Retail Lease Legislation
Yesterday's Hero

SPEIRSRYAN

As shopping centre owners and retailers struggle for traction in the face of significant commercial headwinds, it is important for the industry to find ways of becoming more efficient and competitive.

The patchwork quilt of Australian retail lease legislation now hangs like an anchor around the neck of the retail industry.

When enacted, between 15 and 20 years ago, the legislation was designed to redress perceived imbalance in negotiating power between landlords and tenants. The legislative framework established minimum standards for lease provisions, and imposed conditions on landlord conduct, designed to protect tenants from exploitation and unfair practices.

Over time, those objectives have been largely achieved. Unfortunately, each jurisdiction in Australia saw fit to enact differing legislation to regulate the same transaction. In doing so, the legislation has developed a quagmire of idiosyncratic and bureaucratic procedures which encumber the transaction, often for no real benefit.

Since enactment of the legislation, major landlords have become increasingly conscious of the value of their brands, and of community expectations that they should be good corporate citizens. Over the corresponding period, national tenants have become streetwise, and robust in negotiating to protect their interests. Indeed, it is now not unusual for the tail to wag the dog.

Importantly, the legislation has been amended in all jurisdictions to include unconscionable conduct provisions. These provisions impose general standards of upright dealing, not present when the legislation first appeared. It follows that the legislation now operates on two levels: on one level there are general conduct requirements relating to fair dealing; on the other level, an increasingly complex (and often trivial) set of rules entangling each step of the retail lease relationship.

By implementation of the legislative requirements over a long period, by reason of the good citizen imperative, and because of exposure to the commercial grunt of leading tenants, reputable landlords have become conditioned to behave to the standards the legislation was designed to achieve. In my opinion, they would continue to perform to those standards, even if the legislation was repealed (subject to the safeguards discussed below).

While battle-scarred tenants might dispute this opinion, it would be hard for them to disagree that the retail lease legislation has become yesterday's hero. In many areas, it is simply unintelligible. I defy anyone to explain coherently how section 6A of the New South Wales Act works, or to explain why it is necessary. Similarly, I am yet to meet the person who has managed to read Part 2A of the New South Wales Act (dealing with cash security bonds) from start to finish.

Many of the provisions read well, but when analysed, are ineffectual. Examples of this type of provision include the rent control sections. These were designed to eliminate ratchet clauses and rent reviews which gave to the landlord the highest of a number of possible outcomes.

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Landlords are sophisticated readers of the economy. Leases now simply provide for a single method of review, the one that produces the highest outcome. Before the legislation, it was common for the rent review provision to state that the rent would be increased by CPI or a specified percentage, whichever was the highest. Leases now simply provide for an annual percentage increase, often 5%. Alternatively, they provide that the rent increases by CPI plus a specified percentage. In both examples, the rent increase is higher than CPI, and the legislation provides no benefit to the tenant.
More disturbing, are those provisions that are positively inimical to the interests of tenants.

Before introduction of the legislation, options to renew at a market rent were common. The legislation (in some jurisdictions) introduced an entitlement for tenants to obtain a market rent determination before deciding whether or not to exercise the option. The logic behind this enactment could not be faulted: if the market review produced a low rent, the tenant would exercise, if it produced a high rent, the tenant would not exercise, but would negotiate for a new lease at a lower rent.

The response by landlords was to simply stop granting options. While it remains possible for some tenants to obtain options, the legislation has effectively moved them onto the endangered species list.

The legislation has not been responsive to the changing retail landscape. Instead, over time, more complex and proscriptive provisions have been accreted. This lack of agility is nowhere more evident than in the disclosure ritual.

In most jurisdictions, the lease documentation package presented to the intending tenant of a 60 square metre dress shop will exceed two telephone books in thickness. It is not unusual for the tenant to receive:

- Heads of Agreement
- Lessor Disclosure Statement
- Lessee Disclosure Statement
- Agreement for Lease
- Lease
- Retail Tenancy Warning Guide
- Bank Guarantee Procurement Guide
- Fit-Out Guidelines
- Privacy Statement

The bundle of documents produced will be compliant with a capital 'C'. The same information will be repeated many times, in different places, and the volume of paper produced will be farcical.

The disclosure routine creates a lot of smoke, but almost no fire.

A sophisticated tenant does not need to be warned by statute that there are risks associated with a retail lease. It will cut through the chaff, get to the wheat, and negotiate for its interest. But it cannot risk being bitten by the hand that is supposed to feed it. Failure to record landlord representations in the lessee's disclosure statement can be fatal to a subsequent claim of misrepresentation. Therefore, an experienced tenant might record details of representations in the lessee's disclosure statement. On receipt of that disclosure statement the landlord will either deny or withdraw the representations, and then the disclosure statement itself becomes the subject of negotiation! And this has to be resolved before the parties go to work on the AFL and Lease.

A novice tenant will not see the forest for the trees. All that paper gets in the road of effective communication. It deflects attention from the important issues to the trivial details.

There simply has to be a better way of setting out the key elements of the transaction. While the disclosure routine might once have served a purpose, it has now run its race, and should be scrapped or overhauled, in the interests of something that is actually useful.

The inconsistency and weight of the legislation means that the landlord carries a substantial fixed cost in managing the leasing process, and in compliance with the legislative minefield.

For the landlord, the starting question is invariably to ascertain if the legislation applies.

Each jurisdiction has quirky carve-outs, but in general terms, the legislation will apply in New South Wales if the premises are under 1,000 square metres. In Queensland, the legislation applies to a shop of any size (except that it does not apply if the shop is more than 1,000 square metres and the tenant is a listed company). While the Act applies in New South Wales by reference to the size of the shop and without reference to the amount of rent payable, the Act applies in Victoria and South Australia by reference to the amount of rent payable but without reference to the size of the shop!

You could be forgiven for thinking that this is some kind of joke. Sadly, there sits somewhere, in a dark office, a lonely in-house counsel, whose remit is to apply these rules.

If the Act does apply, then the landlord must do the notification dance. In Queensland and Victoria the landlord must produce a signed copy of the lease to the tenant within 28 days (Victoria) or 30 days (Queensland). Is the 2 day disparity important? If not, why can it not be harmonised? In Victoria, if the landlord misses the deadline, the tenant can terminate. The same right is not available in Queensland. In other jurisdictions, various but differing times are imposed, flowing from the date of registration. In New South Wales, the lease must be lodged for registration within one month after the payment of stamp duty. Perhaps it is time the New South Wales Act recognised that stamp duty on leases was abolished in 2008.

In most jurisdictions, the landlord must give notice to the tenant that the tenant's lease is coming to an end, at least six months before the end date of the lease. Why is this necessary? And if it is necessary, why is it not necessary in Western Australia and the ACT? A tenant who does not know when its lease is due to expire should not be in business. The enactment does not address a real problem, but still has to be managed and administered.

A new branch of jurisprudence has developed in order to understand when a shop lease has been "entered into" for the purposes of the legislation. This is due, in part, to the legislation not apparently understanding the difference between an agreement to lease and a lease. Absent the legislation, the legal principles governing this issue are clear and well-established. Now a new set of principles needs to be applied and managed. In reality, all this means is that the lawyers do the same old dance, to a funky new tune. It is fair to say that millions of dollars have been spent litigating the meaning of this enactment, and some truly startling outcomes have been achieved. Because those outcomes can have serious financial consequences, centre owners are required to invest substantial money in managing the risks.

Compliance with all of these trivial and pointless idiosyncrasies supports a cottage industry of in-house lawyers and lease administrators with all of the major landlords. External counsel are often briefed to advise on compliance issues. Major retailers and many national chain tenants employ in-house counsel to navigate the legislative shoals.

None of this endeavour improves the quality or efficiency of retail business in Australia. But it all comes at a cost, much of it borne, directly or indirectly, by the retailers. Resources that could be deployed in devising strategies for competing with internet retailers are wasted on managing the risk of when a lease is "entered into", for the purpose of legislative compliance.

This leads to the conclusion that it is time to take off the beer goggles, and have a long hard look at the legislation. In doing this we need to acknowledge that the retail industry is becoming increasingly international and competitive. It has moved a long way since the legislation was first enacted. We need to be aware that Australia is unique among its competitors in having retail lease legislation. The concept does not exist in New Zealand, USA, Japan, UK, South Africa, India or China. Internet retailers do not have to worry about it. The legislation is playing ABBA, but the industry is listening to Lady Gaga.

The most sensible solution would be to simply scrap the legislation, possibly retaining the unconscionable conduct provisions.

If it is politically impossible to kill the beast, then at least we need to progress to a solar-powered model. We need to abandon the back-of-the-envelope drafting, clear out the pointless landmines and enact provisions which are effective and targeted. In this model we might retain the tenant disturbance provisions, outgoings and marketing fund transparency, and dispute resolution machinery. The rest can be cast adrift.

Most important, any legislation must be made consistent across all States and Territories.

It would be hard to design a more inept basis for regulating the retail lease industry than that which exists in Australia today. It is no wonder the retail industry appears to be struggling. It is time to take the legislated piano off its back.

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