Presentation to

Property Council of Australia

"Unconscionable Conduct in Retail Leasing"

How to Identify and Avoid it

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1. INTRODUCTION

A healthy retailing sector is an essential ingredient in a vibrant and successful economy. This outcome requires fair competition, entrepreneurial spirit and innovation by retailers and their land lords.

A number of important developments have taken place in trade practices law generally, and in particular the protections for small businesses under the unconscionable conduct provisions. There have also been significant advances in the use of industry codes to address specific issues within a sector. These new legislative schemes apply to such aspects of commerce as disclosure, dispute resolution and remedies.

There are two provisions in the Trade Practices Act dealing with commercial unconscionable conduct – section 51AA and 51AC. Section 51AA was introduced to prevent companies taking unfair advantage of other businesses. The introduction of section 51AC in 1998 created broader protection for small businesses in their dealings with larger businesses.

For retailers, preventing and effectively handling tenancy disputes with landlords are important elements of business sustainability. There are a number of specific steps that landlords can take to ensure this happens, which will mean not only more effective compliance with the TPA, but more efficient and productive business relationships with your small business clients.

While the ACCC and other regulators have an important role in ensuring "the rules of the game are followed fairly", they must take care to avoid impeding reasonable commercial practice, or hindering 'robust competitive behaviour'. Hence the TPA encourages the development of Codes of Practice to provide a voluntary framework for raising industry standards and promoting more efficient commercial relationships.

In discussing the relevance of the TPA to the retail tenancy industry, I will comment on:

- the role of the ACCC and the nature of complaints;
- the developments in relation to unconscionable conduct provisions in the TPA
- regulatory developments in the States and Territories
- ongoing TPA reform
- Best practice suggestions for landlords and tenants
- codes of practice

2. ROLE OF THE ACCC

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 Trade Practices Act.

It is the first role that gains attention. But it is the information and support role, especially for small business, that secures wider business understanding, protection of rights and acceptance of good trade practices compliance.

Since the 1998 government decision to strengthen the protection offered to small businesses under the TPA, the ACCC has upgraded the level and style of its dealing with small businesses and implemented a strategy of small business outreach

The activities of the Small Business Program in the ACCC and my appointment as Commissioner responsible for small business matters have focussed on demonstrating to small businesses how to avoid or handle TPA related problems well before they require litigation. The emphasis is on good business practices, using protections of the TPA, mediation and dispute resolution including voluntary codes of conduct to provide a frame work in industries where there are wide-spread problems.

In many matters that come before the Commission it is possible, with stakeholder cooperation, to reach a fair and reasonable administrative solution without the need to resort to enforcement action. To ensure complaints and issues are dealt with effectively and consistently there is close liaison internally between myself, small business mangers and ACCC investigation teams located in all States and territories

Trends in Retail Tenancy Complaints

The TPA generally prohibits conduct that is anti-competitive, or misleading and deceptive. Retail tenants in a shopping mall, for example, sometimes complain that the restrictions placed on what they are allowed to sell prevent them from competing effectively. Other tenants allege that important issues were not disclosed to them before signing the lease.

I should note, at the outset, that retail tenancy complaints received by the Commission cover a wide range of issues outside the field of unconscionability; they relate to anti-competitive practices, misleading and deceptive conduct, some are purely contractual issues, and various combinations of the above. Retail tenancy issues are generally dealt with under state legislation, and therefore the complaints received by the ACCC represent a small percentage of the total issues. Often the ACCC is the last resort, and the issues brought to it representative of broader systemic concerns.

However, a significant proportion of complaints received by the Commission from retail tenants relate to possible unconscionable conduct. The number of unconscionable conduct allegations received by the Commission tended to increase from 1999, the first full year of operation of s51AC. Roughly a third of all

unconscionable conduct complaints received by the Commission each year involve retail tenancy issues.

Where complaints to the ACCC have been specific they have dealt with the following:

- problems with, or at, lease re-renewal;
- negotiation of rent increases;
- discrimination between tenants that occupy similar premises for similar purposes;
- alleged anti-competitive behaviour by lessor;
- disputes over the interpretation of the conditions within the lease;
- problems arising from renovations to a shopping complex;
- misrepresentations regarding future earnings;
- not allowing the lessee to transfer the lease to a tenant of their choice;
- casual leasing; and
- restrictions placed on the business of existing tenants.

The ACCC receives both individual complaints and representations from associations on behalf of retail tenants. There has been increasing concern expressed about the level of bargaining power wielded by shopping centre owners in relation to getting tenants at end of lease particularly given the access turnover information.

3. UNCONSCIONABLE CONDUCT

What it means

So what exactly is unconscionable conduct?

Two sections in the TPA address commercial unconscionable conduct; section 51AA, the general commercial unconscionability provision, and section 51AC, which deals with unconscionable conduct in the supply of goods or services.

For the purposes of this presentation I will be focussing on the newer provision, s.51AC.

Section 51AC – redressing the imbalance of bargaining power

The courts have generally taken the view that s.51AC will cover a broader range of conduct than that covered under s.51AA. Section 51AC was introduced in 1998 for the specific purpose of redressing the imbalance of bargaining power which often arises between small and large businesses. The Reid Report noted retail tenancy as one particular area of concern. Section 51AC prevents small businesses, when buying or selling goods or services, from conduct by larger businesses which is "in all the circumstances, unconscionable". The value of the goods or services must not exceed

$3 million, and the business subjected to the conduct must not be publicly listed (a publicly listed company has its shares listed on the stock market).

Factors the court will consider

Section 51AC sets out several factors the court can consider in deciding whether certain conduct was unconscionable. They include, but are not limited to, such things as:

- the bargaining strength of each party
- requiring conditions which were not reasonably necessary to protect the legitimate interests of the stronger party
- capacity of the targeted party to understand any document
- the use of undue influence, pressure or unfair tactics
- whether the weaker party could obtain an arrangement on better terms elsewhere
- consistent conduct in similar transactions
- adequate disclosure
- the willingness to negotiate
- the extent to which each party acted in good faith
- the requirements of any relevant industry code

When problems under the TPA do arise, the ACCC recommends alternative dispute resolution processes as the first and best option. Businesses should only resort to court action after all mediation options have been explored.

However, when appropriate the Commission takes firm enforcement action. The ACCC has already secured successful precedents in a number of key areas — franchising, retail tenancy and primary production — which have clarified the scope and meaning of the unconscionable conduct provisions.

Section 51AC cases

The scope of s51AC has been considered in several court decisions, involving actions brought by the ACCC including retail tenancy matters. There are other s51AC cases currently before the courts.

Some key examples of conduct that the court has declared to be unconscionable under s.51AC include:

- Blatant disregard of industry codes of conduct or other law;
- Unreasonably withholding information;

- Placing conditions on supply of essential franchising goods to franchisees, where those conditions were not necessary to protect the franchisor's legitimate business interests;
- Conduct that is inconsistent with the nature of the relationship of the parties, particularly in a franchising context;
- Attempting to terminate a commercial agreement for contrived reasons;
- Conduct calculated to harm the smaller business
- Failing to honour terms of a retail lease;
- Unreasonably refusing to transfer a retail lease;
- Unreasonably refusing to renew a lease;
- Failing to adequately disclose key changes to a lease, despite representing that the lease is unchanged, in circumstances where the changes cause significant detriment to the lessee;
- Granting exclusivity to one business, while at the same time negotiating with another business for a licence that would impinge on that of the first business;
- Terminating a contract in a way that is capricious and unreasonable in circumstances where there was not a sufficient basis to terminate the contract;

The examples that follow illustrate how the law has been applied to particular retail tenancy situations.

Leelee

Leelee was a retail landlord operating a food court. In dealings with one of its tenants Leelee withheld crucial information about changes to the agreement. It also failed to honour existing terms of the contract, and would not allow the tenant to transfer the lease.

The court declared that the landlord had acted unconscionably, and granted injunctions preventing any similar behaviour in the future.

Suffolke Parke

Suffolke Parke Pty Ltd was a master franchisee for The Cheesecake Shop. It leased premises to a franchisee, which operated a Cheesecake Shop business from the premises. Part of the leased premises was a separate shop that the franchisee had been permitted to sublet on previous occasions.

Following disputes between the parties over franchising matters, the franchisor refused to allow the franchisee to sublet the shop again. This refusal was allegedly in reprisal for complaints arising from Cheesecake Shop franchisees concerning the franchisor's conduct as a director of the master franchisee for SA.

When the franchisee sought mediation under the Franchising Code of Conduct, the franchisor refused to attend. The court declared that Suffolke Parke and its director had acted unconscionably toward its tenant and that the company had breached the Franchising Code of Conduct by refusing to attend mediation.

The court ordered Suffolke Parke Pty Ltd and its director to compensate the franchisee, pay the ACCC's costs and implement a trade practices compliance training program.

This retail tenancy dispute was unrelated to The Cheesecake Shop national franchise.

4. STATE AND TERRITORY DEVELOPMENTS

Retail tenancy matters are primarily dealt with under state based regulatory regimes. In general, these mechanisms are best placed to deal with complaints from small businesses and on the whole have been reasonably successful. Sometimes, however, issues arise that are simply unable to be dealt with under the relevant state legislation. Often, in these circumstances, complainants turn to the ACCC as a last resort.

A number of states are currently reviewing their legislation to identify ways they can make their retail tenancy laws more effective, efficient, and in some cases, more consistent with other states. Some states (NSW, Victoria and Queensland) have 'drawn down' the unconscionable conduct provisions under s51AC into their state based regimes. Others are considering doing so.

The Victorian legislation

Victoria's Retail Leases Act 2003 passed through Parliament and came into force in May this year.

The ACCC is not in a position publicly to comment on the efficacy or validity of State legislation. However the Commission supports draw down of 51 AC in the manner States like Victoria are doing.

It is the route to small business getting more timely outcomes at a lesser cost. At the same time ACCC sees benefits in having as much consistency as possible among jurisdictions affecting the market place.

South Australia – end of lease and the 'sitting tenant'

The ACCC also notes the particular vulnerability experienced by a retail tenant at the expiry of their lease, sometimes characterised as the 'sitting tenant'. Specifically, tenants face the prospect of the loss of goodwill and capital investment upon a failure to grant a new lease, or alternatively the application of disproportionately high rent increases if a new lease is offered.

Where this situation arises, there exist between the landlord and the tenant a number of competing interests. For example, the landlord may not wish to grant the new lease

out of a desire to change the composition of goods and services offered in, for example, a shopping centre. Alternatively, the landlord may have other development plans that are not consistent with renewing a particular tenant's lease (for example, a desire to create a food court in a location where an electronics retailer has a lease).

It is arguable that in taking on a lease, rather than speculating on a commercial property as a capital investment, the tenant has transferred a capital risk to the landlord. Having taken on such a risk, the landlord might then be reasonably entitled to exercise certain prerogatives in maximising his return on that investment.

This might entail seeking to attract more customers to a retail precinct by altering the tenant mix, or simply to maximise returns by offering the lease to the most lucrative offer.

The ACCC does not consider regulatory intervention in the sphere of robust commercial negotiations appropriate nor advisable. For example, negotiating a suitable term of a lease, including options to renew, is arguably a commercial bargain which the parties must strike between themselves. The onus, in this sense, would lie on the tenant to ensure that it secures sufficient renewal options to facilitate recouping its initial investment. In looking at matters such as refurbishment, the tenant should consider as part of its decision the remainder of the lease, and whether or not it may be necessary to bargain for an option to renew as a pre-condition to incurring refurbishment costs.

To some extent, it is open to the business, at the end of its lease, to take up a lease elsewhere, however this ability is severely constrained by relocation costs, such as the cost of refurbishing a lease area for a particular commercial use, and the loss of goodwill that comes from moving from an established area with an established clientele.

However, while the ACCC certainly supports a robust competitive market for retail lease space, it is concerned that the special vulnerability of tenants arising at the end of their lease may leave them susceptible to unfair exploitation that is not a true reflection of the market.

One means of striking the balance between allowing commercial landlords to realised the full value of their investments while still having regard to the rights of the lessee is the 'right of first refusal' – that is, effectively allowing the current tenant to match any genuine offer made by other prospective lessees in a transparent market.

The ACCC notes that section 20D of the South Australian Retail and Commercial Leases Act 1995 grants the sitting tenant a preferential right to a new lease subject to certain qualifications. These qualifications include a desire to change the tenancy mix, where the lessor requires vacant possession, or where the tenant has substantially breached the lease conditions.

In particular, Section 20E of the Act requires that before agreeing to enter into a lease with another person, the lessor must make a written offer to renew or extend the existing lease on terms and conditions no less favourable to the lessee than those of the proposed new lease.

While the above example is one of state legislation, the ACCC is supportive of industry initiatives to address specific concerns in a sector that emerge, and in particular recognises the potential for self-regulatory or co-regulatory industry codes to achieve this objective. I will discuss the ACCC's approach to codes in further detail shortly.

5. ONGOING TRADE PRACTICES LAW REFORM

This year has seen some important developments in trade practices law reform.

The government response to the Dawson Review of the Competition Provisions of the Trade Practices Act has seen government endorse the recommendations to reform the authorisations process, and in particular the collective negotiation procedures, to make them more accessible to small businesses.

The ACCC has also made a submission to the Senate Economic References Committee established to examine whether adequate protections are afforded to small businesses under the Act.

The ACCC has made a broad submission dealing with such matters as misuse of market power and industry codes, but in particular notes that the unconscionable conduct provisions have been working well and there is scope for continued refinement of the statutory test in the courts.

This is not to say, however, that the ACCC is completely without concern in this regard. A common complaint in a number of industries is the use of 'unilateral variation clauses' in contracts. A unilateral variation clause is a term in an agreement that purports to confer on one party a seemingly unfettered right to vary a key term of that agreement.

The ACCC has already accepted court-enforceable undertakings from one large business in relation to its use of unilateral variation clauses in agreements, and has recommended that the use of such clauses be included in the matters to which a court can have regard when determining if a course of conduct was unconscionable.

6. BEST PRACTICE SUGGESTIONS FOR LANDLORDS AND TENANTS

- **What Landlords can do**

By the time a dispute gets so out of hand that it has to go to a tribunal or court, both sides have already lost; they have lost in terms of time, money and the stress associated with a legal dispute.

It is a far better policy to prevent such disputes from arising – indeed, the ACCC has always taken the view that 'prevention is better than cure'. It is equally important that where a dispute does arise, it is dealt with as quickly and efficiently as possible, in a way that leaves the commercial relationship intact as far as possible.

So what can landlords do to promote best practice in retail leasing?

Well, the wording of s.51AC itself provides a few clues;

- be prepared to negotiate – whether it be the terms of a lease, any relocation, or refurbishment that has to be done;
- disclose as much information as is possible, bearing in mind any state legislation requirements;
- uphold any benefits conferred to the tenant under the agreement;
- have effective dispute resolution procedures in place, and make sure your tenants know about them.

Clearly this list is not exhaustive, and each business has to consider their own legal requirements and approach to compliance.

- **How can tenants protect themselves from unconscionable behaviour?**

While the unconscionable conduct provisions are an effective means of providing redress for unacceptably harsh commercial conduct, small businesses need to remember that prevention is always better than cure. It is far easier to stop a problem from getting out of hand in the first place than to try and remedy the damage afterwards. There are a number of measures small businesses can take to minimise the risk of exposure to unconscionable dealings by larger businesses. These include:

- get understandings in writing. Although most leases are in writing, sometimes there are aspects of the agreement that are informal, or 'over a handshake'. Having all the terms documented can prevent confusion arising later.
- read all contracts carefully—don't sign anything without reading it first
- if you don't understand something, ask about it
- get professional advice if you're not sure
- if you're not happy with a deal, try to negotiate or find a better offer elsewhere.
- Make sure you negotiate adequate options for renewals at the end of your lease. You should begin preparation for the end of your lease, including notifying your intention to renew, well in advance.

Above all, it must be remembered that the unconscionable conduct provisions are not intended to solve all small business problems, and will not apply to situations where one party has simply made a poor deal.

7. CODES OF PRACTICE

Related to the issue of best practice is the scope for industry participants to take a cooperative approach in identifying issues within the sector and negotiating solutions to them.

The ACCC believes that credible industry codes of conduct can deliver real benefits for consumers and small businesses in their dealings with bigger businesses. Effective industry codes can therefore result in increased compliance and reduced regulatory costs.

Voluntary codes do not, however, only offer benefits for small businesses and consumers. An effective voluntary code can offer a practical alternative to expensive regulatory intervention, and may also offer greater certainty and uniformity to larger businesses.

Voluntary codes are often more flexible in addressing emerging issues within an industry. While legislative reform can be a long and involved process, amendments to voluntary codes can, in contrast, be achieved relatively quickly, which benefits all industry participants.

Casual mall leasing, for example, has been an ongoing concern for retail tenants for some time. Although section 62A of the South Australian Act prescribes a casual mall licensing code in its regulations, industry participants are increasingly recognising the potential for such an issue to be addressed on a voluntary basis.

The ACCC considers that it may be appropriate, in some circumstances, for industry participants to work out a means of addressing issue between themselves, removing the need for the imposition of a regulatory solution.

Continued requests from industry for assistance with code development demonstrate the ongoing interest by industry in the role of effective codes of conduct to address industry concerns. The ACCC believes that a system of endorsing voluntary codes of conduct has the potential to provide effective industry codes of conduct that deliver real benefits to businesses and consumers with the least possible compliance cost placed on consumers or business.

The role of the ACCC will be to assist industry groups in ensuring the success of their codes. The industry will need to demonstrate that its code is achieving its objectives before the ACCC will provide endorsement.

Endorsement from the ACCC will be hard to obtain and easy to lose. The aim of such endorsement is to reassure businesses and consumers that the code participant they are dealing with operates in a fair, ethical and lawful manner.

However, if the ACCC assesses that an industry code is not achieving its objectives, it will recommend possible changes to that code to ensure all the essential criteria are met for an effective industry code. If the industry fails to adopt these recommendations, the ACCC will remove any endorsement.

It should also be noted that the proposed endorsement process should be distinguished from the existing prescription mechanism pursuant to s.51AE. The purpose of prescribing industry codes of conduct under the Act is to underpin or strengthen a voluntary industry code of conduct that has failed to meet its objectives. The effect of prescription is, of course, government regulation in a different form as the code becomes quasi-law. While there is a role for prescribed codes of conduct, as noted

above, the proposed ACCC endorsement of voluntary codes should provide a credible and rigorous alternative to the more regulatory option.

The Webb Report and Industry Roundtable

The ACCC engaged Eileen Webb, a senior lecturer at the University of Western Australia with expertise in trade practices law and retail tenancy, to prepare a paper on the impact of retail tenancy issues and State laws on the TPA and the role of the ACCC ('the Webb report').

The report focused on the interaction of the unconscionable conduct provisions of the Trade Practices Act with the existing state and territory regimes, and the potential for section 51AC, in particular, to provide remedies for retail tenants. The report also identified a number of options that might facilitate greater harmony between the state and territory retail tenancy regimes.

The round table meeting was held on Monday 30 September 2002 in Sydney, chaired by myself. The purpose of the round table was to bring together key industry bodies to canvass some key issues and consider the possibility of a nationally consistent approach to addressing these issues.

Staff contacted the following stakeholders regarding participation in the round table, suggestions for others who should be invited and other agenda items.

- Australian Retailers Association;
- Shopping Centre Council of Australia;
- State and Territory retail tenancy officials;
- Commonwealth Office of Small Business; and
- Commonwealth Treasury

The meeting helped identify a number of concerns relating to disclosure of information between landlords and tenants particularly turnover figures, the issues facing sitting tenants when negotiating lease renewals, and market rental valuations.

The meeting was also an opportunity to discuss the interaction of retail tenancy issues with the Trade Practices Act, current state regulations, and the potential for a nationally consistent approach to retail tenancy regulation.

The meeting presented an opportunity to survey the current status of state and territory legislation, the perceived advantages and disadvantages of the various types of Code options, and to discuss some of the specific issues outlined above.

A number of positive initiatives were identified, particularly the steps taken by the Australian Retailers Association (ARA) and the Shopping Centre Council (SCC) in relation to the adoption of a Code for nationally uniform approach to casual mall leasing. I understand that an application is being made to the ACCC seeking authorisation of the Casual Mall Leasing Code. In addition discussions have been occurring between the ARA and the SCC on a voluntary national Code for outgoings.

8. CONCLUSION

In conclusion let me state a few reasons why the retail leasing industry should be supportive of a balanced approach to fair dealing with retail tenants:

- Although ensuring compliance with regulations such as 51AC can incur administrative costs for larger companies, it is part of good business practice to achieve this, and as good corporate citizens play their part in ensuring the market operates as effectively and fairly as possible.
- Small businesses are responsible for a significant proportion of economic activity, and comprise a large portion of the customer base of retail tenancy lessors. A confident and thriving small business sector is good news for the industry and the wider economy.
- A larger business that consistently gets away with acting unconscionably towards its small business tenants could be gaining an unfair competitive advantage over large competitors acting fairly in their business transactions.
- Where such behaviour occurs in an industry it is often to the detriment of the industry as a whole unless the misbehaviour is addressed quickly.

To the extent it is possible to gauge, there has generally been a positive response by larger businesses to complying with section 51 AC. First tier landlords have indicated they are attentive to ensuring staff and representatives understand TPA compliance obligations. Some have approached the Commission for video training modules and other material the ACCC has produced on unconscionable conduct. The challenge is to achieve good compliance as widely as possible.

The ACCC will maintain its proactive approach to enforcement where appropriate, promotion of sound compliance practices and facilitating dialogue among stakeholders.