shopping centre rentals, whilst undermining the value and vibrancy of local centres as a viable retailing alternative.

Consumer preferences for convenience and parking is fuelling the growth in shopping centres and the decline of strip shopping

The market share of shopping centres compared with shopping strips as a percentage of retail outlets has been steadily increasing in Australia, primarily driven by the growing number of passing consumers through shopping centres. Consumers are increasingly drawn to shopping centres instead of strip shopping as:

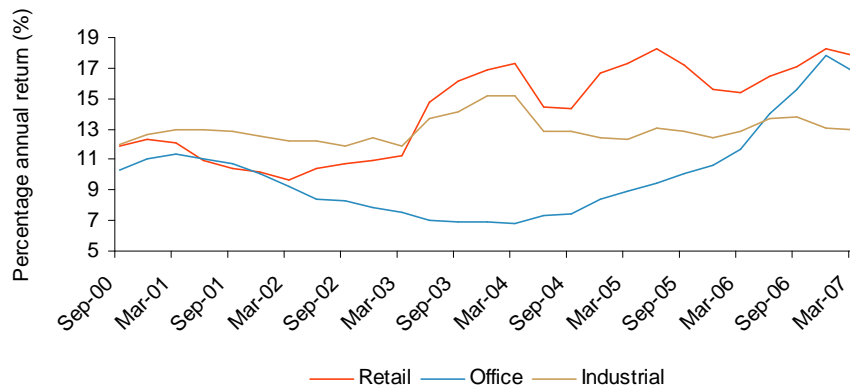
- increasing consumer preference for convenience and time-poor consumers have led to the rise of regional shopping centres that sell a large variety of goods and allow customers to undertake all their shopping conveniently in one centralised location;
- the suburbanisation of cities which began in the 1950s with increasing population growth in outer suburbs led to a decline of 'big city stores' and the growth of decentralised suburban branches. Major anchor stores such as Coles, Woolworths, David Jones and Myer are increasingly choosing to locate in shopping centres rather than shopping strips as standalone entities; and
- increases in car ownership over time have led to high demand for parking, which is freely available in many shopping centres but generally more limited for strips.

The high profits in the shopping centre industry has come at the expense of franchises and small retailers

Retail property returns have increased steadily over the past decade and has been higher than office and industrial property returns for the last five years. This can be seen in **Figure 3** below.

¹⁶ Cummins, C. (2007), "Retail trade strengthens as rents plateau" *The Sydney Morning Herald* (Domain - Commercial), 7 April 2007

Figure 3: Returns in the property market



Source: Property Council of Australia Investment Performance Index: March 2007

The major shopping centre owners in the retail tenancy market outperform this already high retail property return, as they continue to realise increased rental incomes, contributing to increased profits, much of this from sharp rises in rental charges to franchisees and small businesses. This is evidenced by **Figure 4** below, which shows that the key players in the regional and DDS-based shopping centre market have far outperformed growth in other industries and retail property indices.

Figure 4: Shopping centre profit growth FY05/06¹⁷



Source: IBISWorld 2007, Centro Properties Group Annual Report 2006

These increases are generally higher than the increase in retail turnover average for the same period of 5.5 per cent.¹⁸ This indicates that retail tenancy operators are increasing rents at a rate faster than franchisees and small business owners are increasing their sales and hence profits.

In many cases, specialty store rents have continued to grow over a 10 year period, despite volatility in sales growth. This has been shown to be true in the case of Westfield according to recent broker reports.¹⁹ Westfield's

¹⁷ GPT Group profit growth taken from FY2004 – FY2006 growth. Weighted average annual growth in profits calculated according to weightings based on Total Revenues.

¹⁸ ABS 8501.0 retail turnover, all industries

¹⁹ Deutsche Bank Broker Report, Westfield Group, 25 June 2007, p. 12.

Australian portfolio consistently mainly of regional shopping centres has consistently shown annual rental income growth over the past 20 years, despite several downturns in specialty store sales over the same period. This has been accompanied by rising occupancy costs as tenants absorbed the increase in rents despite declining sales.

In addition, Stockland has shown an increasing percentage of income obtained through renewals of leases versus new deals, illustrating that rental increases have been consistent and that lack of competition is placing greater pressure on tenants to accept rental increases and take up lease renewals.²⁰

To demonstrate this trend, a recent presentation given by the Australian Retail Lease Management at the National Small Business Summit 2007 highlighted that specialty stores in a typical 50,000m² shopping centre will often account for 65 per cent of the total rent paid whilst only occupying approximately 35 per cent of the total retail floor space. Conversely, major tenants are only accounting for 35 per cent of total rent paid.

Recent articles in the franchise business arena indicate that small retailers in shopping centres now have to pay rents of 15 to 20 per cent of turnover, which can be unsustainable for many small businesses.²¹

This is particularly the case because small retailers are often forced to pay increasingly high rents and to accept short leases for the privilege of being in a well-patronised shopping centre, whereas large retailers receive favourable treatment. Rentals per square metre are distorted disadvantageously for small specialty retailers, who are in effect subsidising the rental of larger retailers such as Coles Myer, David Jones and Woolworths. Small retailers are also discriminated against because they are generally only offered short leases of five years with no options, while their bigger, low rent counterparts are offered 10 to 15 year leases with multiple options.²²

Unsustainable shopping centre rentals are further forcing some retailers to relocate, for example, to community shopping strips. Although sales turnovers in strip locations are typically lower than those in shopping centres, lower rentals offer retailers a higher margin on this turnover.²³ However, this means that franchisees lose their investment in a prime real estate and retailing position, the goodwill they have built up with shopping centre property managers, the higher sunk costs related to fit-out in new shopping centres.

The nature of unsustainable rentals in shopping centres has been an issue for over a decade. According to Laurie Eakin in 1993 of the Retailers Council of Australia, "...average annual sales increased by 8.8% from 1986/87 to 1990/91, however tenancy costs have increased 23.7%." Over the same period, he said, "As a percentage of sales, tenancy costs increased from 9.3% to 11.5% of turnover."

²⁰ Deutsche Bank Broker Report, Stockland Trust Group, 7 February 2007, p. 5.

²¹ Franchise Business.com.au, "Australian franchises and the ongoing battle with landlords", 26 July 2006. (Available at: http://www.franchisebusiness.com.au/articles/Australian-franchises-and-the-ongoing-battle-with-landlords_z49367.htm)

²² Ibid.

²³ Ibid.

More recently in December 2004, Brian Donegan, of the Australian Retailers Association urged “no more rent increases”, responding to the 2003/04 UrbisJHD retail averages report which revealed that, even in a year where speciality sales are up by 8.5 per cent, the growth in speciality shop turnover was unable to significantly outstrip rent increases, with a negligible fall in occupancy cost ratios from 16.1 per cent to 15.6 per cent. More recent figures indicate that occupancy costs have increased to over 16 per cent.

Given that the average profit margin for small businesses commonly ranges from 10-20 per cent²⁴, including franchises, the rise in occupancy costs represents a significant erosion of profit and future value of the business. In a recent survey of lessees, around 5-10 per cent of shops have had to shut down due to a rise in rental costs.²⁵

Several recent articles in *Business Review Weekly* have focussed on the increasingly concerning issue of rising occupancy costs for franchised retailers. One article suggests that franchise retailing industry is expected to experience slower growth in 2007 partly due to rising occupancy costs. The pressure of rising costs with decreasing sales is exposing the most marginal sites in some franchise chains and resulting in a higher level of disputes between unprofitable franchisees and their franchisor.²⁶

Similarly, another article quoted UrbisJHD director of research, Michael Baker, as indicating that occupancy cost levels in Australia are higher than the US average.²⁷

²⁴ Wendy's profit margin of 15% (www.licenseenews.com/news/news218.html), and Taxation Statistics 1998-99, Chapter 4 "Small Business: Profitability" indicate that individual small businesses have profit margins around 22%.

²⁵ PricewaterhouseCoopers, Review of market trends for retail tenancy leases, 2007

²⁶ Walker, J. (2007), "The Bigger the Better" *Business Review Weekly*, 25 January 2007, Vol. 29 Issue 3, p. 28.

²⁷ Larsen, C. (2007) "The Rent Squeeze", *Business Review Weekly*; 25 January 2007, Vol. 29 Issue 3, p. 71.

2 Competition, regulatory and access constraints on the efficient operation of the retail tenancy market

Summary Points:

- The market is not operating efficiently due to competition, market entry and regulatory constraints:
 - A small number of shopping centre owners dominate the market, preventing efficient market operation
 - In many circumstances, shopping centres operate as virtual monopolies due to regulatory and other constraints
- Due to this inefficient operation of the market, franchises and other small retail tenants have little bargaining power compared to the shopping centre owners

The number of major players in the shopping centre industry is low and declining

Section 1 has shown that in many parts of Australia, shopping centres have effectively out-competed strip shopping areas to dominate the retail tenancy market. This has largely been driven by changes in consumer preferences over the last 25 years and is arguably inevitable. However, the lack of competition within the shopping centre industry should be of cause for concern to the Productivity Commission.

There are only six major retail tenancy operators in Australia who operate a significant number of shopping centres: Westfield, Centro Property Group, Stockland Group, General Property Trust (GPT), CFS Retail Property Trust (CRT) and AMP Capital Investors Shopping Centres. **Table 3** below provides an indication of their relative size.

Table 3: Major shopping centre industry participant statistics

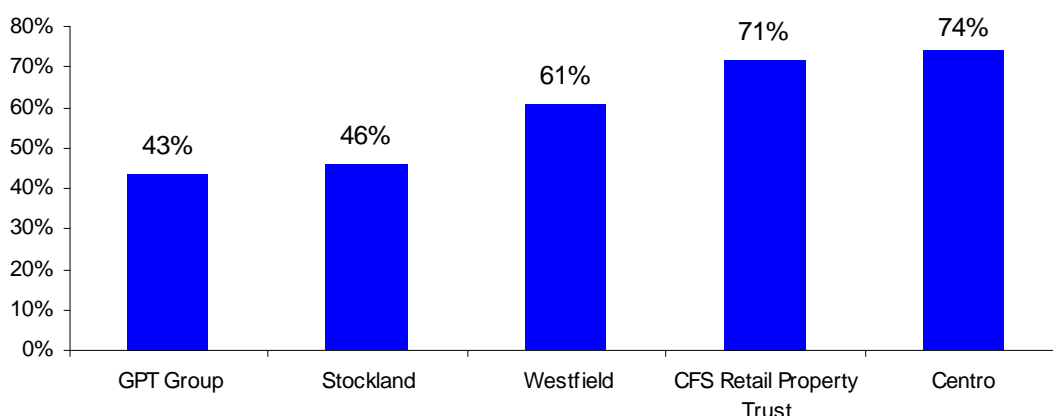
Shopping centre industry participant	No. of shopping centres (owned or managed) in Australia	Annual Sales (\$bn)	Rental Performance
Westfield Group	128	>9.2	<ul style="list-style-type: none"> • 32% growth in total revenues and other income over the year to December 2006
Centro Property Group	120	>0.8	<ul style="list-style-type: none"> • Average retail rental growth of 6.9% and average occupancy rate of 99.5% in directly owned centres at June 2006

Shopping centre industry participant	No. of shopping centres (owned or managed) in Australia	Annual Sales (\$bn)	Rental Performance
Stockland Group	38	>4.5	<ul style="list-style-type: none"> 29.2% increase on renewals at December 2006
General Property Trust	29	>2	<ul style="list-style-type: none"> 129% increase in rent from investment properties over the year to December 2006
AMP Capital Shopping Centres	43	>5 (incl. NZ)	N/A
CFS Retail Property Trust	23	>0.8	<ul style="list-style-type: none"> 24.2% increase in unit price over the year to December 2006
Total	381	>22	N/A

Source: Company websites, 2007

Westfield alone operates 22 per cent of gross lettable floor space in shopping centres. Given that there are only 331 regional and DDS-based shopping centres in Australia, the vast majority of these centres are owned by these aforementioned six companies, along with Lend Lease who owns 7 major regional shopping centres. The small number of regional shopping centre operators has a number of adverse effects on the shopping centre retail industry through reduced competition, including the potential for higher rents and less flexibility on lease terms. **Figure 5** below shows that the profit margin for the key shopping centre players ranged from 43-74 per cent, more than twice to three times that which is achieved by the average small business.

Figure 5 Profit Margin (Net Profit After Tax / Total Revenues) of Shopping Centre Owners



Source: IBISWorld 2007

A number of acquisitions and mergers of retail tenancy operator has resulted in a further decrease in the number of players in the market. Some of these recent acquisitions and mergers are outlined in **Table 4** below.

Table 4 Major acquisitions by shopping centre operators

Company	Major Acquisitions Since 2002
Westfield	<ul style="list-style-type: none"> ▪ Sydney Central Plaza in 2003 ▪ \$1.9 billion takeover offer for AMP Shopping Centre Trust ▪ Joint Ventures for Bay City Plaza, Geelong and Airport West, Melbourne with Perron Group ▪ Skygarden and Imperial Arcade ▪ Acquisition of GPT Shopping Centres ▪ Transactions with Centro Properties Group and Somera Capital Management ▪ Opens new centre in Helensvale, Queensland in 2005
Centro Property Group	<ul style="list-style-type: none"> ▪ In July 2002, Centro acquired Bay Central Shopping Center, in Hervey Bay, Queensland for \$41.0 million and the David Jones CBD Complex, Perth in Western Australia for \$90.5 million. ▪ Bankstown Square, a metropolitan Sydney based regional shopping centre, ▪ Galleria and Toombul shopping centres. ▪ Colonnades shopping centre. ▪ Completion of the merger with Prime Retail Group, ▪ Acquired Heritage Property Investment Trust, a listed real estate investment trust (REIT) ▪ In July 2007, acquired Warnbro Fair Shopping Centre in Western Australia for \$57.05 million
Stockland Group	<ul style="list-style-type: none"> ▪ Acquired 3 shopping centres, together with a parcel of land, from Allco Retail Centre Fund for \$100 million in July 2007 ▪ Wallsend in Newcastle ▪ Engadine in Sydney's south, ▪ Lilydale, Victoria; ▪ Acquired Halladale in the UK via Scheme of Arrangement ▪ Acquired the retail component of Cammeray Square in April 2007, a new mixed use development on Sydney's lower north shore for approximately \$42 million
General Property Trust	<ul style="list-style-type: none"> ▪ Acquired 50% interest in Highpoint Shopping Centre, Vic ▪ Acquired Rouse Hill Town Centre, which is a \$470 million greenfield development located approximately 35 kilometres north-west of the Sydney CBD. Construction commenced in April 2006 and the development is programmed for completion from late 2007
CFS Retail Property Trust	<ul style="list-style-type: none"> ▪ Acquired Chatswood Chase, Sydney in November 2003 ▪ Forest Hill Chase, Melbourne ▪ Post Office Square, Brisbane ▪ Acquired a large number of shopping centres in October 2002 across South and Western Australia in particular
AMP Capital Shopping Centres	<p>In 2004, assumed asset and property management responsibility following the purchase of these properties by AMP's various property funds:</p> <ul style="list-style-type: none"> ▪ Northbridge Plaza, ▪ Royal Randwick Shopping Centre, ▪ Marrickville Metro Shopping Centre ▪ Auburn Home Mega Mall

Sources: company websites

The wave of consolidation in the industry has reduced the number of players in the market. The shopping centre industry's barriers to entry are also arguably high due to the high level of debt and equity funding required to enter the industry and establish a regional shopping centre.

In addition, the rationalisation that has been occurring in the managed retail property market has seen prices for shopping centres rise. This has put enormous pressure on property managers to maintain their returns via increasing rental streams²⁸. Anecdotal evidence suggest that yields at regional shopping centres have fallen to the 4-5 per cent range, rather than the historical average of closer to 7 to 10 per cent. Indeed, *The Australian Financial Review* highlighted on 27 July 2007 that regional shopping centre yields are down to 4.75 per cent and according to CBRE director of research, Kevin Stanley, are forecast to fall further.

There is evidence that the shopping centre owners are turning their focus to improving yields at DDS-based shopping centres. One of the largest increases in shopping centres has been in the sub-regional (DDD-based shopping centres) group. Since 1998/99 there has been a growth in the number of sub-regional shopping centres of around 25 per cent.

Regional shopping centres often operate as a virtual monopoly in their region

There are numerous factors that limit competition between regional shopping centres, in effect allowing them to operate as a monopoly within their catchment area(s):

- **Local council planning regulations**

Many local councils place restrictions on development, which effectively restricts the number of shopping centres which can be developed within their zoning areas to one or two. As a result, franchisees who seek to operate in a specific area are often restricted to only one shopping centre which runs a virtual monopoly. With vacancy rates in shopping centres often below 1 per cent, (Westfield's Australian portfolio has consistently maintained occupancy at around 99 per cent for 20 years²⁹, and Centro and Stockland's averaged vacancy rates of 0.5 per cent and 0.2 per cent respectively for the 2005/06 financial year), there is evidence that the supply of retail tenancy space within shopping centres is constrained, to the benefit of shopping centre operators.

Furthermore, shopping centre operators take an aggressive stance in lobbying town planners and local councils to further limit competition between operators. This is highlighted in the case study below.

²⁸ Franchise Business.com.au, "Foodco on the shopping centre versus the retail strip debate for franchisees", 8 May 2006. (Available at: http://www.franchisebusiness.com.au/articles/Foodco-on-the-shopping-centre-versus-the-retail-strip-debate-for-franchisees_z49934.htm)

²⁹ Deutsche Bank, report on Westfield Group, 25 June 2007

Case Study

There were recent plans for a large retail shopping centre to be opened at Sydney Airport. The proposed development was a 60,000 square metre precinct with 3,000 car park spaces. It was estimated to cost approximately \$200 million. Westfield however was concerned that the opening of a competing shopping centre in close proximity to its Pagewood centre (around 7-10km) would reduce the turnover and hence profitability of its centre. Consequently, Westfield employed numerous lobbyists during the 90-day consultation period that ended on 30 January 2006, which contributed to the development being blocked.

- **Long, favourable lease terms for anchor tenants**

The presence of a major existing shopping centre with long term lease agreements and good anchor tenants also make it less viable to establish another shopping centre in close proximity. A survey of franchisees who lease premises from regional shopping centres found that less than a third of regional shopping centres operate within a 5km radius of another similar shopping centre, which may be owned by the same landlord. The long lease terms offered to anchor tenants, commonly 20-year lease terms,³⁰ can act as a barrier to entry for other shopping centre operators who may want to establish a competing centre in the region.

Anchor stores also receive reduced rents (or turnover based rent which falls during times of declining retail sales) due to their ability to entice customers to the centre, with smaller retailers paying more rent per square metre and paying a greater share of parking, administration and security costs. This is a particular issue given that smaller, independent franchisees have smaller turnover and profits compared with anchor stores.

However, the same favourable lease terms are generally not offered to smaller retailers. This is particularly relevant for the franchising sector, as individuals or couples own 93 per cent of all franchises and single-unit franchise ownership is the norm. A recent presentation given by the Australian Retail Lease Management at the National Small Business Summit 2007 highlighted that specialty stores in a typical 50,000 square metre shopping centre will often account for 65 per cent of the total rent paid whilst only occupying approximately 35 per cent of the total retail floor space. Conversely, major tenants are only accounting for 35 per cent of total rent paid, thereby having their rents subsidised by smaller franchise retailers.

Major shopping centre landlords have excessive market power

Occupancy rates as reported by all the major shopping centre owners and managers have also remained relatively constant at circa 99 per cent. This suggests that “high barriers to entry and relatively low supply constraints for

³⁰ University of Reading Business School, An Evaluation of the Policy Implications for the UK of the Approach to Small Business Tenant Legislation in Australia, August 2006

regional retail malls” continue to exist, strengthening the position of shopping centres as the dominant player in the retail tenancy market.³¹

Due to the limited competition between shopping centre operators, they have the power to charge rents at the high end of market ranges, which are then subject to significant escalations and reviews. A substantial proportion of major centres operate as a virtual monopoly within their local market. The bargaining power of regional shopping centres is excessively high compared to that of the individual franchisee or small retailer, as:

- **Small retailers and franchises compete intensively with each other, they cannot act collectively against the large shopping centre operator**

The artificial constraint (due to lack of competition and local council planning regulations) on the supply of retail tenancy leases in regional shopping centres has meant that the demand for spaces far outweighs supply. This has increased the competition between smaller retailers and franchises for retail leases. This competition between tenants limits their ability to act collectively against the shopping centre landlords.

Franchisees are essentially small businesses and their ability to successfully negotiate with large shopping centre operators is minimal. They also often cannot afford expensive legal representation to undertake dispute resolutions and action against possible unconscionable conduct.

The ability for tenants to act collectively is limited due to their large number and status as competitors. The ACCC has indicated that recent changes to Trade Practices Act to permit collective bargaining in certain circumstances are likely to assist tenants in their negotiations and dealings with landlords. However this is unlikely to be the case.

Collective bargaining is an arrangement under which two or more competitors in an industry come together to negotiate terms and conditions (which can include price) with a supplier or a customer. A collective boycott occurs when a group of competitors agree not to acquire goods or services from, or not to supply goods or services to, a business with whom the group is negotiating, unless the business accepts the terms and conditions offered by the group.³²

As the ACCC itself notes on its website, both collective bargaining and collective boycotts may raise serious concerns under the prohibitions in the Trade Practices Act against anti-competitive arrangements (section 45), price-fixing (section 45A) and agreements between competitors to limit dealings with a particular supplier or customer (section 4D). This is somewhat of an understatement, as these offences carry a range of very strong sanctions including substantial fines. Given the potential consequences, there is a strong reluctance on the part of competitors to meet.

³¹ Deutsche Bank Broker Report, Westfield Group, 25 June 2007, p. 12.

³² ACCC website definition.

The amendments to the Trade Practices Act from 1 January 2007, propose a collective bargaining notification process whereby parties which propose to engage in collective bargaining conduct which might otherwise be a breach of the Trade Practices Act may obtain immunity from legal action under the Trade Practices Act, if the conduct is in the public interest. However the process is complicated, the forms long and difficult to complete with obtaining specialist advice, all participants are required to sign consents and there is a \$1,000 fee for lodging the notification.

More importantly, the “collective bargain” is often very difficult to find. Tenancies rarely end at the same time, so any of the typical landlord conduct problems encountered by tenants at end of lease term would be likely to be discrete to that tenant and no collective issue would arise. It is not a collective issue if one tenant has a problem, and other tenants rally in support or even threaten to refuse to deal with that landlord. Indeed, it would appear almost impossible to imagine circumstances where the two major issues identified by tenants – excessive rental increases and inadequate protection to sitting tenants – could give rise to a collective issue for the purposes of collective bargaining. At the commencement of a tenancy the various retail networks are in fact competing for sites, and would not wish to bargain collectively even if the public benefit test could be satisfied in such a situation. It would only be in unusual cases where there was a genuine common interest – perhaps a poor performing centre or negligently managed centre renovations that were impacting several tenants – that collective discussions would be useful. And in such cases these discussions already occur, albeit perhaps in breach of the collective bargaining provisions of the Trade Practices Act.

It should also be noted that fear of an ACCC prosecution is not the major concern of tenants, who from time to time have tried to bargain collectively even prior to the recent amendments. By far the major fear is landlord retribution. Informal collective discussions often occur in relation to matters such as a poor performing centre or the impact on trade of centre renovations. However such attempts by tenants to negotiate collectively have been very strongly discouraged. The following case study was provided by a large franchisor member to the Franchise Council of Australia as part of a retail tenancy workshop on July 26, 2007 and validated by another member at the meeting.

Case Study

When several food retailers who were tenants at a Sydney Westfield shopping centre’s food court sought to collectively negotiate with Westfield in relation to a poorly performing 2nd Food Court, Westfield representatives indicated they would not attend the meeting or participate in the negotiations. Furthermore, the major tenants received a specific call from Westfield management in which they were “strenuously advised” not to pursue this strategy.”

- **A shopping centre is essentially a captive market, tenants are afraid to risk being forced out**

Franchises and other small retail businesses generally build up their customer base in a certain region and relocation to a different region impacts heavily on their revenue and business viability.

Unlike shopping strips, where most shops are operated (and often owned) by different operators (and landlords) and therefore tenants can move to adjacent retail spaces on a strip relatively easily, regional shopping centre operators hold a captive market within their centre and tenants are either in or outside of the shopping centre.

As a result, regional shopping centre operators have a high degree of bargaining power over franchisees and other small businesses. A franchisee is less likely to have a dispute or raise issues with their retail tenancy operator, given the risk of being forced out of the shopping centre. This risk is due to the fact that the retail tenancy operators operate all tenancy space within the shopping centre, and therefore relocation due to issues with management necessarily involves relocation out of the shopping centre.

This is a particularly concerning issue given the monopoly of many shopping centres within their local council zone (see earlier discussion), which means small tenants are often forced to accept all the terms of the shopping centre operators in order to remain in the shopping centre in their local area.

The vicious cycle of rental increases perpetuate as whilst the tenant may not feel the new rent is fair, they cannot divest their business without a lease, so to realise the goodwill tenants are forced to sign the new lease. The new lease then becomes the new benchmark rate as fair market value.

Table 5 below highlights the fact that the typical Australian retailer faces less favourable lease terms and rental review processes, with more frequent reviews and potential increases, then compared to their international counterparts in UK and the US.

Table 5: International comparison of lease terms

Nation	Typical lease duration	Rental review process
Australia	4 - 5 years	<ul style="list-style-type: none"> • Rents typically reviewed annually with a rental growth clause
United Kingdom	10 - 12 years	<ul style="list-style-type: none"> • Lease terms may also often range between 15 to 25 years
United States	8 - 10 years	<ul style="list-style-type: none"> • Rents typically structured with fixed growth and stepped increases

Source: Deutsche Bank Broker Reports, *Estates Gazette* UK

3 Information asymmetry between shopping centre operators and tenants leads to abuse of market power

Summary Points

- Shopping centre operators have access to turnover information of all tenants in centres operated by the same owner
- Tenants have no reliable, up to date sources of information on net effective market rent levels
- Confidential deals restrict the free flow of information in the market
- The information asymmetry leads to a risk of market power abuse by the shopping centre operators

Shopping centre operators disclose little information, but have access to a large amount of information on store turnover and implied store profitability

Unlike shopping strips and other shopping centres, regional shopping centres usually require their tenants to disclose revenue turnover in their tenancy agreement. Shopping centre operators also have access to the revenue information of all tenants in all shopping centres by the same owner.

The low number of players in the shopping centre industry also means that effectively, a small group of shopping centre operators have access to the turnover information for over 50 per cent of retail sales in Australia. This is of particular relevance for franchises as knowledge of existing franchisee turnovers allows the shopping centre landlords to have a ready estimate of the turnover of new franchisee stores.

This same level of information is not available for tenants. Whilst it is possible to obtain copies of the UrbisJHD report on retail averages in shopping centres, which shows average occupancy costs as a percentage of turnover for various types of shops in shopping centres, the data is costly to obtain and does not allow year on year comparison.³³

Also, shopping centre owners often do not disclose information on planned extensions to a centre, despite their prior knowledge of such plans which can affect the tenancy mix and cause significant disturbances to the tenant.

³³ Definitions of 'retail turnover' has changed year on year and sales is reported inclusive of GST whilst rent is reported excluding GST. This does not allow occupancy costs as a % of turnover to be verified against disclosure statement data and does not allow year on year comparison.

Tenants have no reliable, up-to-date sources of information on rents paid by other tenants

In contrast to the amount of detailed, comprehensive information on store revenues that are easily accessible to shopping centre operators, there is limited or no information available to tenants (in particular, franchisees and other small retailers) on the rental charges paid by other tenants to determine fair market value.

In Victoria, WA, SA, NT and Tasmania, virtually no public register of rental charges exist. Whilst Queensland and NSW have registers of rental charges, it is costly to obtain and a lot of information is out of date. Furthermore, the NSW register does not include information on the size of rebates, and therefore is somewhat misleading as to the true cost of rent (this is also discussed in the next section). Victoria's requirement to notify the Small Business Commission of lease commencement does not include information on rents and areas or escalations, and the information is not publicly available.

The lack of an efficient public register of rental information for tenants effectively prohibits franchisees and other small retailers from accessing any data on what constitutes 'fair market value' for rents and lease terms. As competitors, they cannot informally share information without compromising their own competitive position.

A large amount of hidden rebates and confidential deals limit the flow of information in the market

Factors which further restrict the effective flow of information on rent levels, lease conditions include:

- **Rebates**

Presently, whilst franchisees in shopping strips and other commercial spaces are usually charged a fixed rate, retail operators of shopping centre adopt a different approach. Retail operators charge a gross rent determined through negotiation with the lessee, of which a percentage is returned in the form of a rebate at the end of each year. The basis of determination for this rebate is unclear, and often varies subject to the bargaining power of the tenant. Operators do not disclose rebates for other shops in the centre, or how the rebate is calculated.

Whilst NSW, ACT and Queensland have legislation requiring the registration of leases which may include gross rental information, this does not include rebates, and is therefore not indicative of true cost faced by other franchisees.

- **Multi-site deals**

Multi-site deals also distort information on the fair value of rents in an area. A multi-site deal is one where several sites are leased from the same shopping centre operator and the rent is negotiated as a package. This means that rent levels and lease conditions at any particular site does not reflect the value of that site, and makes it difficult for tenants to compare the true level of rent charged for any particular site.

- **Overage**

Furthermore, some shopping centres charge certain tenants overage, whereby a percentage of a lessee's gross sales in excess of a specified dollar amount is added to the rent. This makes it difficult for individual tenants to calculate the amount of rent they would pay (given that forecasts of turnover are imperfect) over the year, and also makes it difficult for tenants to compare rent levels between sites.

- **Confidentiality agreements**

Regional shopping centre operators often seek to further extend the level of information asymmetry in the market by asking tenants to sign confidentiality agreements about rent negotiations and their tenancy agreements. A survey of franchises showed that over 80% of franchisors who leased from regional shopping centres had been asked to sign confidentiality agreements.

The high extent of the information asymmetry has allowed shopping centre operators to abuse their market power in lease negotiations

The result of this information asymmetry between the regional shopping centre operators and tenants, in particular franchisees and small retailers, is that the regional shopping centre operators are able to abuse their market power and have a significant degree of bargaining power in the rental negotiation process. This is due to:

- **Increased difficulty for tenants to compare rent levels between shopping centres and determine what is fair market value**

The lack of a public register of leases, their terms and conditions and the effective rent paid by other tenants makes it very difficult for tenants to compare rent levels within and between shopping centres. The information asymmetry allows landlords to create a false focal price point for rent negotiations, further weakening the level of competition between centres.

Anecdotal evidence suggests that the lack of data on what level of rent has made it difficult for independent valuers to conduct a fair and reliable rent review. Even where an independent rent review can be conducted, the 'benchmark' rate used to indicate 'fair market value' is often inflated as most tenants are forced to pay significant rental increases at renewal, under duress due to their high sunk costs and captive economic relationship with the shopping centre landlord.

A recent survey of franchisors showed that despite franchisors being aware of rent levels in all shops across their own network, over 70% of franchisors were hindered in their knowledge of market rents by issues such as multi-site deals.³⁴

³⁴ PricewaterhouseCoopers, Review of market trends for retail tenancy leases, 2007

- **Regional / DDS-based shopping centre operators have an unfair advantage in rent negotiations due to their knowledge of the tenant's ability to pay**

Knowledge of a tenant's revenue turnover means that regional shopping centre operators can determine and charge the maximum amount of rent a lessee can afford to pay, not the fair market value of the rented space.

This allows retail properties to gain advantage of charging higher rents to those who can afford it, but do not take gain any disadvantage from those who cannot; they simply do not offer them a rental space in their shopping centre. It is an unfair determination of rent compared with shopping strips and residential property who do not disclose financial details of their business, and are charged a fixed rate based on the value of the property they are leasing.

The common practice for regional shopping centre operators to require all turnover details be presented to them also unfairly discriminates new and smaller franchisees, who have no financial statements or make relatively small profits. They are less likely to be able obtain a retail space within regional shopping centres.

There is also anecdotal evidence that shopping centre owners often disclose turnover information of existing tenants to prospective tenants, which unfairly damages the competitive position of the existing tenant.

- **Outgoings including management and marketing fees have increased substantially, and are often used as 'quasi-rent'**

Management fees and marketing levies have been referred to as 'rent by stealth'. Audited statements showing the details of management fees (i.e. management of the shopping centre as opposed to 'general' management fees to the company) should be made available, however anecdotal evidence suggests that this is often not the case, and most small tenants do not have the experience and resources needed to scrutinise and challenge such fees.

A member of the FCA with premises in many regional and DDS-based shopping centres have indicated that over the past five years promotional budgets within certain centres has doubled as a proportion of base rent, in addition to significant management fees for large centres, with little justification for the rising fees.

4 Lease conditions are unfair and lack transparency

Summary Points:

- Regional shopping centres typically charge substantial rent increases at lease renewal (often 30% to 50%)
- Due to high sunk costs and a desire to retain goodwill in the business, tenants are in a captive economic relationship with shopping centre owners and have little defence to:
 - excess rent increases at renewal
 - changes by the shopping centre to the tenancy mix
 - demands by the shopping centre to relocate / renovate
- The sitting tenant has little rights at lease end:
 - no guaranteed right of renewal
 - unfair disclosure of information by shopping centre to the competing retailers at lease end

The high level of rent increases at lease renewal indicate that there is market failure in the regional shopping centre sector

A recent survey of franchisors in Australia indicate that the average rental increases at lease renewal is highest in regional shopping centres, followed by DDS-based and supermarket based shopping centres. The average increase at lease renewal is more than double that at standalone / strip shops.

In around 22% of instances, the rent increase proposed at renewal is 40% greater than passing rent for regional shopping centres. Tenants located at other shopping centres are in a similar situation, with rent increases higher than 40% at lease renewal in more than a quarter of instances. Standalone / strip shops, however, only encountered this situation less than one in ten renewals.³⁵

Case Study

A food retail franchisee was located in a regional shopping centre owned by one of the six major players in the shopping centre industry. After only 5 years in the centre, the new lease at renewal increased by 67%. The franchisee was unable to sustain this increase in occupancy costs and was forced to relocate to another location in the centre with lower rent. This was done at a cost of \$200,000 as the franchisee had to pay full relocation costs.

³⁵ PricewaterhouseCoopers, Review of market trends for retail tenancy leases, 2007

With existing contracts already locked in, one of the ways to generate a greater rental stream up has been via the use of kiosks, which often mimic existing tenants' offerings and thereby erode retailer profits for small retailers already burdened by high fit-out and occupancy costs³⁶. This is evidenced by the case study below.

Case Study

A food retail franchisee was located in a regional shopping centre owned by one of the six major players in the shopping centre industry. After only 5 years in the centre, the rent proposed by the landlord at renewal time was close to double the original rent.

The size of the store at over 100sqm including seating space meant that there were substantial fit-out costs and the franchisee had a highly vested interest in the location.

Ultimately the negotiated new lease was settled at a 61% to the passing rent, under condition that a mini-kiosk be opened at the same centre by the franchisee. Full refurbishment costing \$150,000 was also carried out by the franchisee.

Individual franchisees and small retail tenants have little defence to the abuse of market power by regional shopping centre landlord

Individual franchisees are essentially in a captive economic relationship with the regional shopping centre landlord. This is because:

- Shops usually face high fixed costs for set-up, renovation and fit-out. These costs take a number of years to recover and on top of rental costs, franchisees are required to pay all fit-out costs of the premises to convert the area to one suitable for their particular business. Fit-out costs for franchisees in major shopping centres average over \$100,000, however can reach levels of up to \$550,000³⁷.

These fit-out costs are a sunk cost which is lost if a retailer leaves a shopping centre. This means that franchisees have made a significant investment in the assets at the premise, and cannot terminate the lease without losing their investment. These large costs provide a disincentive for franchisees to relocate to less expensive shopping centres or to terminate a lease when faced with excessive rent increases.

- Franchises and other small retail businesses generally build up their customer base and goodwill in a certain region and relocation to a different region impacts heavily on their revenue and business viability. Unlike strip shops where relocation to an adjacent premise is relatively easy, the single ownership structure of the regional shopping centre makes it impossible for the tenant to relocate to another location in the shopping centre. Hence, the tenant cannot leave the landlord without losing the existing customer base, even if they were willing to forego losses on large parts of fit-out.

³⁶ Ibid.

³⁷ 2006 Griffith University and FCA survey on franchising in Australia

This captive relationship leaves tenants with little power to defend against unfair lease conditions including:

- **Changes in the tenancy mix:** Franchisees have minimal control over competing retailers opening in the shopping centre. Whilst competition between retailers is natural and generally beneficial for the economy, the regional shopping centre owner has a high level of control over the level of competing retailers in the centre.

This means that the regional shopping centre landlord can increase the number of competing retailers in the centre after existing tenants are locked in to a certain level of rents. It also increases the landlord's bargaining power during lease negotiations and the threat of allowing more retailers in the same category into the centre can force the tenant to accept excessive rent increases and unfair lease conditions.

For example, James Fitzgerald, managing director of Foodco, operator of the 270-store Muffin Break franchise and Jamaica Blue franchise, highlights that certain franchisees find it unsustainable to remain in shopping centres. He states that whilst shopping centres offer retail food outlets high volumes of throughput in terms of customers, over the past couple of years the tenancy mix has changed, with many shopping centres having no cap on the number of coffee businesses thereby increasing competition and reducing the level of consumer spending that each store is able to capture.³⁸

Case Study

A fashion accessories retailer that has been operating in a regional shopping centre in Sydney for 10 years has recently agreed to a high increase in rent during lease renewal negotiations.

However, the landlord has then allowed a competing retailer to open in the shopping centre after the lease was renewed. This was not disclosed to the retailer during lease negotiations.

A survey of franchisors who lease premises at regional shopping centres found that in almost all instances, landlords have allowed significant competing retailers to establish in the shopping centre.

- **Forced relocations:** Franchisees have minimal power over shopping centre operator decisions to relocate them within a shopping centre. Different locations within shopping centres have different volumes of passing consumers. For example, retail space surrounding the entrances and exits to shopping centres and surrounding escalators have a larger number of passing traffic than retail space on the top floor in the corner. Given that increased passing traffic increases the number of potential customers, tenant profits are directly affected by their location. With no control over relocation, the tenants also have no control over their future income.

³⁸ Cummins, C. (2007), "Retail trade strengthens as rents plateau" *The Sydney Morning Herald*(Domain - Commercial), 7 April 2007

Franchisees and other small retail tenants are seldom adequately compensated for forced relocations. A recent survey of franchisees found that around 17% of tenants in regional shopping centres have been asked to relocate, with close to 50% of these relocations not being adequately compensated for the relocation.³⁹

- **Payment for renovations:** Franchisees profits can be directly affected by retail tenancy operators' decisions, such as renovations. During renovations, less people visit shopping centres due to factors such as noise, mess and the disruption to normal business activity. As a result, potential customers do not visit the centre, reducing franchisees' profits. Retail tenancy operators also have the power to close down shops during this period, completely removing franchisees source of income.

For example, a case study from www.insideretailing.com.au states that "a retailer in a major suburban shopping centre who was paying \$117,064 per annum in rent, was forced to undertake a new fit-out and increase rental payments to \$208,366 per annum for the lease to be renewed. This was despite centre sales being down 3 per cent and the retailer's category sales being down about 20 per cent."⁴⁰

The sitting tenant does not have a guaranteed right of renewal and shopping centres often unfairly disadvantage existing tenants

A major problem facing franchisees is the lack of guarantee by retail tenancy operators in renewing leases. Upon the termination of a lease under the current regulation, no guarantee is made to the lessee that the lease will be renewed, even if all rental payments have been made in full and on time. Given that most leases expire after only 5 years, the lack of security to franchisees regarding the future of their business is a matter of large concern. This is due to concerns about realising the goodwill value that franchisees make during their tenancy with their customers in a shopping centre, and the large set-up costs that are incurred which need to be covered.

The inability of sitting tenants to determine what could be the fair market value of their site, due to the information asymmetry, has also allowed shopping centre landlords to adopt aggressive negotiation tactics at lease renewal. Anecdotal evidence indicates that a common tactic by landlords is to suggest that other prospective tenants are competing for the site and are prepared to pay a significantly higher amount of rent than that currently paid by the sitting tenant. Despite the lack of evidence supplied by the landlords on the existence of these prospective tenants and their offers, sitting tenants are not able to effectively counter these tactics as they cannot provide evidence of the true market value of their site.

³⁹ PricewaterhouseCoopers, Review of market trends for retail tenancy leases, 2007

⁴⁰ Are Property Rents Too High? *Inside Retailing*, (<http://www.insideretailing.com.au/articles-page.aspx?articleType=ArticleView&articleId=764>) February 27 2006

5 Recommended reforms

Summary Points:

- Any consideration of the costs and benefits of reform should note the high costs of Government inaction. The problems in retail tenancy are well documented and proposed solutions have either not been implemented or have not worked
- National legislation, such as the enactment of a mandatory industry code pursuant to section 51AE of the Trade Practices Act to be administered by the ACCC, is essential
- Although some level of industry input and consultation is appropriate in the development of the Code the ACCC should have a strong stewardship role to ensure the exercise is completed within a relatively short time frame. Critical issues must be addressed in order to improve the efficient operation of the market, notably:
 - tenants should have longer guaranteed tenure. In this respect we note that Oilcode and previous legislation in the petroleum industry addressing a similar issue mandated 9 year minimum terms. In the UK sitting tenants have preferential rights of renewal;
 - sitting tenants must be protected from excessive end of term rental increases;
 - the level and quality of free information available to tenants must be improved, preferably via the establishment of a national tenancy register;
 - the efficiency and effectiveness of dispute resolution systems must be improved, possibly using an expert panel of mediators similar to that which has operated so successfully as part of the mandatory mediation process in the Franchising Code of Conduct;
 - landlords should be banned from taking any action that discourages tenants from using the collective bargaining provisions of the TPA, and any retributive conduct (such as not renewing a tenant that has taken collective bargaining action or sought dispute resolution through regulators)
 - clear justification required for rental increases at renewal, and protection from excessive rental reviews, particularly at or near lease end;
 - greater transparency and strict controls and audit requirements on fees such as management fees, promotional contributions and levies which are often simply disguised rent;
 - all incentives granted to tenants must be grossed up and included in rent to ensure integrity of reported rental figures; and

- **banning of landlord practices which harm exiting tenants.**
- **Overall simplification of State laws with legislative consistency, common disclosure documentation and requirements and streamlined processes. If above reforms are enacted it is likely that significant reductions in compliance costs could occur**
- **Turnover information should no longer be disclosed to shopping centre landlords, or if necessary should be disclosed to an independent third party such as the ABS**
- **Remove the capacity of employee bodies such as the NSW Industrial Relations Commission to have any jurisdiction over business transactions such as leases and franchise agreements. The scandalous situation of conflict between two courts in NSW – the Industrial Relations Commission and the Supreme Court – must be addressed**
- **Remove the public company exemption from legislative protections provided to tenants where a franchisee or other sub-tenant is also involved**

The costs of inaction are high – problems in retail tenancy and proposed solutions are well documented there has been a history of either inaction or inadequate action by Government.

The problems in the retail tenancy market relating to shopping centres have been well documented since the early 1990s, including the Beddal Report (1990) which criticised major shopping centre landlords, in particular the impact of their actions on rent and outgoings.

In May 1997, the House of Representatives Standing Committee on Industry, Science and Technology report on retail tenancy issues (the Reid Report) identified many of the issues mentioned in this submission, and recommended the drafting of a Uniform Retail Tenancy Code by the ACCC. The report recommended that the ACCC approve the Uniform Retail Tenancy Code for underpinning in the Trade Practices Act 1974, thus providing for the courts to take into account provisions of the Uniform Retail Tenancy Code. Key recommendations for the uniform code included:

- accredited retail property valuers to have access – on a non-disclosure basis – to relevant Tenancy Schedules of shopping centres, showing the total occupancy costs for each tenant in the centre and the value of any concessions or rebates given, for the purposes of valuing retail property or providing advice on market rent reviews;
- the disclosure statement set out clearly the method by which rent is to be calculated for the term of the lease without provision for review or for unpredictable increases; (a) market rent review only be permitted on renewal of a lease; and (b) the level of market rent on lease renewal be determined by an independent accredited valuer, with costs shared between the parties;

- for the merchants' association in a shopping centre to be consulted in relation to changes in tenancy mix; and for lessors to include in disclosure statements provided prior to the signing of a retail lease the tenancy mix of the shopping centre and whether or not there are any provisions for rent reduction to apply if the turnover of the lessee falls owing to the introduction of new competitors.

The Baird Report in 1999 further endorsed the recommendations of the Reid Report to establish a Uniform Retail Tenancy Code. However, to date there is still no uniform national tenancy code in Australia, ten years after the publication of the Reid Report. The information asymmetry still exists and sitting tenants are afforded little protection under state legislation.

Any cost benefit analysis of proposed reforms must first take into consideration the high baseline costs that result from the inaction of Government.

State legislation has been ineffective and inconsistencies are costly to both landlords and tenants. A national Code would reduce compliance costs.

The result of the lack of Government action to implement a national Code of Conduct in regards to retail tenancy issues is that the each State and Territories is governed by specific legislation. The relevant legislation typically covers matters relating to lease terms, security bonds, unlawful threats, exclusion clauses and warranties. The State and Territory legislation governing retail tenancies is shown in **Table 6** below.

Table 6: State and territory legislation governing retail tenancies

State	Main legislation	Right to Renew	Minimum Term	Other Significant Areas of Difference
NSW	<i>Retail Leases Act 1994</i>	None	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies to premises under 1,000m² in a shopping centre or selling goods by retail, but not if the premises are leased to a public company or its subsidiary • Combination reviews (such as CPI+2%) are allowed during rent reviews.
Victoria	<i>Retail Tenancies Reform Act 1998</i> <i>Retail Leases Act 2003</i>	None	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies regardless of premise size, but not where the lease occupancy costs exceed \$1m p.a. or the premises are leased to a listed company or its subsidiary. • Prohibitions on recovering land tax. • Limits on recovery of management fees.

State	Main legislation	Right to Renew	Minimum Term	Other Significant Areas of Difference
Queensland	<i>Retail Shop Leases Act 1994</i>	None	None	<ul style="list-style-type: none"> • Retail tenancies legislation applies to premises under 1,000m² in a shopping centre or used wholly or predominantly for the conduct of a retail business, but not if the premises are leased to a public company or its subsidiary • Combination reviews (such as CPI+2%) are allowed during rent reviews. • Prohibitions on recovering land tax.
South Australia	<i>Retail & Commercial Leases Act 1995</i>	Sitting tenants have preferential right to renew lease	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies regardless of premise size, but not where rent exceeds \$250,000 p.a. or premises are leased to a public company or its subsidiary.
Western Australia	<i>Commercial Tenancy (Retail Shops) Agreements Act 1985</i>	None	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies to premises under 1,000m² in a shopping centre or used wholly or predominantly for the conduct of a retail business, but not if the premises are leased to a public company or its subsidiary
Tasmania	<i>Fair Trading (Code of Practice for Retail Tenancies) Regulation 1998</i>	None	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies to premises under 1,000m² in a shopping centre
Australian Capital Territory	<i>Leases (Commercial & Retail) Act 2001</i>	Sitting tenants have preferential right to renew lease, however not if substantially advantageous for landlord to lease premises to another tenant or change tenancy mix	5 yrs	<ul style="list-style-type: none"> • Retail tenancies legislation applies to leases of premises under 1,000 m² of a specified kind.

State	Main legislation	Right to Renew	Minimum Term	Other Significant Areas of Difference
Northern Territory	<i>Business Tenancies (Fair Dealings) 2003</i>	None	5 yrs	<ul style="list-style-type: none"> Retail tenancies legislation applies to premises under 1,000m² in a shopping centre or used wholly or predominantly for the conduct of a retail business, but not if the premises are leased to a public company or its subsidiary. Not covered for premises outside shopping centres unless premises wholly or predominantly used for retail.

Source: Retail tenancies Comparative Analysis 2005, Clayton Utz, Cameron and Blom, One stop shop, Lawyers Weekly 15 October 2004

Obligations on landlords are different under each Act. For example, in Victoria and NSW a landlord must give 60 days notice before alternation or refurbishment, however there is no such requirement in Queensland. There are also differences in the definition of a 'shopping centre' and provisions for 'shopping centre' premises.

These differences in state legislation make it costly and difficult for franchisors, who often operate nationally, to understand and comply with the requirements in each jurisdiction. Hence, the costs of enacting national legislation would be somewhat offset by the cost savings realised from removing the inconsistencies between state legislation.

Specific regulations are required to address the imbalance of market power, 'unconscionable conduct' prohibitions in the TPA have been ineffective

The *Trade Practices Act 1974 (Commonwealth)* contains provisions of relevance to retail tenancy arrangements:

- Part IVA of the TPA contains laws prohibiting unconscionable conduct, including unconscionable conduct in business transactions (Section 51AC) under \$10 million;
- Part IVB enables the establishment of industry codes and prohibits the contravention of any applicable industry code; and
- Section 51AC was introduced in 1998 with the stated aim of redressing the imbalance of bargaining power which can arise between small and large businesses.

Retail tenancy leases were one of the key concerns at that time, and remain a crucial issue today.

The Australian Competition and Consumer Commission (ACCC) enforces the TPA. It also provides education and information for businesses and consumers in relation to compliance with the TPA and has a small business program to help ensure small businesses are not subject to unconscionable conduct.

Under the section 51AA and AC of the TPA, a corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law. It also sets out a number of matters which will help

indicate whether conduct is unconscionable. These include inequality of bargaining power between parties, lack of good faith and unwillingness to negotiate. There is however no precise legal definition of "unconscionable conduct". It is a concept which creates enforceable rights both in general law and under the TPA and other legislation.

The courts have said that conduct will be found to be unconscionable if it goes against the ordinary dictates of conscience to such an extent that the law must intervene. However, there is no contractual certainty regarding unconscionable conduct, which is a matter of concern to franchisees renting in regional shopping centres. Furthermore, the costly court or legal action for small businesses often prevents action being taken.

Whilst the ACCC has undertaken attempts to protect small businesses under unconscionable conduct where the weaker party finds themselves unfairly disadvantaged by landlords, many have been unsuccessful. This is due to the fact that the courts have given section 51AC of the TPA very limited scope.

The unconscionable conduct provisions of the TPA have not proven to be an adequate response to the behaviour of landlords. The sweeping prohibition on "unconscionable conduct", which has been left undefined by the legislation, has been read down by the courts. The original intention of the legislation, and the expectations of the ACCC were that it could exercise significant control over landlords where it considers a landlord had behaved unconscionably. The ACCC had some initial success on a consent order / no admissions basis, but in each instance where the matter has had to be decided by a court the ACCC has been unsuccessful. The following facts clearly demonstrate that the unconscionable conduct provisions provide little or no protection to tenants:

- In *ACCC v Leelee Pty Ltd* the ACCC alleged specific breaches of the prohibition on unconscionable conduct, notably that Leelee had engaged in unconscionable conduct towards tenants:
 - in relation to the rent charged from time to time;
 - by permitting other stallholders to sell food of the same kind as that exclusively reserved to the tenants;
 - by permitting other stallholders to sell food at prices lower than the level at which their respective competitors under lease were permitted to sell at, whilst insisting that the tenants adhere to prices as fixed in accordance with their lease; and
 - by failing to "consider" the grant of a fresh lease of the premises to prospective tenants introduced by the tenants.

These are classic issues that are of concern to tenants of major shopping centres, yet they were not considered to constitute unconscionable conduct and the ACCC's statement of claim was struck out.

- In the case of *ACCC v Samton Holdings* the ACCC took action alleging landlords had engaged in unconscionable conduct. However the court felt that the tenant had to show they were at a “special disadvantage” to succeed. Again the ACCC was unsuccessful.
- In June, the Federal Court once again ruled against the ACCC was in the case *ACCC v CG Berbatis Holdings*.

The unconscionable conduct provisions were intended to address acknowledged concerns as to the operation of the retail market place. The clear intent has been frustrated. The following quote from Westfield “*We would prefer to be judged in court rather than by unsubstantiated rhetoric by the ACCC's chairman...If the ACCC decides not to return to the courts, then we have very little recourse and the public will have to make up its own mind as to why the ACCC has refused to state its case in court. It is easy for the ACCC to create a publicity stunt by speaking to the community through the media.*”⁴¹ shows that the unconscionable conduct notions are clearly not prohibitive to the shopping centre landlords.

The current position is that there is binding High Court authority that severely limits the application of the unconscionable conduct provisions of the Trade Practices Act. The type of conduct that ought to be illegal, such as bullying, taking advantage of end of term inequality of bargaining power, massive rental hikes and unfair conduct in relation to tenancy mix will clearly not be considered to be unconscionable. Further, the ability of the ACCC to intervene and help facilitate a negotiated settlement is in doubt given that at least one major landlord has indicated it will only deal with such allegations in the courts.

It is therefore recommended that instead of relying on an ambiguous definition of ‘unconscionable conduct’, reforms in the retail tenancy market take the form of an industry code of conduct.

Recommendations for priority areas of reform to protect sitting tenants

The FCA recommends that a national tenancy Code of Conduct, similar to the National Uniform Retail Tenancy Code recommended by the Reid Report, and the code of conduct be developed between franchisees and franchisors, be established to address the issues which have arisen due to information asymmetry and the excessive market power realised by the shopping centre landlords. The recommendations for this code of conduct are discussed below.

- ***Tenants should have longer guaranteed tenure, including a longer minimum term and a right of renewal for sitting tenants.***

Given the high fit-out costs incurred in setting up a franchise in a retail space, it is recommended that a minimum term be guaranteed for retail tenants.

This type of reform has been successfully implemented in the oil industry, where there is a guaranteed 9-year term. This increased lease

⁴¹ Ooi, Teresa, Lowy wants watchdog's day in court – Competition Law Reform, *The Australian*, June 24 2004

time was driven by similar market dynamics to that faced in the retail tenancy market, where there were allegations of abuse of power between large oil companies and small franchisees. This resulted in minimal financial costs and business restrictions to companies, but the protection given to franchisees has been significant. In this respect we note that Oilcode and previous legislation in the petroleum industry addressing a similar issue mandated 9-year minimum terms.

- ***Sitting tenants must be protected from excessive end of term rental increases.***

This would provide franchisees with an automatic right of renewal if the landlord intends to re-let the premises, and protect the franchisees from large rental increases without justification. This would mean that if a sitting tenant in a shopping centre has complied with the lease and seeks to renew and the landlord intends to relet the space, the sitting tenant gets the automatic right to renewal. The renewal rental would need to be fair market value. To remedy the information imbalance and protect the lessee, it is recommended that retail tenancy operators who propose to increase the rent by more than 20 per cent from the previous year have to go through an independent retail justification process.

- ***Clear justification required for rental increases at renewal, and protection from excessive rental reviews, particularly at or near lease end.***

Given the high sunk costs of fit-out and the significant goodwill attributed to the existing premises, sitting tenants are particularly vulnerable to landlord tactics to aggressively increase rent at annual market rental reviews, particularly at lease end. There should be legislative protection against excessive rental increases, for example the need for clear justification for rental increases above say 10 per cent, or for rental reviews to be carried out by an independent third party.

- ***The level and quality of free information available to tenants must be improved, preferably via the establishment of a national tenancy register.***

To address the information asymmetry between franchisees and lessors, it is recommended that a compulsory national register be developed, in which all rental and overage charges, as well as rebates, be recorded to increase transparency in the market. This would allow franchisees to compare rental charges, and provide guidance as to the fair market value of rental properties. This would improve the functioning of the free market without regulating it.

Due to the large amount of hidden rebates and confidential deals hindering the flow of information, all incentives granted to tenants must be grossed up and included in rent disclosed on the register to ensure integrity of reported rental figures.

- ***The efficiency and effectiveness of dispute resolution systems must be improved, possibly using an expert panel of mediators***

Many States and Territories also have special support bodies such as shop lease tribunals. Dispute resolution mechanisms, which are

available in all jurisdictions, generally enable disputes to be referred to mediation, conciliation or arbitration before proceeding to a tribunal or court. However, the current available avenues for dispute resolution are costly and time consuming.

It is recommended that a clear, fair, timely and affordable procedure under the code of conduct for dispute resolution is set up. Current procedures are timely, expensive and often ineffective in resolving franchisees issues. A dispute resolution system which is cost effective and easy to access, similar to the expert panel of mediators mechanism that is adopted by the Franchising Code of Conduct, should be set up by a federal regulator.

- ***Landlords should be banned from taking any action that discourages tenants from using the collective bargaining provisions of the TPA, and any retributive conduct (such as not renewing a tenant that has taken collective bargaining action or sought dispute resolution through regulators).***

Reforms need to ensure that landlords are not allowed to threaten retributive conduct towards tenants who wish to engage in collective bargaining. There should be a clear avenue for reporting such matters (e.g. a dedicated Retail Tenancy Ombudsman) and specific bans against landlords not renewing leases as retribution against tenants who seek legislative protection.

- ***Greater transparency and strict controls and audit requirements on fees such as management fees, promotional contributions and levies which are often simply disguised rent.***

Disclosure and audit requirements on management fees, marketing levies and promotional contributions should be clarified and reinforced, so that they cannot be used as a form of 'quasi-rent' by shopping centre landlords.

- ***Landlord practices which harm existing tenants should be banned.***

Landlord practices such as the disclosure of turnover information of sitting tenants to prospective tenants, and previously undisclosed changes in the tenancy mix which result in increased competition for the sitting tenant, should be banned.

Turnover information should no longer be disclosed to shopping centre landlords, or if necessary should be disclosed to an independent third party such as the ABS

The disclosure of turnover information leads to the information asymmetry which contributes to market failure in the regional / DDS-based shopping centre market for retail tenancy leases. Turnover information is commonly used for informing landlords of tenant ability to pay during rent negotiations, whilst its usefulness in improving the management of shopping centres is not proven. Hence, legislation should be enacted to either ban the requirement to disclose turnover to landlords, or only allow disclosure to independent third parties such as the ABS.

The turnover information collected should only be presented in a summary form for landlords, such that identification of individual tenants is not possible. This information on turnover, if collected, should also be freely provided to all market participants along with occupancy costs and made easily accessible, such that there is not an imbalance of information between landlords and tenants.

Remove the capacity of employee bodies such as the NSW Industrial Relations Commission to have any jurisdiction over business transactions such as leases and franchise agreements.

The conflict between two courts in NSW – the Industrial Relations Commission and the Supreme Court – must be addressed. Section 106 of the NSW Industrial Relations Act enables the IRC to deem a contract “unfair”. However, this provision has been used to deal with leasing matters, which has resulted in increased regulatory complexity in the retail tenancy market, and should be removed.

Remove the public company exemption from legislative protections provided to tenants where a franchisee or other sub-tenant is also involved.

Currently, most of the state legislation around retail tenancy leases do not offer protection to tenants identified as ‘public companies’. This definition has been applied to situations where a franchisee or other sub-tenant is also involved. However, it is the view of the FCA that the structure of franchises is clearly different from public companies and closer to that of small businesses. The public company exemption in state legislation on retail tenancies should not apply to franchises.

6 Further Information

This submission has been developed through:

- private discussions with members of the FCA;
- case studies submitted by members of the FCA;
- review of publications and publicly available information on the market retail tenancy leases in Australia;
- a PricewaterhouseCoopers survey of members regarding their experiences in the retail tenancy market, commissioned by the FCA to inform this submission; and
- a Roundtable discussion on retail leasing held on July 26 2007, attended by members of the FCA and Stephen Spring from Australian Retail Lease Management.

We also wish to direct the Productivity Commission's attention to the numerous reviews of state legislation relating to retail tenancies and the previous Government inquiries relating to this issue including:

- *Small business in Australia: Challenges, problems and opportunities*, date tabled: 31 May, 1990;
- *Finding a balance: Towards fair trading in Australia*, date tabled: May 1997; and
- *Effectiveness of the Trade Practices Act 1974 in protecting small business*, date tabled: 1 March, 2004.

Members of the FCA are available to offer witness at public hearings for this inquiry. Please contact:

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The FCA also wishes to express its willingness to offer the Productivity Commission further input to this inquiry if required.