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The Trade Practices Act and retail tenancy – is it working?

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Introduction

The year 2000 was a busy time for the ACCC and the Trade Practices Act (TPA). While there were a number of major issues during the year - not the least being our price monitoring role with the New Tax System - retail tenancy was one of the priority areas for the ACCC, particularly in light of some significant developments in the law of unconscionable conduct.

The ACCC has a dual role as:

- a national enforcement agency; and
- a provider of education and information for business and consumers in relation to compliance with the TPA.

It is the first role that gains most publicity. But it is the information and support role, especially to small business, that secures a wider spread of business understanding and acceptance of good trade practices compliance.

The ACCC is currently involved in 44 cases before the courts. However the majority of the ACCC's actions do not end up this way. Rather, most result in administrative settlements such as court enforceable undertakings provided by the offending party or other forms of mediated settlement.

ACCC's Role with Small Business

Over the past two years the ACCC has upgraded the level and style of its dealing with small businesses to inform them in relation to the TPA. The ACCC program of outreach to small business resulted from the Government's decision in 1998 to strengthen the TPA and provide resources to address unconscionable behaviour by larger business dealing with small business.

The activities of the Small Business Unit in the ACCC and the appointment of a Commissioner responsible for small business have also focussed on demonstrating to small businesses how to avoid or handle TPA related problems well before they require litigation.

The Small Business Unit has developed a considerable network of contacts for getting messages out to small business. The messages emphasise how

understanding and compliance in relation to TPA matters reflects good management practice and hence assists business success and profitability. It is a pro-business message and one which has good effect.

It is not just a one-way process and the ACCC has also fostered consultation with business and professional representatives. This has included a Small Business Advisory Group that meets regularly under the Chairmanship of the Small Business Commissioner.

Testing the new unconscionable conduct provisions

The new unconscionable conduct provisions of the TPA have had to be tested and the ACCC has already taken three court cases alleging unconscionable conduct under section 51AC.

In 2000 the Federal Court handed down decisions in two cases under section 51AC and two cases under section 51AA. Three of these cases involved retail tenant and landlord disputes. The fourth case involved franchising but the principles to come out of it are directly relevant to retail tenancy.

Broadly speaking, the cases have clarified the meaning of unconscionable conduct under the TPA. This has the potential to significantly improved the position of retail tenants in their dealing with landlords.

Well before the outcome of these cases however, there had been clear indication from discussions with groups such as the Property Council that the unconscionable conduct provisions are being taken seriously by substantive larger businesses. These businesses have developed comprehensive compliance arrangements to avoid breaching this area of the TPA. However there are indications that awareness among "second" and "third" tier landlords about their responsibilities under the TPA is much lower.

It is interesting to note the statistics on complaints and enquiries to the ACCC about unconscionable conduct (across all sectors) over 2000. In terms of annual movement the level of complaints and enquiries relevant to the new section 51AC provision was almost the same in 2000 as in the previous year (507 compared to 492 in 1999). Interestingly the level of complaints and enquiries relevant to the section 51AA provision increased to 263 in 2000 from 176 in 1999.

The numbers in 2000 were fairly consistent over the first half of the year and the fourth quarter. However, there was a sharp increase during the third quarter. This may have been due to increased awareness of the unconscionable conduct provisions following some of the recent cases. The ACCC will continue to closely monitor trends over 2001.

Before discussing the recent cases on retail tenancy, it is worth briefly reviewing the unconscionable conduct provisions in the TPA. As many of you will know, Part IVA contains the three relevant sections.

The first, section 51AA, is a broad prohibition. To prove unconscionability, the weaker party in a transaction must establish that it was in a position of special disadvantage that the stronger party knew about (or should have known about) and that the stronger party took unfair advantage of the position.

The second, section 51AB, introduces a general duty to trade fairly in relation to consumers by prohibiting conduct which is unconscionable.

The third, section 51AC, is more precisely focussed. It specifically prohibits one business dealing unconscionably with another. Section 51AC was introduced in 1998 as part of legislation specially designed to improve the legal protection and remedies available to small business. It sets out specific factors the courts may consider. These relate to both bargaining strength and a sample list of circumstances where the smaller party was required to submit to unreasonable conditions.

Cases under section 51AC

I will discuss the section 51AC cases first since this is the provision that has the greatest impact on the rights of retail tenants.

Leelee

This was the first case decided under section 51AC.

Leelee was the landlord of Adelaide International Food Plaza. It leased 12 food stalls to retail tenants. One of these stalls was leased by the Choongs who operated a noodle bar. The Choongs' initial lease expired on 6 January 1999 and they exercised an option to renew for a further 5 years. The Choongs encountered the following problems.

- The lease provided that rent reviews were to be the same percentage as for other stall holders, but the Choongs were not given details of rent increases in those other leases. When the Choongs requested further information, Leelee threatened to withhold the supply of cutlery and plates.
- Leelee failed to honour an agreement that no other stall holders would be permitted to sell certain types of Chinese food sold by the Choongs.
- The lease specified the minimum price at which the Choongs could sell their dishes. Other stall holders were allowed to sell those dishes at less than the minimum price set for the Choongs. When the Choongs complained about this, Leelee threatened to terminate the lease.
- In previous years, the Choongs had attempted to assign their lease to a prospective purchaser of the business. Leelee refused to consent to the assignment.

On 15 June 2000, the Federal Court granted a declaration against Leelee, that it engaged in unconscionable conduct towards the Choongs. It also granted a declaration against Mr Pua Hor Ong, director of Leelee, that he aided or abetted or was knowingly concerned in the contravention. The Court granted

injunctions against the company and its director in relation to their future dealings with tenants at the food plaza.

The Court declared that Leelee engaged in unconscionable conduct by:

- consenting to, or giving approval for, another tenant to infringe on the exclusive menu entitlements conferred by Leelee on one of its tenants; and
- specifying the price at which its tenant sold their dishes in a manner which unfairly discriminated against, or inhibited, the tenant's ability to determine the prices at which its dishes were sold in competition with another tenant.

The Court granted injunctions, for three years, restraining Leelee and Mr Ong:

- from consenting to, or giving approval for, tenants to infringe on exclusive entitlements conferred by Leelee on any other tenants;
- from specifying the prices at which tenants sell their goods and services in a way that unfairly discriminates against, or inhibits, any tenants ability to determine their own prices; and
- from discriminating, during the course of negotiating a lease, against any prospective tenant on the ground the prospective tenant has entered into an agreement, arrangement or understanding to purchase the plant, equipment or goodwill of an existing tenant; and
- requiring Leelee and Mr Ong to disclose to tenants:

- all information that relates to the fulfilment or non-fulfilment of any conditions precedent to which periodical reviews and rent increases are subject; and
- the time period of the rent review and the basis of calculation of any rent increase where the conditions have been fulfilled.

The *Leelee* decision was a positive first step for retail tenants. It provides a concrete example of conduct by a landlord that will be regarded as more than just tough commercial behaviour.

It also shows that a retail tenant can look beyond its lease to the TPA for protection in dealings with a landlord.

Simply No-Knead (Franchising)

The Federal Court expanded on the parameters of section 51AC in *ACCC v Simply No-Knead*. Although this is a franchising case, the decision has implications for retail tenant/landlord relationships.

Simply No-Knead (SNK) was a franchisor that had signed up a number of small business franchisees. The business involved bread making and related products. The operation of the franchise depended on the supply of products from the franchisor and group advertising for the franchise as a whole. A

series of disputes developed between the franchisor and franchisees. As a result, the following complaints against SNK were found to have occurred.

- SNK demanded that franchisees wishing to negotiate must put their requests in writing (facsimile was not sufficient). No joint meeting with franchisees was acceptable. Meetings had to be one on one and confined to specific matters. The 'price' of a meeting was to comply with SNK's directives.

  The Court found this conduct to be 'unreasonable, unfair, harsh, oppressive and wanting in good faith'.

- SNK had refused to supply some of the franchisees with products because they either disputed the content of advertising material or the supply of double the quantity of flour they requested.

  The Court found this to be an unfair pressure tactic by the franchisor.

- SNK demanded that franchisees distribute to customers brochures that referred only to the franchisor and not the franchisee. The franchisees paid for the advertising and were denied products if they failed to distribute.

  The Court found this conduct to be 'unfair and unreasonable having regard to the franchisor/franchisee relationship, and oppressive'.

- SNK directly competed within the franchisees' territories in a way calculated to damage the franchised business.

  The Court found that this demonstrated a lack of good faith by the franchisor.

- When certain franchisees made written requests for the disclosure of information documents, SNK made it a condition that the franchisees had to indicate an intention to renew the franchise before the documents would be supplied.

  The Court found this type of conduct to be bullying tactics that were harsh and oppressive.

In summarising the conduct of the landlord, the Court found 'an overwhelming case of unreasonable, unfair, bullying and thuggish behaviour' amounting to unconscionable conduct under section 51AC.

The *Simply No-Knead* decision demonstrates that the Federal Court will look to the criteria specified in section 51AC in deciding whether unconscionable conduct has occurred. Importantly, it establishes that those criteria do not limit what types of conduct the court may consider. The *Simply No-Knead* case itself identified the following types of conduct:

- the imposition of undue pressure and unfair tactics;
- a failure to negotiate;
- a lack of good faith; and
- a failure to comply with an applicable industry code of conduct (the Franchising Code of Conduct in this case).

It is not hard to imagine that these might be issues at the centre of a retail tenancy dispute.

Cases under section 51AA

Just two days after the *Simply No-Knead* decision, the Federal Court handed down its decision in *ACCC v C.G. Berbatis Holdings Pty Ltd.* This case, known as *Farrington Fayre*, develops the concept of unconscionable conduct under section 51AA.

Farrington Fayre

CG Berbatis Pty Ltd, GPA Pty Ltd and P&G Investments Pty Ltd (the owners) operated the Farrington Fayre Shopping Centre at Leeming, Western Australia which comprised 26 tenancies. A number of tenants had instituted proceedings against the owners in the Commercial Tenancy Tribunal for alleged overcharging of rates, taxes and other matters.

One of the tenants, Mr and Mrs Roberts, wished to renew their lease in order to sell their business. One of the reasons for selling the business was to obtain finance to care for their ill daughter. The owners were aware of this. However, the owners refused to grant a new lease unless the Roberts dropped their claim in the Commercial Tenancy Tribunal. The Roberts refused to withdraw their claim and lost a potential purchaser. The Roberts eventually agreed to sign a document waiving their rights against the owners.

The owners used the proceedings in the Commercial Tenancy Tribunal as a bargaining tool with two other tenants. One was in arrears and there was no potential purchaser for the business. The other had been unsuccessful in its attempt to renew the lease because a third party was prepared to pay more rent.

The ACCC commenced an action alleging that the landlord implemented a strategy in 1996 and 1997 where they refused to grant renewals, variations or extensions of leases to the three tenants unless those tenants withdrew from proceedings before the Commercial Tenancy Tribunal.

The Federal Court found that the conduct of the landlord 'was grossly unfair exploitation of the particular vulnerability of the Roberts in relation to the sale of their business' and a contravention of section 51AA.

The Court decided that circumstances in which a business operator on a lease may effectively lose the value of that business upon expiry of the lease does place the tenant at a 'special disadvantage' in dealing with the owner.

Further, unfair exploitation of such a disadvantage may occur when an owner uses its bargaining power to extract a concession from the tenant that is commercially irrelevant to the terms and conditions of any proposed new lease.

In relation to the two other tenants, the Court found that the owners had not engaged in unconscionable conduct within the meaning of section 51AA. The Court did note that 'a different result could have been obtained under the wider provisions of section 51AC'.

The *Farrington Fayre* decision is currently under appeal.

Samton Holdings

In this case, the small business tenant purchased a business in early 1997 with a three month lease of the business premises with an option for a further seven year term.

Under the terms of the lease, the tenant was required to notify the landlords of his intent to exercise the extension option shortly after the purchase of the business. The tenant failed to formally notify the landlords of his intent to exercise the option until after the required date.

The ACCC alleged that the landlords were aware that the tenant wished to continue trading in the long term before the option expired.

Following the failure of the tenant to exercise the option on time, the tenant was required to pay $70,000 to secure the extension.

The Federal Court confirmed the expanded view of 'special disadvantage' developed in the *Farrington Fayre* case. In this case, it found that the tenant was in a situation of special disadvantage and that the landlord knew of that special disadvantage. The Court said the landlord adopted an avaricious, opportunistic approach and struck a hard bargain.

However, the Court decided that the landlord's conduct 'fell short, but not far short, of being the sort of conduct which equity would regard as unconscionable'.

This case is also under appeal.

What do the cases mean for retail tenants?

The cases discussed represent some significant developments in the law of unconscionable conduct. This, in turn, has major implications for retail tenancy.

Simply No-Knead is perhaps the most important decision to date since it clarifies the distinction between the three TPA provisions dealing with unconscionable conduct.

It seems clear that while the meaning of 'unconscionable' conduct in section 51AA will be limited to the meaning it has in the case law, 'unconscionable' conduct for the purposes of sections 51AB and 51AC has a broader meaning.

More specifically, it is not necessary for a person wanting to establish a contravention of sections 51AB or 51AC to show that the weaker party was in a position of 'special disadvantage' and that the stronger party took unfair advantage of that disadvantage (which is the requirement for unconscionable conduct in equity, or unwritten law).

The approach taken by the Court to sections 51AB and 51AC has established a wider definition of unconscionability and offers better protection against excessive conduct by big businesses or businesses with market power. In the retail tenancy sphere, the new approach will hopefully make the small proportion of cavalier landlords think carefully about the way in which they deal with their tenants.

Litigation is not the only way

While the ACCC has generally been pleased with the direction of the recent cases, it prefers that retail tenants (and other small businesses) negotiate successful outcomes without recourse to litigation. By way of example, the ACCC recently encouraged such a process in a matter involving renewal of a commercial lease.

In this matter, the tenant leased a motor inn from the landlord. The lease contained an option to renew the lease for four further terms of four years, provided the tenant notified the landlord of its intention to renew at least three months prior to the expiry of the lease.

The tenant arranged for the re-painting of interior and exterior of the motor inn during the last six months of the first term of the lease and the landlord was aware of this.

The tenant inadvertently overlooked exercising the option by the required date. Six days before the end of the lease term, the landlord wrote to the tenant stating that the tenant had failed to exercise the renewal option and requesting an indication of the tenant's intention. The tenant responded immediately that it wished to exercise the renewal option.

Subsequently, the landlord produced a new lease with some significant differences to the expired lease, including:

- an increase in annual rental of more than $10 000;
- additional maintenance responsibilities on the tenant including plumbing works to be carried out at the premises;
- removal of the tenant's right of first refusal to purchase the freehold of the property should the landlord wish to sell;
- additional insurance requirements; and

- a guarantee making the guarantor liable in respect of further terms and for defaults by future assignees of the lease.

The tenant attempted to negotiate the draft lease but was only successful in limiting the guarantee and indemnity to the current option. The landlord then threatened to withdraw the offer of a new lease if it was not accepted within 14 days. In these circumstances, the tenant signed the new lease.

The tenant then approached the ACCC. In the first instance, the ACCC encouraged the tenant to participate in a mediation session with the landlord. When this approach turned out to be unsuccessful, the ACCC began an investigation into whether the landlord had contravened section 51AC. After several months of negotiation, the landlord and tenant reached a settlement late last year involving a number of variations to the lease including a refund of approximately $16 000 in rent to the tenant.

It should be noted that this matter occurred before the *Simply No-Knead* case, when the width of section 51AC was still untested.

The way forward: compliance and education strategies

In the ACCC's experience, education is a key element in ensuring compliance with the TPA. This is particularly so when the subject matter is as complex as unconscionability. To this end, the ACCC Small Business Program has focussed on innovative and "user friendly" ways of getting this information and skills out to the small business communities.

Now the ACCC is developing some "high impact" ways to help people to understand the law of unconscionable conduct.

Competing Fairly Forums

'Competing Fairly' is a proposed program of local forums held in regional towns in all States throughout Australia and focussed around a video presentation and discussion via satellite.

The forums build mutually valuable connections between the ACCC, industry and community organisations through local government and business leaders. Participants are given an opportunity to:

- hear panelists discuss trade practices issues that have an impact on the local area, and interact with those panelists;
- identify how the TPA and ACCC can work for regional businesses, industries and governments;
- explore ways to provide useful information to, and support, local communities and organisations; and
- discuss market and consumer issues that affect local communities.

The forums and the processes leading up to them are not merely one-way presentations. Each event is intended to be as participatory as possible. Each

participating town is provided with a local 'mini-web site' through which they can register for the event, lodge suggestions and queries, and contribute to shaping the telecast's content. The Internet is also used after the event for participants to provide feedback.

The pilot forum was held on 8 November 2000, linking 28 towns across regional and outer-metropolitan Australia. The pilot involved local governments and community representatives and organisations such as the Australian Chamber of Commerce and Industry, the Australian Retailers' Association, the National Farmers' Federation and Australian Business.

Following the success of the pilot program, arrangements are now fully in train for the next Competing Fairly Forum to be held in May 2001, linking around 70 towns. The main topic for this forum will be unconscionable conduct.

Corporate video

The ACCC is also preparing a corporate video to explain what is involved in the legal concept of unconscionable conduct.

The video will be released ahead of the next Competing Fairly forum and will serve as a primer to assist the audience in an awareness of the key issues that arise in unconscionable conduct.

Ongoing law reform

The ACCC strongly encourages developments in the law which improve the protection to small businesses such as retail tenants.

In March 2000, the Small Business Safeguards Reference Group in Western Australia released a report entitled "Small Business in Western Australia: Adequate Fair Trading Protection?". The Western Australian Government has now drafted the *Fair Trading Amendment Bill 2000* by which it proposes to insert a mirror provision to section 51AC into the WA Fair Trading Act. It has also produced a discussion paper considering the adequacy of current fair trading protection for small business in Western Australia.

The report notes that the Small Business Safeguards Reference Group did not directly uncover substantial unfair conduct in small business retail tenancy relationships in Western Australia. However, it did uncover significant examples and concern about small business retail tenancy matters from other Government agencies and reports.

The report recommends, among other things, the enactment of a small business unconscionable conduct provision, which mirrors section 51AC, in the *WA Fair Trading Act* (FTA) and the *WA Commercial Tenancy (Retail Shops) Agreement Act 1985* (CTA).

The recommendation that an unconscionable conduct provision be inserted into the CTA is subject to the proviso that the Commercial Tribunal be changed to ensure that:

- unconscionable conduct provisions be subject to mediation by the Commercial Tribunal
- a Deputy Registrar and other staff be appointed to the Tribunal to reduce delays
- unconscionable conduct claims in the Tribunal be heard by a District Court judge
- unconscionable conduct claims in the Tribunal be subject to rights of transfer and appeal to the Supreme Court.

The proposed amendments would extend the application of 51AC principles to those businesses not captured by the TPA and provide for mediation of such disputes while not delaying.

The ACCC provided a submission to the Reference Group which broadly supported the recommendations of the report.

Conclusion

The Commission and its Small Business Unit understands that there are continuing areas of difficulty in retail tenancy relationships, especially in the start-up stages of a development when the levels of occupancy and throughput of the premises are extremely uncertain. This can leave some "early starter" tenants highly vulnerable to factors outside their control.

The industry itself is best able to assess the extent of this problem and develop an appropriate response such as self-regulatory guidelines. The Commission looks forward to any assistance to the industry in such processes.

A recent assessment by a leading national law firm noted that to avoid allegations of "unconscionable conduct", landlords will need to ensure that a tenant seeks independent legal or financial advice. It was pointed out that this is mandatory under some state-based retail legislation (eg in Queensland as a result of the passing of the *Retail Shop Lease amendment Act 2000*).

It was recommended that landlords should

- avoid one-sided contracts;
- use plain English leases;
- avoid onerous/discriminatory clauses in leases; and
- avoid non-disclosure of material facts or events that could affect a tenant's decision to enter into a lease.

This is sound advice.

In closing I would congratulate the ARA for pulling this conference together and signal once again ACCC willingness to work with all sections of the retail

tenancy industry to achieve good practice and compliance with the trade practices law.