Retail Leases Amendment (Review) Bill 2016

Second Reading

The Hon. NIALL BLAIR (Minister for Primary Industries, Minister for Regional Water, and Minister for Trade and Industry) (20:50): I move:

That this bill be now read a second time.

The bill amends the Retail Leases Act 1994. These amendments will ensure the Act increases transparency and certainty in the New South Wales retail leasing sector. The amendments will improve the standards of conduct between the parties to a retail lease as well as increase the operational efficiency of the Act by simplifying its key processes. The Retail Leases Act 1994 was introduced to help level the playing field between tenants and landlords of retail shop leases. It was a significant reform to safeguard the rights of parties to retail tenancy agreements. At the core of the Act is a dispute resolution mechanism to help parties resolve the vast majority of their disputes without having to go to court. As we all know, the cost of litigation is prohibitive for small businesses. An important business relationship will not survive a dispute that leads to litigation or indeed a court battle.

Now, more than 20 years later, we find that the combination of having a legislative framework and the provision of free strategic and procedural advice with a low-cost mediation service offered by the NSW Small Business Commissioner has been a resounding success. The Act is a testament to the foresight of those who pushed the first bill. In 1994, as now, the Government was reluctant to interfere in commercial dealings by introducing legislation. The introduction of the Act was a direct response to the economic exploitation of some tenants that resulted from power imbalances between the parties.

The Act introduced protective measures for tenants whose businesses are location sensitive. For example, a law practice that moves from Burwood into the central business district [CBD] is likely to take most of its clients as well as increase its customer base, but this is not so with a café. As we know, the planning framework in New South Wales limits the ability for small business to set up in any location. The ability for a tenant to strike a bargain with a landlord on a fair basis is the cornerstone of any successful retail business. The protective measures of the Act apply equally to landlords, as many landlords are themselves small businesses. They might be self-funded retirees or individuals with their savings tied up in bricks and mortar. Without a clear framework for how a retail leasing relationship should be conducted, everyone except the lawyers will lose.

The retail market contributes significantly to the New South Wales economy. According to Australian Bureau of Statistics data, there are more than 44,500 retail businesses in New South Wales, of which 96 per cent are small businesses.

The data available to measure the number of retail leases is poor. The retail industry accounts for almost 390,000 jobs and $36 billion in annual sales. The retail industry is dynamic and constantly evolving in response to disruptive technologies and consumer

trends. The cost of leasing affordability presents a significant challenge for New South Wales retailers. Shops are located in shopping centres, local communities, shopping strips, standalone premises, strata buildings and large format retail centres. The trend is for landlords of shops in local communities and in shopping strips to increasingly report high vacancy rates. These landlords are directly impacted by the growth and increasing popularity of shopping centres. The market power of large shopping centres—which represent about 20 per cent of retail space—is based on the concentration of centre ownership by a select group of companies. The shops in centres generate a higher proportion of revenue due to the traffic flow generated either by having a large number and variety of shops, the anchor tenant, such as a supermarket or department store, and/or transport services that are co-located.

A corporate landlord who owns sought after retail premises and has access to a vast array of market information is able to force high rents to deliver high yields for investors. These high yields come at a cost to small business operators and the consumers of New South Wales. Demand for limited retail space in Sydney's central business district has driven up rents to the point that in 2015 only four other cities—New York, Hong Kong, London and Paris—are able to charge more rent than is paid in our own Pitt Street Mall. As small businesses are the backbone and indeed the heartbeat of the New South Wales economy, in order to support the growth and sustainability of the retail industry the Government must ensure that the protective measures of the Act remain relevant. The Act must be amended in response to the needs of an industry that is undergoing rapid and significant change. The amendments proposed are the result of an extensive multitiered consultation process. As in every review of this Act, tenants consistently advocate for greater government intervention in the leasing relationship. Conversely, landlords advocate for less regulation.

The Act, combined with the services delivered by the Office of the NSW Small Business Commissioner, ensures that important safeguards are provided for this industry. However, an updated and strong regulatory framework is needed to promote equity in the bargaining positions between tenants and landlords, to increase transparency and to provide certainty of each party's rights and obligations. I appreciate that the review of the Retail Leases Act 1994 has taken a considerable amount of time to complete. The review was undertaken by the office of the NSW Small Business Commissioner [OSBC], which incorporates the former Retail Tenancy Unit. For decades the Retail Tenancy Unit has assisted both landlords and tenants with information about the Act, together with dispute resolution and strategic and procedural advice when they face problems. Assistance is provided to all sectors of the retail leasing industry which includes landlords and tenants, their legal and financial advisers, real estate agents, leasing consultants, and industry associations. The OSBC understands better than any other agency the issues facing the retail leasing sector from both the landlord's and tenant's perspective. Its retail industry insight and dispute prevention expertise enables it to understand the issues that industry faces.

The Government has listened to industry. The amendments were developed in response to concerns raised by stakeholders through an extensive multilayered consultation process that consisted of a large and diverse working group, written submissions, multiple industry and regional forums, an online survey and individual and group stakeholder meetings. The

consultation process was extensive to ensure that all stakeholders had an opportunity to contribute and to ensure that the smaller voices were heard alongside the stronger industry advocates. It has been a difficult review, which has sought to reach a consensus on issues where stakeholder interests are in opposition to each other. It has not always been possible to reach a consensus and, as a result, many amendments have not progressed and, where they have, further amendment has been negotiated by stakeholders.

In an industry that has divergent views, those stakeholders who were either landlords or representatives of landlords tended to take a view that was invariably at odds with those of retail tenants and their representatives on almost every issue.

Industry associations representing shopping centres and retail shopping centre tenants have negotiated to resolve some issues by consensus, and the resulting amendments are therefore expected to meet the needs of the broad range of stakeholders in this industry. Where possible, the Government has encouraged industry to develop its own solutions to some of the concerns identified over the course of the review. The Retail Leases Amendment Review Bill 2016 will inform the Retail Leases Act 1994 to ensure that it remains effective into the future. The bill takes a practical approach to the inevitable tensions between the needs of landlords, tenants and their commercial rights.

The bill will amend the Act to increase transparency and certainty of the deal during the negotiation stage. It ensures that landlords must disclose certain costs in some detail before the tenant is bound to the lease. It will improve access to justice and remedies by increasing the financial jurisdiction of the NSW Civil and Administrative Tribunal to deal with the greater number of matters, and empowering NCAT to award compensation to a party who suffers harm as a result of breaches of some new provisions of the Act by their counterpart to a retail lease. The bill will increase operational efficiency by simplifying the processes of starting or transferring a retail lease, and it repeals unnecessary provisions and makes various technical amendments to improve the operation of the Act.

Turning first to the proposed amendments relating to increased transparency and certainty of the deal during the negotiation stage of a lease, the bill makes amendments to clarify the landlord's disclosure obligations. All landlords will know what needs to be disclosed and tenants will understand what they are committing to before being legally bound to a deal. The Government is committed to ensuring the original intent of Parliament for upfront disclosure of the financial cost of the lease to be mandated as a foundation of the Act. The inability to plan businesses and manage cash flow greatly increases the chance of failure, particularly for a small business. Incomplete or inaccurate disclosure is the source of a substantial number of disputes. The actual amount charged for outgoings can vary substantially from the estimates provided.

The disclosure obligation in the Act, when interpreted by NCAT, identified a loophole that has been exploited by some unscrupulous landlords. The bill clarifies the obligation for landlords to disclose certain terms of the lease at least seven days before a tenant is committed to a lease. The amendments make it clear that tenants are not liable for undisclosed outgoings with one exception—an outgoing in the nature of a tax, rate or levy

that is imposed by or under an Act after the lessor's or landlord's disclosure statement is given, and that it was not an outgoing of the lessor when the lessor's disclosure statement was given. Advertising and promotion costs are not outgoings for this purpose.

The bill provides that if a lessor's disclosure statement provides an estimate of the amount of an outgoing and there was no reasonable basis for the estimate—for example, the costs from the previous year—the tenant's liability for the outgoing will be limited to the estimated amount and future increases in the outgoing will be limited by reference to the estimate amount. To illustrate what this means, imagine the landlord estimates that a tenant's contribution for land tax will be $1,000 per quarter but the actual cost is $2,000. This represents a variation of 100 per cent. Therefore, the tenant will be liable for only 50 per cent of the actual amount of the outgoing throughout the term of the lease.

A breach by the landlord of the obligation to disclose the outgoings is dealt with by reducing the tenant's liability for outgoings. Estimates for disclosure of outgoings are for the first year of the lease and landlords must be able to generate accurate estimates. This amendment means that landlords are required to provide an accurate disclosure of outgoings for the first year. Where an actual cost is not available, a landlord must have a reasonable basis for making an accurate estimate. For example, if an increase in land tax occurs due to a redevelopment, developers are able to obtain estimates of the variation from the Valuer-General and estimate increases in land tax accordingly to tenants.

The purpose of this amendment is to prevent the burden of inaccurate disclosure by landlords being put on the tenant. When there are other breaches to the disclosure obligations, such as a failure to disclose when the lease for the anchor tenant expires, the NSW Civil and Administrative Tribunal can award compensation to put the tenant back into the position they would have been in if proper disclosure had been made. Under the current Act, landlords are able to recover non-disclosed outgoings and potentially charge a higher rent than if the tenant factored in the actual costs of the outgoings. A tenant's only alternative for improper disclosure in the current Act is to walk away from the lease and all of their sunk investment within the first six months. In fact, if a tenant walks away, the landlord benefits from the fit-out work funded by the tenant and they can charge a new tenant higher rent. Without compensating the tenant for their lost investment, such as expensive fit-outs, the current remedy is inadequate.

The amendments allow NCAT to order the rectification of a lease or lessor's disclosure statement to correct an error or omission, giving effect to the intention of the parties when the lease was entered into or reflecting the actual disclosure of information between the parties if the disclosure requirements of the Act are otherwise met. This is particularly important if the landlord sells the building or if the tenant sells the business and the new party does not know the original deal that was struck. These changes are consistent with the Act's objective of ensuring that parties enter into a lease from the best possible negotiating position, with certainty and the information necessary to make effective business decisions. These reforms provide incentives for landlords to share the important information they hold and for disclosure statements to be accurate. This change will minimise disputes over

outgoings and the detriment caused to tenants who are liable for costs they have not been able to budget for properly.

These amendments are consistent with the key recommendations in the 2008 Productivity Commission report to encourage transparency in dealings with between landlords and tenants. One of the principal imbalances between landlords and retail tenants during negotiations relates to market information. This includes access to information about the value of leases in the market, the turnover a lease is likely to produce, and the landlord's collection and use of tenants' turnover figures. The result of this imbalance is that the tenants feel that landlords hold all the important industry information and tenants are flying blind. In the current situation tenants are unable to conduct due diligence in their business dealings and are therefore unable to negotiate reasonable and informed contracts.

As a result of this review, industry stakeholders have worked together and an outcome has been achieved to increase access to market information. I commend the Australian Retailers Association, the National Retail Association, the Pharmacy Guild of Australia and the Shopping Centre Council of Australia for having reached an agreement on the voluntary Retail Industry Code of Practice—the Reporting of Sales and Occupancy Costs. This code is an agreement on the collection and sharing of industry information. There is an implicit duty of good faith within the code, and these associations are now working together in a collaborative way. Consistent with the New South Wales Government's objectives to let industry develop its own solutions to issues, these parties have found consensus on some of the issues.

Landlords and tenants will remain free to negotiate the terms they choose, with better access to information. The code will support enhanced competition for retailing space and more market-based outcomes from rent negotiations. The code is a voluntary industry code, industry led and industry developed. The voluntary industry code is not referenced in the amendment bill and will not be referenced in the Retail Leases Act. The Government listened to industry stakeholders, who said that they did not want a mandatory code and did not want the heavy hand of government dealing with this issue. I understand that the signatories to the code have one or two matters to finalise, such as whether the code will adjust sales for the goods and services tax. Industry players have told us that they do not want the Government intervening if industry can negotiate solutions. If the code cannot successfully address these issues, the Government will revisit the earlier proposal of the review to develop a mandatory code prescribed by the Act to manage the collection and reporting of turnover data.

The bill recognises that retail is a dynamic industry and that as shopping moves online there is a shift in the way the industry operates. Some tenants are required to report their turnover. This can be a significant issue when a sale comes through an online portal.

First, if a tenant has multiple locations, which landlord has the right to the online sales information? Secondly, if the goods are not collected or delivered from the shop, should any landlord have the right to access the information—and charge rent—for an online sale? The bill provides that a tenant cannot be required to provide the landlord with information

about online transactions except for transactions where goods or services are delivered or provided from or at the retail shop or retail shopping centre of which the shop forms part or where the transaction takes place while the customer is at the retail shop.

Additionally, the bill provides that for the purposes of determination of rent by reference to turnover, "turnover" does not include information about online transactions—other than transactions where goods or services are delivered or provided from, or at the retail shop, or retail shopping centre of which the shop forms part, or where the transaction takes place while the customer is at the retail shop, for example shoes, "customised" on a store device in-store before being ordered from the store.

Turning from the proposals that increase transparency, I will now outline the second area of amendments. The bill amends the financial jurisdiction of the New South Wales Civil and Administrative Tribunal [NCAT] to increase it from $400,000 to $750,000. This acknowledges increases in the cost of leasing and, coupled with a broader range of remedies, will improve access to justice by enabling NCAT to deal with a greater number of matters. Where the only mechanism to have your problem dealt with will cost hundreds of thousands of dollars, the outcome is uncertain and likely to take a number of years, and justice is seen to be controlled by the powerful party. The solicitor for a powerful party once said:

I think my client probably did do the wrong thing, but I don't think the small business can afford to run the case.

If they spend $30,000 or $40,000 with a solicitor then we will talk about compensation.

As the majority of disputes are settled through mediation it is unlikely that the amendments will produce any long‑term increase in litigation. The final amendments in the bill relate to increasing the operational efficiency of the Act by streamlining processes, repealing unnecessary provisions and effecting various technical amendments. The bill consolidates and streamlines provisions relating to the process for obtaining a landlord's consent to assign a lease. The amendments remove confusion by separating the processes for assignment from the process for obtaining protection from any ongoing liability after a lease has been transferred. The current Act is not sufficiently clear on the assignment requirements, which has led to conflicting outcomes in the case law and created a minefield for litigation. The path to assignment is simplified to enable tenants to transfer the leases and/or sell their businesses and ensure the landlord gets a new tenant that meets the landlord's requirements to be a tenant in that shop.

Under the current system, landlords can decide what type of tenant they require. They can require that a certain level of capital is available or a certain level of retailing experience. The shop cannot be passed on to someone with less experience or financial resources without the landlord's express consent. The bill amends the Act to make it clear that the point in time when a proposed assignee's financial resources and retailing will be assessed against those of the tenant is at the time the lease is assigned. This amendment will assist tenants who want to sell a business that is not doing well, because it will lower the standard that the landlord can hold the new tenant to when assessing whether to consent to an assignment.

This will assist tenants to assign their leases when retail businesses are sold on retail strips where there are high vacancy rates.

Conversely, if a landlord is willing to take a punt on someone just starting out who later becomes a success, they won't be compelled to consent to an assignment to a tenant with unproven skills like those of the proposed assignor at the beginning of their lease. Whether it is more or less advantageous to a landlord for a tenant to be assessed at the beginning or the end of the relationship will depend on the landlord's circumstances, and the skills and financial resources of the tenant who wishes to assign their lease.

In addition, particular locations, especially those with public significance, bring complexity to the issue of assignment. There are instances in which a tender process may require a security clearance to ensure that a tenant is considered as a fit and proper person, and any other issues may weigh heavily on a public tendering process. The amendments recognise that a landlord may impose these types of requirements for employees of a retail shop, and that landlords who award leases by a public tender process may require any proposed tenant to be held to the same criteria.

The bill will also introduce the requirement for landlords to register leases for a term of more than three years, and for a tenant tobe provided with an executed copy of the lease. The time for registration has been extended to threemonths after the tenant has executed and returned the lease to the landlord because having a leasewith multiple landlords and a mortgagor is not always a simple process. Lease registration provides afundamental protection for a tenant's investment in a retail business against transfers in the ownershipof the building. Failure to register a lease greatly weakens the position of retail tenants if a landlordsells the premises or a mortgagee takes possession of the property.

Industry stakeholders have raised concerns regarding hundreds of unregistered leases in major suburban and regional shopping centres. The bill introduces a requirement for a copy of the executed lease to be provided to a tenant within three months of the tenant providing an executed copy to the landlord or landlord's agent. Tenants are disadvantaged when they are denied a copy of the lease, which is required by franchisors or a lending facility to secure finance. The largely unregulated nature of bank guarantees has resulted in poor practice among some landlords and agents. At the end of a lease, by delaying the return of a bank guarantee document, landlords can limit a tenant's ability to raise capital to finance a new business or to mo ve to a new location. This happens by simply holding on to the document that is a bank's commitment to unquestioningly prov ide a tenant's funds on demand.

Bank guarantees have been used by some unscrupulous landlords as leverage to pressure a tenant into s ettling a dispute and accepting a less favourable outcome. Others have drawn down on bank guarantees for illegitimate purposes unrelated to a tenant's performance of obligations under a lease, such as the landlord's own cash flow problems. At other times, the return of a piece of paper is just not a priority for an agent or landlord who is possibly annoyed that the tenant found another shop to rent. Seeking an order from NCAT for the landlord's use of a bank guarantee for an illegitimate purpose is a costly exercise that is a

difficult option for most tenants. Landlords, who fail to return a bank guarantee within two months of a tenant completing performance of their obligations under a l ease will be subject to a penalty , and NCAT may make an order to return funds they are not entitled to keep.

One of the key recommendations in the 2008 Productivity Commission report was that clear requirements for bank guarantees should be established to improve transparency and certainty in retail lease relationships. The b ill clarifies when demolition clauses can be triggered. This addresses landlords' uncertainty as to when their use is legitimate. Demolition clauses in leases require a tenant to vacate the premises so that the demolition of a substantial part of the build ing can take place. The bill makes it clear that lessee protections under the Act in relation to termination on the grounds of proposed demolition of a building of which the retail shop forms part extends to proposed demolition of any part of the building, and that termination on the grounds of proposed demolition is only permissible when demolition requires vacant possession of the shop.

The bill's amendment will eliminate concern that a landlord cannot use a demolition clause unless the whole building is being demolished, yet prevent the use of demolition clauses to terminate a tenant's business for an illegitimate purpose. Demolition clauses are frequently used to change tenancy mixes and deny tenants their property rights in favour of another tenant. Whe n used unjustly, it means a landlord can use a demolition clause as a trigger to terminate a lease if a tenant offering a higher rent wants the tenant's shop, y et the tenant is committed to a lease agreement for three to six years with no ability to termin ate the lease, regardless of how things are going.

The bill also makes a number of amendments to clarify provisions in the Act that have been the source of disputes over differing interpretations. The amendments clarify when leases in an office tower will come under the operation of the Act by removing an exception from the Act for premises in an office tower that forms part of a retail shopping centre, on the basis that the exception is unnecessary because an office tower does not form part of a retail shopping centre merely because it is in the same building as, or is above, the retail shopping centre. A food court or shopping precinct of an office tower is capable of being separately distinguished from the office tower for the purpose of the operation of the Act.

The bill also makes it clear that a landlord cannot recover from a tenant the cost of obtaining a mortgagee's consent to a lease. A number of amendments to operational provisions enable the transition of the Retail Bond Scheme as part of a new digital platform with a contract management system and secure escrow holding service. This is a very exciting development that members will learn more about soon. The bill repeals the minimum five-year term for retail leases, transfers the administrative process for the appointment of specialist retail valuers to determine rent disputes from NCAT to the Registrar, and repeals redundant references to stamp duty. The Government is committed to reducing red tape for industry. By repealing the minimum five-year term, streamlining assignment and disclosure processes and clarifying provisions, the New South Wales Government is reducing red tape for the retail leasing industry.

In terms of the transitional provisions in the bill, clause 38 of schedule 3 provides that an amendment extends to a lease entered into, and a disclosure statement given, before the commencement of the amendment except as otherwise provided by the schedule. It would be inaccurate to say that the amendments to streamline and clarify provisions will apply retrospectively as they do not amend the rights and obligations of parties but merely restate the existing policy intention of the provisions. For example, a tenant could not go back and collect their mortgagee consent fees for the past 11 years because clause 45 of schedule 3 provides that sections 14 and 45 do not apply to the seeking or accepting of payment of expenses incurred in connection with obtaining the consent of a mortgagee before the commencement of the amendment made by the bill to the definition of lease preparation expenses in section 3.

The following amendments will only apply to new leases entered into after the commencement of the provision: disclosure statement amendments; execution and registration of leases; return of bank guarantees; and the repeal of the minimum five-year term. The Government has undertaken an extensive period of consultation on the amendments. The amendments represent the outcome of the most substantive review of the Act since it was introduced in 1994. The bill introduces amendments that were put forward by the industry and developed through a lengthy and multi-tiered consultation process. Following the consultation period, the Office of the NSW Small Business Commissioner has extensively engaged with industry and government stakeholders to determine sensitivities and test recommendations. The proposed amendments have been developed in conjunction with stakeholders in the sector.

As mentioned earlier, the major industry associations including the National Australian Retail Association, the Pharmacy Guild of Australia, the Retailers Association and the Shopping Centre Council of Australia have been actively involved in the process on particular points concerning leases in shopping centres. Some amendments have not progressed due to the lack of consensus by the major stakeholders representing large landlords and retailers in large shopping centres. Industry associations support the amendments to the Act that relate to their members: The key amendments that are needed to allow small business operators, be they landlords or tenants, to make and keep their deals as leases are the lifeblood of the retail leasing industry. In summary, this bill introduces important reforms to support the future of small businesses in the retail industry. I commend the bill to the House.