

The market for retail tenancy leases in Australia

Australian Commonwealth Government
Productivity Commission inquiry.

Submission

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Personal background

Solicitor in Melbourne: negotiating and preparing retail leases for two of Australia's major retail shopping centre owners 1987 - 1990

Solicitor in Melbourne and Sydney: advising franchisors, master franchisors and franchisees 1991 - 1999

Law Academic UNSW: 2001 - present

Specific relevant current research projects include:

- franchisees' and their retail premises occupancy
- franchisor insolvency, for PhD thesis.

The views in this submission are my own and are not those of my employer.

This submission focuses on a small number of specific areas. I would be happy to elaborate on this submission, or to comment on other aspects of the issue.

Improvement

I submit that there is scope for improvement in the State and Territory retail tenancies regimes in the following areas:

1. Uniformity

I support the submissions by Westfield and the Shopping Centre Council of Australia that nationwide uniform tenancy laws are desirable. Landlords, chain operators and franchisors have tenancies across several states. Consistency would promote clarity and transparency and, presumably, reduce costs.

2. Access to data

I support any moves to create a national database of retail rents that could be accessed on payment of a modest amount. This would enable tenants, franchisors, franchisees and valuers to have ready access to some reliable data for the purposes of assessing accurate rental values of retail premises, in the same way as residential sales data can currently be accessed.

Where information is currently available for purchase it is either prohibitively expensive for a single retailer, or is not packaged in a useable way for the market.

3. Relocation

Landlords have a legitimate interest in being able to require tenants to relocate. This enables landlords to maximize earnings from the retail premises asset. However, the party instigating the relocation (often, the landlord) should never be able to require relocation without providing fair, timely, compensation direct to the party that is being dislodged. It should be noted that this may be a franchisee who may have sunk the cost of the fit out into the premises but who may not currently fit the definition of lessee in the relevant retail lease legislation.

4. Changed pattern of many retailers as franchisees.

Today many retail premises are occupied by franchisees. In regional and sub-regional shopping centres, the brand recognition and proven track record of a franchisor will help it secure a specialty shop lease for its franchisee. An unaffiliated or first time retailer may not have the track record to secure premises in a large shopping centre and will often be unable to secure a lease of retail premises unless they have a particularly quirky concept that the leasing manager likes, or are prepared to take a lease of a less desirable shop. The major shopping centre owners and managers would be able to provide the Productivity Commission with accurate figures as to the % of specialty stores and kiosks in shopping centres are inhabited by franchised and non franchised operators.

Definitions in all leasing laws should be reviewed to ensure they reflect the 21st century retailer who may be a franchisee. As State and Territory retail premises laws have been amended over the years, the drafters do not appear to have revisited the definitions of 'lease', 'lessor/landlord' and 'lessee/tenant' to ensure the legislation accommodates franchisees' interests appropriately. Once these key definitions have been re-examined, consequential amendments may be required. This will be examined in a little more detail under the heading 'The retail leasing legislation' pages 6 - 10.

Australian research shows that 'Where the franchise units operate from a specific site, the head lease is held by the franchisee in almost 64% of cases. 26% of franchisors hold the head lease. At the industry level franchisors are more likely to hold the head lease in retail (food and non food) systems.¹' The 2006 franchising Australia survey did not provide an opportunity for the franchisor respondents to elaborate. My research shows that a franchisee may be connected to premises in at least 10 different ways, probably more. Franchisees occupying retail premises under some of these occupancy models are not protected by the current legislation of some (not all) States.

¹ Frazer L., Weaven S. and Wright O., Franchising Australia 2006, Griffith University, p30

Some consequences of the current omission are:

- Franchisees may have inappropriate rights under the lease. For example if the franchisor becomes insolvent, the head lease may be disclaimed by the franchisor's liquidator (as happened in Kernel's popcorn when the Australian master franchisor became insolvent). This leaves the franchisee who is a sub lessee, licensee, or casual tenant without a contract based right to remain in the premises unless a side agreement has been reached between the franchisee and the landlord.
- Franchisees may have no rights under the relevant retail lease legislation; but they
 - pay for the fit out of the premises (costs ranged from an average of \$10,000 to a maximum of \$550,000 in 2006²) and
 - take the site risk and
 - sometimes also provide the guarantee for the franchisor's head lease.
- Franchisee retailers can be vulnerable to the conduct of both the landlord and their own franchisor. Both landlord and franchisor have a legitimate right to 'clip the ticket' but this can leave little room for the franchisee occupying shopping centre premises to make a sound profit.

10 Franchisee occupancy models

1. *Franchisor owns the premises and leases to franchisee*
2. *Legal entity related to the franchisor owns the premises and leases them to the franchisee*
3. *Franchisor leases the premises from a landlord unrelated to the franchisor; franchisor sub-leases to franchisee*

This is the model that is widely assumed to be adopted by franchisors. For example, quoting the submission to this inquiry by Subway® Systems Australia Pty Ltd, "Subway currently has 1031 leased premises in Australia." This is an accurate statement about

² Frazer, Weaven and Wright, Franchising Australia 2006, Griffith University, p35

how the franchisor thinks of the situation. To the law, there is a further layer that significantly affects the legal rights of landlord, franchisor and franchisee. (see 4 below).

4. *Franchisor related entity leases premises from landlord unrelated to the franchisor; franchisor related entity sub-leases to franchisee*
5. *Franchisor leases the premises from a landlord and grants a licence to the franchisee to occupy the premises*
6. *Master franchisee leases from landlord then sub-leases to franchisee*

This is the model that overseas based franchisors that have appointed a master licensee for Australia often use. For example, Subway® Systems Australia Pty Ltd is the Australian Master licensee (the franchisor company in Australia) for the Subway® sandwich shop chain. In NSW, based on searches of all leases in the name of Subway in the NSW Dept of Lands, almost all of the 290 odd Subway® leases are in the name of a subsidiary, Subway Realty Pty Ltd, as lessee. Subway Realty sub-leases to franchisees. The case *Timic v Hammock* [2001] FCA 74 shows that the same leasing pattern exists in Subway® sites in Victoria.

7. *Master franchisee leases from landlord and grants licence to occupy to franchisee*
8. *Franchisee leases the premises direct from the landlord.*
9. *Franchisee owns the premises.*
10. *No formal occupancy arrangements.*

Wherever the franchisee is a sub-lessee (Models 3, 4, 6) or a licensee (Models 5, 7) or has no formal tenure (Model 10), the franchisee may be vulnerable to conduct by a landlord, franchisor, premises purchaser or liquidator. That conduct may be lawful because the franchisee may not be a recognised stakeholder under the relevant State or territory retail leasing legislation. The franchisee may fall outside the definition of lessee/ tenant, or the tenancy arrangement may fall outside the definition of lease. All definitions in each of the State and Territory acts or regulation are below.

The retail leasing legislation.

Leases (Commercial and Retail) Act 2001 (ACT)

lessor	<p>Defined in Dictionary: lessor, of premises, means a person who grants a right to occupy the premises under a lease, and includes—</p> <ul style="list-style-type: none"> (a) a sublessor; and (b) a person who receives the right to lease the premises by assignment from the lessor or by operation of law; and (c) in relation to negotiations for a lease—a prospective lessor.
tenant	<p>Defined in Dictionary: tenant, of premises, means a person who has the right to occupy the premises under a lease, and includes—</p> <ul style="list-style-type: none"> (a) a subtenant; and (b) a person who receives the right to occupy the premises by assignment from the tenant or by operation of law; and (c) in relation to negotiations for a lease—a prospective tenant.
lease	<p>Defined in ss.10,12(5), and Dictionary: lease means a lease, within the meaning of section 12 (What leases does this Act apply to?), to which this Act applies under that section.</p> <p>S 12. (1) This Act applies to a lease for premises, in the ACT, of the following kinds:</p> <ul style="list-style-type: none"> (a) retail premises other than large excluded premises; (b) premises located in the retail area of a shopping centre other than large excluded premises; (c) small commercial premises; (d) premises under a lease to an association incorporated under the <i>Associations Incorporation Act 1991</i>, or an entity eligible to be incorporated under that Act, other than premises used for residential purposes; (e) premises under a lease to an unincorporated charitable entity, other than premises used for residential purposes; (f) premises under a lease that are used to provide a combination of business accommodation and secretarial services; (g) premises under a lease that are used as a child care centre; (h) premises under a lease that are used as a sports centre (other than premises covered by another paragraph); (i) premises under a lease that are used as an art gallery; (j) premises under a lease that are used as a gardening supply centre; (k) premises prescribed by regulation for this subsection. <p><i>Note</i> <i>Large excluded premises</i> is defined at the end of the section, and <i>small commercial premises</i> is defined in the dictionary.</p> <p>(2) However, this Act does not apply to a lease if—</p> <ul style="list-style-type: none"> (a) the lease is for premises prescribed by regulation for this paragraph; or (b) the lease is prescribed by regulation for this paragraph; or (c) the lease is for less than 6 months, unless the lease is a continuous occupation lease.

The franchisee holding premises as a licensee or under Model 10 is not covered by a strict reading of the retail leasing legislation in the ACT.

Retail Leases Act 1994 (NSW)

lessor	Defined in S3. <i>lessor</i> means the person who grants or proposes to grant the right to occupy a retail shop under a retail shop lease, and includes a sublessor and a lessor's or sublessor's heirs, executors, administrators and assigns.
lessee	Defined in s3 <i>lessee</i> means the person who has the right to occupy a retail shop under a retail shop lease, and includes a sublessee and a lessee's or sublessee's heirs, executors, administrators and assigns.
lease	Defined in s3 <i>retail shop lease or lease</i> means any agreement under which a person grants or agrees to grant to another person for value a right of occupation of premises for the purpose of the use of the premises as a retail shop: <ul style="list-style-type: none"> (a) whether or not the right is a right of exclusive occupation, and (b) whether the agreement is express or implied, and (c) whether the agreement is oral or in writing, or partly oral and partly in writing.

The franchisee is probably covered by retail leasing legislation in New South Wales, although it could be argued by applying principles of statutory interpretation that the definition of lessee does not extend to licensees and franchisees without formal tenure contracts.

Business Tenancies (Fair Dealings) Act 2003 (NT)

landlord	Defined in s5 "landlord", in relation to a retail shop lease, means the person who grants or proposes to grant the right to occupy a retail shop under a retail shop lease and includes a sublandlord and a landlord's or sublandlord's heirs, executors, administrators and assigns;
lessee/ tenant	Defined in s5, "tenant", in relation to a retail shop, means the person who has the right to occupy the retail shop under a retail shop lease and includes a subtenant and a tenant's or subtenant's heirs, executors, administrators and assigns.
Retail shop lease	Defined in s5 "retail shop lease" means an agreement under which a person grants or agrees to grant to another person, for valuable consideration, a right of occupation of premises for the purpose of the use of the premises as a retail shop – <ul style="list-style-type: none"> (a) whether or not the right is a right of exclusive occupation; (b) whether the agreement is express or implied; and (c) whether the agreement is oral or in writing, or partly oral and partly in writing;

The franchisee holding premises as a licensee or under Model 10 is not covered by a strict reading of the retail leasing legislation in the Northern Territory.

Retail Shop Leases Act 1994 (Qld)

lessor	Defined in Dictionary: lessor means the person who, under a lease, is or would be entitled to the rent payable or the leased premises regardless of the person's interest in the premises, and includes – (a) a person acting under the lessor's authority; and (b) in relation to a retail tenancy dispute – the former lessor.
lessee/ tenant	Defined in Dictionary: lessee (a) in relation to a retail tenancy dispute, includes the former lessee; and (b) for part 6, division 7, includes – (I) a lessee who is holding over under the lease or with the lessor's consent; and (II) a sublessee or franchisee entitled to occupy the retail shop under the lease or with the lessor's consent.
lease	Defined in Dictionary: Lease means an agreement under which a person gives or agrees to give to someone else for valuable consideration a right to occupy premises whether or not the right is – (a) an exclusive right to occupy the premises; or (b) for a term or by way of a periodic tenancy or tenancy at will.

All franchisees are probably covered by retail leasing legislation in Queensland.

Retail and Commercial Leases Act 1995 (SA)

lessor	Defined in: s. 3 lessor means the person who grants or proposes to grant the right to occupy a retail shop under a retail shop lease, and includes— (a) a sublessor; and (b) a prospective lessor or a former lessor;
lessee	Defined in s3 lessee means the person who has the right to occupy a retail shop under a retail shop lease, and includes— (a) a sublessee; and (b) a prospective lessee or a former lessee;
Retail shop lease	Defined in s3 retail shop lease or lease means an agreement under which a person grants or agrees to grant to another person for value a right to occupy a retail shop for carrying on a business— (a) whether or not the right is a right of exclusive occupation; and (b) whether the agreement is express or implied; and (c) whether the agreement is oral or in writing, or partly oral and partly in writing;

The licensee or Model 10 franchisee does not fit within the strict definition of 'lessee' although they arguably do hold a 'retail shop lease' as defined by the South Australian retail leasing legislation.

Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998 (Tas)

lessor	Not defined "property owner" means a person who grants a right of occupancy of premises under a lease;
lessee/ tenant	Not defined
lease	Defined in: s1 "lease" means – (a) any agreement providing for the occupation of retail premises, whether for a term, periodically or at will; and (b) a licence or other agreement to use the common area of a shopping centre for a term of more than 6 months;

The Tasmanian Regulation seems to acknowledge the possibility of the franchisees occupying under all occupancy models except Model 10.

Retail Leases Act 2003 (Vic); amended 2005

landlord	Defined in: s. 3 landlord under a retail premises lease— (a) means the person who under the lease is entitled to the rent payable for the premises; and (b) in Part 10, includes a former landlord (because of section 83);
tenant	Defined in: s. 3. tenant under a retail premises lease— (a) means the person who under the lease is entitled to occupy the premises; and (b) in Part 10, includes a former tenant (because of section 83);
lease	Defined in: s. 3 lease — (a) means a lease, sub-lease, or an agreement for a lease or sub-lease, whether or not in writing; and (b) in Part 10, includes a former lease (because of section 83);

The franchisee holding premises as a licensee or under Model 10 is not covered by retail leasing legislation in Victoria.

Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA)

landlord	Defined in: s.3 landlord , in relation to a lease, means – (a) the person who, under the lease, grants or is to grant to the tenant the entitlement to occupy the premises the subject of the lease; or (b) a person who obtains a reversionary interest in those premises, But does not include a person who assigns his interest as tenant under the lease.
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tenant	Defined in: s. 3. tenant , in relation to a lease, means the person whom under the lease, is or would be entitled to occupy the premises the subject of the lease.
lease	Defined in: s. 3 lease means any lease, licence, or agreement whether in writing or not, that provides for the occupation of premises situated within the State for a term or by any way of a periodic tenancy or a tenancy at will, and whether or not the lease, licence or agreement is entered into outside the State or purports to be governed by any law other than the law of the State but does not include a licence of agreement relating to the common area of a retail shopping centre by reason only that it provides for a person to use a portion of the common area the continued use of which as a portion of the common area is not intended to be otherwise precluded. s. 3 ' retail shop lease ' means a lease that provides for the occupation of a retail shop other than (not relevant here)

The Western Australian legislation seems to protect the franchisees occupying under all 10 occupancy models.

5. The impact of franchisor insolvency on the franchisee retailer

The liquidator has a right under s 568(1) and 568(1A) Corporations Act 2001 (Cth) to disclaim property. This includes retail leases in the name of the franchisor as lessee/ tenant. It also includes franchise agreements if they are considered onerous. The liquidator's statutory duty is to maximize the return to the creditors of the insolvent party.

Each franchisor insolvency affects many franchisees. My research shows that the 46 franchisors that failed between 1995 and 2006 had an average of about 50 franchisees each³. It is acknowledged that not all of these franchisees occupied retail premises, and not all of those that did occupy retail premises, lost them as a result of the insolvency.

Thus, all franchisees that are not leasing direct from the land owner are vulnerable if the franchisor becomes insolvent as the liquidator's statutory right overrides franchisees' contractual rights and their rights under retail leasing legislation where they occupy as sub lessees or licensees. The inquiry into retail leasing markets can probably do little to address this particular issue. An awareness of it, however, should help underscore the franchisees' vulnerability in some retail leasing models.

³ It is impossible to state any of these numbers with certainty as entities are not identified as franchisors or franchisees on ASIC or Land Titles databases and franchisors are not required to register their systems or their disclosure documentation in a publicly accessible repository.

The submission by The Franchise Advisory Centre, paragraph # 9, shows another aspect of the franchisor insolvency issue.

END OF SUBMISSION