Submission to the NSW Government's 2013/14 Review of the *Retail Leases Act 1994*

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Context

The Australian Sporting Goods Association Incorporated (ASGA) welcomes the opportunity to make a submission to the NSW Government's review of the *Retail Leases Act 1994*.

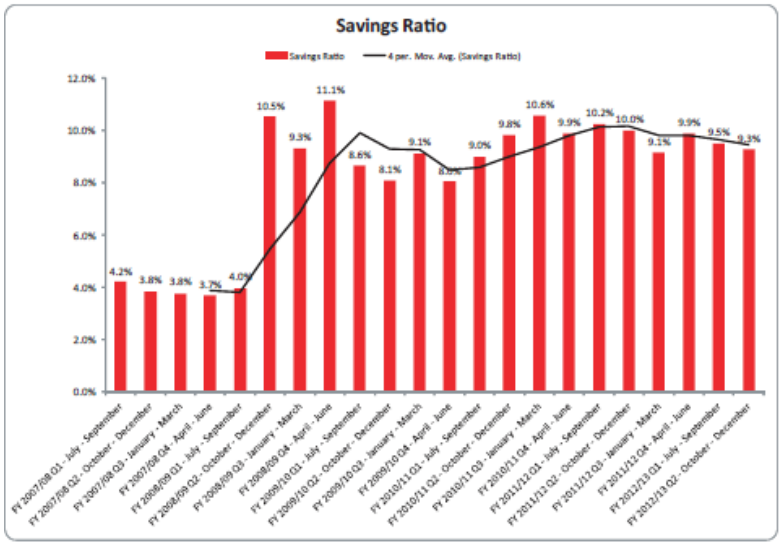
ASGA was formed in 1981 as the national industry association representing a broad spectrum of sporting goods and active lifestyle industry participants, including manufacturers, importers, agents, wholesalers and retailers.

ASGA is a leading industry voice on issues impacting the health, trade, regulation and taxation of the sporting and active lifestyle goods industries. ASGA aims to foster market growth, provide services and advocate for increased participation in sport and physical activity.

Members of ASGA include the world's leading sports brands and major Australian retailers. We represent over 1000 sporting and active lifestyle goods retail stores around Australia.

Sports retailers range from the very large (1,000+m^2) like Rebel Sport and Sportsmart, through to franchisees like The Athletes Foot, family-owned businesses in the High Streets of regional towns and tiny golf club pro-shops. Ownership and business models include franchises, listed corporations, family-owned companies and vertically-integrated international brands.

NSW sporting goods retailers are facing significant challenges, from a higher household saving rate (see the graph below) to the low value threshold on goods purchased overseas.



Source: Reserve Bank of Australia

High rents and an opaque leasing process are part and parcel of the major challenges faced by retailers.

These rents are of particular concern within shopping centres. As noted by research conducted by the Shopping Centre Council of Australia (SCCA), shopping centres account for $84 billion in retail sales each year, across 1,338 individual centres. These centres are very productive in comparison to strip shopping areas, with nearly 41 per cent of all retail sales in less than a third of available retail space across the country. The large centres attract in excess of 15 million shopper-visits per year.[1]

Indeed, as pointed out in the Australian Retailers Association (ARA) submission to the Productivity Commission's *Economic Structure and Performance of the Australian Retail Industry* inquiry in May 2011 "the smaller an individual business is, the greater the disparity in the power dynamic between the retailer and the landlord. This factor is further compounded by the very real notion that large-scale shopping centres are

[1] http://www.scca.org.au/HTML%20Pages/Research.htm

oligopolistic in nature. The fact that companies such as Stockland, Centro, Westfield and AMP are really the only providers in the market, retailers (even one with branches across different jurisdictions) are reliant upon securing sites within these premises. In addition, smaller retailers are further exposed to the inherit imbalance in the rental arrangements particularly when negotiating and continuing retail leases."[2]

We're basing this submission in large part on the Productivity Commission report *The Market for Retail Tenancy Leases in Australia* 2008[3] (PC Report), although we will be responding directly to those issues posed by the Discussion Paper.

Broadly, ASGA is concerned, like many of the retail groups submitting to this Discussion Paper, with issues including: the power imbalance between landlords and retailers currently in favour of landlords; transparency of information available to both parties; security of tenure; the use of retail turnover to determine occupancy costs; rent and fit out costs.

As a general comment, in addition to those areas mentioned above, ASGA is also concerned with achieving consistent legislation across the country. As noted in the 2008 PC Report "Until 2001-02, jurisdictions met regularly with the aim of harmonising legislation, but these meetings were discontinued. Although the broad architecture of retail tenancy legislation or codes is similar across Australia, there are significant differences in detailed provisions and application between jurisdictions, and indications are that policies and regulations across jurisdictions will diverge further."[4]

For reviews like this one, harmonising NSW state legislation with similar laws in other jurisdictions should be a priority, although not at the expense of tenant rights in NSW.

Please note that ASGA will not be commenting on every issue in the Paper.

ASGA is happy to discuss any of the recommendations to this review in more detail and looks forward to further discussions with the Commissioner's office about retail tenancy issues.

[2] http://www.retail.org.au/Portals/0/Policy/PCRetailInquiryARA%20submission%20-%20FINAL.pdf
[3] http://www.pc.gov.au/projects/inquiry/retail-tenancies/finalreport
[4] http://www.pc.gov.au/__data/assets/pdf_file/0011/82748/02-overview.pdf (Overview, p. XVIII)

1.1 Information Asymmetry

ASGA is extremely concerned about information asymmetry biased in favour of landlords. ASGA members, particularly small businesses, have indicated they are often at a disadvantage when negotiating with landlords. This is not because of a lack of information necessarily (although that can be part of the problem), but rather because the information available is not transparent and requires significant legal advice to be understandable.

As noted in the PC Report: "The Commission was repeatedly told that there is an information imbalance in the relationship between shopping centre landlords and retail tenants. One retailer association stated that retailers often find themselves in an information 'vacuum' when negotiating or assessing their leases." (p. 153)

A fundamental tenet of fairness in contracts is that all parties negotiating a lease should have access to the same information that is easy to access and understand.

The current system of disclosure statements and optional registering of leases on the Title Register do not provide enough information for tenants. This is particularly true in a shopping centre, where the landlord has the data for all leases, compared to the tenant who has access only to the single disclosure statement and their own lease.

For there to be information parity, it is vital that all leases are publicly available. Ongoing information parity between landlord and tenant trumps financial agreement confidentiality. Besides which, if everyone's data is publicly available, confidentiality becomes a moot point – irrelevant to the marketplace – anyway.

ASGA members have indicated that disclosure statements are biased towards landlords. The statements are too big, too general and too vague. One ASGA member gave an example of a refurbishment clause that was so vague it could have referred to any refurbishment done at any time, whether within the current lease period or not. In the end a refurbishment wasn't done until eight years later.

Concerns have also been raised about the movement of anchor tenants. It would be useful for retailers to know, for example, when the lease of the anchor tenant expires.

ASGA agrees with the PC Report 2008 that recommended a summary sheet of information be included in lease documentation. At a minimum, this summary sheet should include basic data about:

- The square metres / size of the physical area to be leased
- Price
- Any incentives
- The beginning and end dates of the lease
- Side deals (or at least the fact that side deals exist and a pointer to the page the details can be found within the lease agreement)
- Reviews.

The summary sheet, disclosure statement and the lease itself should be publicly available on a searchable website / database (possibly for a small fee to make it self-sustaining) held centrally by the NSW government. It should be the responsibility of the landlord to register the lease and other documentation within a specified time-frame.

Recommendation: That all leases and accompanying documentation, including a detailed one-page summary sheet, be made publicly available in a searchable online database to be held by the state government.

1.2 – Turnover data

ASGA opposes any requirement on retail tenants to provide turnover data to landlords and calls for laws removing the ability for landlords to charge rent based, in any way, on turnover figures.

In our considered opinion, collecting turnover data is little more than a mechanism that allows landlords to hold tenants to ransom. Moreover, rents should not be based on tenant profits, they should only ever be determined by fair market value when compared to other retail shop leases in the centre or immediate area/ street shopping strip.

As noted by the ARA: "The ARA's grave concern is that there is presently no effective mechanism to accurately determine the market rate of commercial tenancies. The tenancy is initially calculated incorporating a theorised retail turnover figure and at the point of re-negotiation specific data has thus been collated by the landlord and then aggressively leveraged. This exacerbates the power imbalance between the parties. Moreover, the ARA objects to this practice as there is no comparable data provided to the tenant of the works or strategies undertaken by the landlord which would indicate their contribution to profitability other than providing a premises in which to transact."[5]

In no other sector – commercial or residential – is rent determined explicitly, or in conjunction with other formulae, on capacity to pay. Certainly more desirable rental properties (because of their facilities or location) will be more expensive, but that value is not determined by the renter, it is determined by the local market rate. Retail rents should be the same as commercial and residential rents – set by market rate and not determined by income or turnover.

ASGA can see a use for general turnover data for a shopping centre as a whole. If turnover data is to be collected, we recommend that turnover data be supplied to an independent third-party, which can then be disclosed to the landlord and tenants in category form, so individual shop turnover cannot be identified.

Recommendation: That landlords be prohibited from directly collecting turnover data from retail tenants and that all retail leases be based on the fair market value of the property.

Recommendation: That if turnover data is to be collected it should be supplied by tenants to an independent third-party, who can then disclose the data in category format only, so individual store turnover cannot be identified.

2: Outgoings

Note this submission will deal with Outgoings generally, without breaking the section up into specific areas (management fees, advertising and promotion levies, land tax, etc)

There are two specific issues around Outgoings that need to be addressed. The first is the actual cost of the Outgoings and the second is the effective communication about specific Outgoings within a lease agreement to the tenant.

[5] http://www.retail.org.au/Portals/0/Policy/PCRetailInquiryARA%20submission%20-%20FINAL.pdf p. 6.

Outgoings should be capped as a fixed percentage of the income collected for the shopping centre, in a similar way the funds management sector collects fees for their services. There seems to be a perception that Outgoings provide a cash cow for shopping centre managers and landlords, with Outgoings set for expenses that retail tenants should not have to pay for.

In particular, we have grave concerns about landlords essentially 'double-dipping' – as landlords are often the managers of a centre, surely they cannot charge both rents and management fees? In the residential market, body corporate fees are only charged to the owner, not the tenant.

Specifically, we would argue that:

1. Management fees should not be charged by shopping centre managers to tenants. If a shopping centre manager wants to charge a fee for managing a centre, it should be charged to the landlord(s). Landlords should not be able to pass those costs onto tenants. See the legislation in WA.
2. Advertising and promotion levies need more transparency. Audited financial statements should also include independent analysis of the effectiveness of advertising and marketing campaigns.
3. Land tax is a land owner's expense that should not be passed onto tenants.
4. All Outgoings must be disclosed before the lease is signed. If a Landlord attempts to impose new Outgoings within the life of the lease, the Landlord should face fines or other penalties.
5. An Environmental Upgrade (as per the EUAs) is a capital benefit to a landlord that can be used by landlords to attract more tenants (as they can offer lower utility costs to potential tenants). There is no justification to force tenants to pay back the loan of a capital investment that is made solely at the discretion of the landlord.

ASGA agrees that Outgoings collected as part of a lease agreement can be fair and reasonable. Where a tenant receives a benefit from works that improve a shopping centre as a whole, such as an advertising campaign, it is appropriate for the tenant to contribute costs. However, the purpose of a rent is to provide income that goes to pay off costs like Land Tax – there should not be an Outgoing cost charged on top of the rent.

It is vital for the Small Business Commissioner to have powers to investigate and audit Outgoings, to ensure they are fair, reasonable, and transparent and communicated properly to tenants.

Recommendation: That Outgoings be capped as a percentage of income collected for the centre, with the Small Business Commissioner to determine the fixed cap level.

Recommendation: That the Small Business Commissioner has the power to investigate and audit lease agreements to ensure Outgoings are fairly applied.

3. Fidelity of the bargain

While many retail businesses have significant resources to negotiate leases and gain proper legal advice about lease agreements, the fact remains that small retail businesses are often at a disadvantage when negotiating with large shopping centres and their legal teams.

It is important therefore to have measures in place that protect the agreed understanding between parties and not just the letter of the contract. To that end, ASGA support an anti-avoidance clause in the Act.

At the moment franchisees are generally protected because landlords are dealing with the franchisors, often large, publicly listed corporations that have a proven business record and financial and legal resources more than adequate to negotiate with those landlords. In fact it is far more likely for an individual franchisee to fail than for a franchisor to fail. However, in cases where the franchisor fails, there should be some mechanism within the lease where sub-lessor / licensee has the first right of refusal to continue a lease.

In regards to damaged premises, the Act needs to be clarified to determine whether or not section 36 applies to damage caused by neglect as well as damage caused by an event. ASGA argues that section 36 should apply to damage caused by neglect (as well as by an event), with the landlord responsible for both fixing the damage and compensating the tenant if the tenant cannot trade because of the damage or remedial works.

Security of tenure is a major issue for retail tenants in both shopping strips and shopping centres. It is a concern that new leases take so long to renegotiate at the end of a term. Giving tenants the option of first right of refusal should go some way towards giving tenants more security of tenure and landlords more certainty around continuity of trade within their shopping centre.

Recommendation: That an anti-avoidance clause be inserted into the Act.

Recommendation: That tenants (including sub-lessors where the lessor fails) have a first-right-of-refusal to renew a lease or negotiate a new lease for the same premises.

Recommendation: That section 36 be clarified so it explicitly applies to damage caused by neglect as well as damage caused by an event.

4. Streamlining / Simplification

ASGA supports a standard national retail shop lease for NSW and, hopefully, for the country. ASGA members have indicated that leases from small landlords (ie: in strip shopping centres) can vary wildly, while shopping centre leases, while generally more uniform, are often highly legalistic and overly long and proscriptive.

It would benefit both landlords and tenants to simplify and standardise NSW retail leases agreements. In particular, ASGA suggests that:

1. Leases must be written in plain English
2. Leases have a certain minimum set of requirements (see 'Information Asymmetry', above) that must be included in every lease agreement
3. Non-shopping centre leases (a) use a standardised lease agreement, (b) work on gross leases (that is, the rent and all outgoings are captured in a single dollar amount), (c) use a standard disclosure statement and (d) have a standard term – perhaps five years.
4. Shopping centre leases use a standardised lease agreement with the ability to vary the agreement with the consent of both parties.

We envisage the development of a standardised lease agreement would take some time and should be created through consultation (possibly a reference group) with representatives from retailers, landlords and leasing experts.

Again, as mentioned in 'Information asymmetry' above, registering leases is vital for ensuring both landlords and tenants have equal access to information. The registration of all leases and accompanying documentation (disclosure statements, etc) must be mandatory. The landlord should be responsible for registering each lease, within a specified timeframe. Four weeks should be plenty of time for that to occur, but ASGA acknowledges a longer timeframe (not longer than three months) may be required. A landlord should be required to provide the tenant with the final copy of the lease before it is publicly registered.

Landlords should face stiff financial penalties for not registering a lease on time and/or for not providing the final lease to the tenant before registering it. In particular, shopping centre landlords are large and sophisticated organisations that should have no trouble adhering to the law. As well as a financial penalty payable to the government a lease that is not registered on time should have a fixed percentage (say 10 per cent) reimbursed to the tenant.

While noting concerns with information asymmetry between landlords and tenants, ASGA agrees there is generally too much regulation and disclosure requirements where the Retail Leases Act and the Franchising Code of Conduct intersect. It is more important to have one comprehensive disclosure statement, easily accessible in a public repository, than multiple disclosure statements all serving slightly different but similar needs. ASGA agrees that a working group should be convened to work out ways to streamline disclosure requirements.

Recommendation: That a standardised lease agreement be developed (as outlined above).

Recommendation: That all non-shopping centre leases be gross leases.

Recommendation: That all leases must be registered by landlords within a specified timeframe, with fines and reimbursements to tenants for non-compliance.

Recommendation: That a working group be convened to discuss streamlining disclosure statements.

5. Fair Dealings

The Act requires further clarification to ensure the requirements for bank guarantees are transparent. Landlords should not be able to access bank guarantees after the term of the lease ends (unless it is to be carried over to a new lease and there is some delay in renegotiating a contract).

At no time should landlords be able to draw down the bank guarantee unless there is a clear breach of the lease by the tenant. In fact, the landlord should supply a written warning to the tenant, that there has been a breach and that the landlord intends to draw down on the bank guarantee, much the same way utilities warn customers they will turn off the power if their bill is not paid.

Recommendation: That the Act be amended to clarify how and when bank guarantees can be drawn down by the landlord.

6. Coverage of the Act

Using a schedule of businesses to define a retail shop is problematic and has previously given rise to confusion for both tenants and landlords. A simpler definition of what a retail shop is would be preferable, although ASGA recognises the difficulty in reaching agreement on what that definition might be.

Any definition should include retail shops that are in buildings used primarily for other purposes, such as residential apartment complexes or commercial office towers. The move to higher density living suggest that retail premises on the ground floors of apartment buildings and office towers is likely to become more prevalent.

ASGA suggests that while excluding leases by publicly listed corporations may lead to greater harmonisation with retail tenancy laws in other jurisdictions, in this case the change would result in retailers – particularly franchisees – being disadvantaged. The mooted change could potentially lead to two 'classes' or tiers of tenants, with those operating under the exclusion operating without the protections of the Act but with the market power of a national franchise and those store owners (franchisees or not), given the protections of the Act but potentially disadvantaged because they lack the power of a national franchise. It is important therefore that publicly listed companies not be excluded under the Act.

Recommendation: That a simple but comprehensive definition be used to define a retail shop.

Recommendation: That retail shops in office buildings and apartment complexes be included in the Act.

Recommendation: That publicly listed companies remain in the Act.

7. Reduce prescriptive legislation

ASGA opposes any move to reduce or remove the minimum term, unless varied by agreement by both parties. In particular, if standard leases are to be introduced, a minimum term is an important standard to be upheld.

ASGA adamantly opposes any move to remove the prohibition on terminating leases for inadequate sales. Firstly, we have previously argued that turnover data should not ever be provided to landlords. Without that data any determination by a landlord cannot be made. Secondly, as long as the tenant is meeting the terms of their lease, the landlord has no business in determining how the tenant uses the premises – if they can pay their rent and meet their other obligations the tenant doesn't have to sell a thing.

Recommendation: That the minimum term remains in the Act.

Recommendation: That the prohibition on terminating leases for inadequate sales remains in the Act.

8. Technical issues

The Act should be reviewed every seven years.

The monetary limit for retail tenancy disputes in the Administrative Disputes Tribunal (soon to be transferred to the NSW Civil and Administrative Tribunal), at $400,000 is probably too low now and will certainly be too low in the next three to five years. ASGA suggests the limit be raised to $500,000 immediately with an option to raise it to $750,000 in the next five years.

If this leads to an increase in workload for the Tribunal, it must receive more resources so if can effectively deal with retail lease disputes.

This submission has previously talked about penalties for landlords who fail to disclose the full information about their premises to a prospective tenant or who fail to register their leases in a timely manner. The ability of a tenant to terminate a lease is valuable, but probably overkill in most situations. In addition to that option a tenant should also have the ability to reduce their rent for a specified time frame, by a set amount (perhaps 10 per cent for the life of the lease). In addition, landlords should be forced to pay financial penalties.

ASGA has previously suggested that turnover data should not be supplied to landlords by tenants, which would make any discussion of online sales data moot. However, if turnover data is still supplied, online data must not be included.

It is too difficult to connect a particular store to online sales. Certainly, in the case where an individual store runs its own retail website it would be possible, but the fact remains that most online stores are run by the head office of a chain of stores, so assigning online sales to a particular store is irrelevant. ASGA adamantly opposes any moves to include online sales data with bricks and mortar sales or turnover data.

Finally, although not mentioned in the discussion paper, ASGA notes that most shopping centre leases forbid tenants from acting collectively. Through, for example, a traders association. Banning tenants from associating and acting collectively is a fundamental breach of the right of any entity to associate freely. Forbidding tenants from acting collectively should be banned from all leases.

Recommendation: The Act should be reviewed every seven years.

Recommendation: The monetary limit for retail disputes in the ADT should be raised to $500,000 or $750,000.

Recommendation: The Act should forbid online sales data from being collected by landlords.

Recommendation: The Act should ban any attempts by landlords to forbid tenants from acting collectively.

Conclusion

ASGA and its members are convinced the current NSW Retail leases Act 1994 does not provide enough protections for retail tenants.

ASGA's retail members – sporting goods companies – range in size and business models from large, publicly listed companies to tiny specialist shops. Some are 'big-box' retailers, others are in shopping centres or local shopping strips. All of them have raised concerns with ASGA about the difficulties they have with landlords and the different laws in each state.

We are very pleased this review is taking the time to consider the effects –intended and unintended – of the Act as it currently stands and we thank the NSW Small Business Commissioner for providing this opportunity to comment on the Act and the Discussion paper.

ENDS