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SECURITY OF TENURE FOR SMALL RETAIL BUSINESSES

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ABSTRACT

The laws protecting retail tenants in some parts of Australia have been amended to confer security of tenure. Similar provisions are being considered for other Australian states. Owners and their representatives argue fiercely that security of tenure makes shopping centres effectively unmanageable. Some go so far as suggesting that these rights make shopping centres unattractive investments. Tenants contend that retail businesses become tied to their existing locations and that assured rights of renewal give them a proper incentive to build their trade and prevent those operating small businesses from being subjected to undue pressure towards the end of their leases.

This paper identifies some of the useful features and shortcomings of the recent Australian legislation and compares its approach with that adopted in the UK where commercial tenants have security of tenure. It seeks to present an impartial view of the likely consequences of the Australian statutes for both the owners of shopping centres and those operating private retail businesses. In particular, the paper considers how easy it will be to enforce and contest renewal rights under these new regimes and the extent to which landlords' concerns as to their effects on the management and investment value of shopping centres have any genuine foundation.

SECURITY OF TENURE FOR SMALL RETAIL BUSINESSES

I INTRODUCTION

At last year's PRRES Conference the authors conducted a wide ranging review of the ways in which Governments in the UK and Australia take steps to protect small business tenants (Murdoch, Rowland and Crosby, 2001). That Paper revealed widely differing approaches between the northern and southern hemisphere in many of the areas where statutory intervention has taken place. One matter stood out as one in which not only were the approaches of the UK and Australia very different but also where changes in both jurisdictions was imminent – security of tenure at lease end. In the UK changes to the existing law under which business tenants have statutory rights of renewal were being proposed. In Australia the conferment of security of tenure was being actively considered in most States and Territories.

Security of tenure remains topical in some States. South Australia's legislation - which confers preferential rights on tenants when their leases come to an end – is about to come into effective operation. The Australian Capital Territory has now introduced a similar scheme and Victoria is in the middle of consultations regarding reforms to its retail tenancies legislation which include the possibility of taking a similar step. The NSW, Queensland and Western Australian governments are not currently proposing further retail tenancy legislation. Therefore, the introduction of security of tenure is not imminent in these states although it remains on the agenda for those advocating more protection for retail tenants. In the UK, the government is about to finalise changes to the long standing statutory regime governing security of tenure, some of which may have the effect of reducing its operation. The implementation of these proposals will produce some convergence in legal frameworks which have hitherto been very different.

This paper explores the benefits and disadvantages of granting security of tenure to some retail tenants. The paper identifies some of the useful features and shortcomings of the recent Australian legislation and compares its approach with that adopted in the UK. It seeks to present an impartial view of the likely consequences of the Australian statutes for both the owners of shopping centres and those operating retail businesses. Using the UK scheme as a point of comparison, the paper considers how easy it will be to enforce and contest preferential rights under the new Australian regimes. The paper also explores the extent to which preferential rights may affect the the management and investment value of shopping centres.

A. THE BACKGROUND TO STATUTORY INTERVENTION

In the UK[1] the trigger for the introduction of security of tenure (in replacement of an existing system of compensation for tenants' improvements and loss of goodwill) was the shortage of commercial premises in the aftermath of the Second World War (see Haley, 1999; Haley, 2000; Murdoch, Rowland and Crosby, 2001). Although it was acknowledged that the size of the problem was difficult to assess, there was clear evidence that landlords were demanding very significant rent increases for very short renewals (Leasehold Committee, 1949). The bare

[1] It should be noted that there is no single scheme of protection in the UK. In Scotland there is little or no security of tenure. The scheme in Northern Ireland is very similar to that applying in England and Wales, but does differ in some important respects; notably it does not allow the parties to contract out. For the purposes of this paper, reference to the UK scheme should be taken to be that applying in England and Wales.

bones of the proposal which ultimately shaped Part II of the Landlord and Tenant Act 1954 was that the scheme should apply to tenants engaged in all types of business activity (including retail, industrial, commercial, professional and non-profit making)[2] irrespective of the size of the business, length of lease or period of occupation. There should be no contracting out[3] and the tenant should not be limited to a single renewal. The new lease should be at a market rent (excluding the effect of the tenant's goodwill and improvements) and the lease terms should follow the terms of the existing lease, including any right to assign.

The roots of the current initiatives to introduce some degree of security of tenure in Australia lie in the history of oppressive behaviour by landlords, especially those of shopping centres. In the early 1980s pressure from small retail businesses for a fairer deal from their landlords provoked the latter – in the shape of the Building Owners and Managers Association (now the Property Council of Australia) - into drawing up a voluntary code of practice. While this temporarily staved off State intervention in New South Wales, other States, notably Queensland, Western Australia, South Australia and Victoria all legislated in the mid 1980s. Despite amendments to these initial statutes in the early 1990s, retail tenants remained dissatisfied. This discontent was revealed as well-justified by the Reid Committee, an influential federal investigation into the manipulation of small businesses, including retail tenancies (Commonwealth of Australia, 1997). This Committee recommended that a uniform retail tenancy code provide for a minimum five year lease, an option to renew for a further five years and then a right of first refusal for one further five year period (Commonwealth of Australia, 1997, p.39).

The Commonwealth Government's response to this report was to propose the introduction of a "set of principles consistent across Australia to provide minimum standards for retail tenancy laws" (Ministerial Statement, 1997). Following consultation with State and Territory ministers, a set of benchmarks for retail tenancies legislation was identified (which were manifestly weak on the most controversial area - security of tenure for tenants). The statement, while noting that tenants should be given adequate warning of the landlord's intentions regarding lease renewal, went no further than to encourage all representative bodies to address end of lease issues and to work together to achieve a workable solution (Press Release, 1997). Nevertheless, as a result of this lead from the Commonwealth, most States and Territories have very recently further reviewed and amended their retail tenancies legislation and, in the course of so doing, have considered the question of renewal rights.

B. THE ARGUMENTS FOR AND AGAINST SECURITY OF TENURE

The rhetoric used by both landlords and tenants in the debate over the introduction of security of tenure for small retail businesses makes it difficult to predict its likely consequences. In abstract, the introduction of security of tenure shifts one of the rights over the property from the landlord to the tenant. It is likely to increase the value of the tenant's interest but to lower the value of the property (unless the tenant pays more rent to reflect the statutory option to renew). To this extent, it simply transfers wealth from landlords to tenants, which explains the partisan submissions to governments in Australia.

However, security of tenure may also encourage behaviour that is beneficial or detrimental to investing owners, small business tenants and shoppers. Three effects of security of tenure

[2] Thus, in the UK, statutory protection is not confined to retail businesses (or to premises within shopping centres) as is often the case in Australia. However, for the purposes of this Paper, the UK scheme will be discussed only as it applies to retail leases.

[3] The Act was amended in 1969 so as to permit contracting out with the prior approval of the court.

appear to underlie the current debate in Australia. First, the main benefit of security of tenure is that it encourages retail tenants to develop their businesses for the long term. More successful businesses should enhance the value of the premises and improve shopping facilities for the community. Secondly, the main detriment of security of tenure is that it reduces the control by landlords of their investments. Loss of control makes the rental income stream less certain and may prevent the landlord from pursuing strategies that increase the value of the shopping centre. Thirdly, with security of tenure, sitting tenants should no longer feel pressured to accept unfair terms for the renewal of their leases (for fear of being forced to move if they do not accept).

1. Encouraging retailers to invest for the long term

In relation to the first (and third) effect, tenants contend that retail businesses become tied to their existing locations and that assured rights of renewal give them a proper incentive to build their trade. Because the success and goodwill of most retail businesses is tied largely to their location, tenants are aware that, should they be forced to move to other premises, part of the investment in their business will be lost.

The public debate in Australia over the consequences of granting statutory rights of lease renewal has concentrated on the few tenants who wish to renew their leases against the wishes of their landlords. However, security of tenure may change the behaviour of other tenants, particularly at the tail end of their leases. Without security of tenure, one might expect to see less investment of time and money in a retail business as the lease of its premises approaches expiry. This could damage the trade of nearby shops, adversely affecting the value of the shopping centre. Even if the tenant intends to vacate, they would benefit from maximising the value of their business if they could assign their leases with any assignee acquiring rights of renewal.

This may be too simple an interpretation of tenant behaviour. It is true that tenants who are resigned to the fact that their leases will not be renewed will presumably let their businesses run down. However, some tenants who are concerned that their leases may not be renewed may take a variety of short-term measures to improve business in order to impress their landlord and encourage the offer of new lease. In practice, it appears to be common for tenants to assume that their leases will be renewed, sink money into their premises without considering how long it will take to recoup this expenditure and then feel aggrieved if they are not offered a new lease. In other words, they act as though they have security of tenure.

2. Preventing active management of shopping centres

Turning to the principal disadvantage, owners and their representatives argue that security of tenure makes shopping centres effectively unmanageable. Like the retail businesses they house, shopping centres must continually revise the merchandise they offer to attract new and returning customers. Sometimes, this will require the centre owner to replace tenants with others that either sell different products or bring a different style to the centre. Owners cannot do this easily if the existing tenants have a right to stay in their premises indefinitely. Renewing leases to inferior tenants can damage the prospects for the other tenants in the shopping centre, as well as lowering the value of the centre.

However, security of tenure does not prevent changes of tenant. It may prevent the owner from dictating the tenancy mix and inviting new tenants to lease on the owner's terms. But, leases can be assigned to businesses which are potentially more profitable than the existing ones, subject to the landlord's consent to assignment. If there is security of tenure, the existing tenants can sell their ongoing rights of occupation to more profitable businesses, instead of the landlord demanding a higher rent from those more profitable businesses. The landlord can even buy out an existing tenant to introduce a preferred user. With security of tenure, the existing tenant benefits if there are more profitable businesses wanting the premises. Security of tenure may make it expensive for landlords to change tenants but rarely would it make it impossible.

3. Restoring the balance in negotiations for lease renewal

Another reason for introducing security of tenure for retail tenants is to counter perceived imbalances in the negotiating strengths of landlords and tenants. Many tenants have claimed that they are at a severe disadvantage when they are negotiating the renewal of their leases (for example, see Commonwealth of Australia 1997, p.34). Their expenditure on the premises and the goodwill of their businesses will be lost if they cannot negotiate a new lease. It has become an accepted tenet of government in Australia and the UK that small businesses should be protected from undue pressures from larger corporations, in the same way as consumers are protected from unfair business practices. Renewing tenants feel under pressure to accept terms that new tenants would reject. These pressures are reduced if the tenant has security of tenure, provided that the law includes some mechanism to ensure the rent for the new lease is fair.

However, there is no evidence that security of tenure is the most effective way of controlling any tendency of landlords to exploit their power over small business tenants at the time of lease renewal. It is shown below why this may be especially true where security takes the form of preferential rights rather than full rights of renewal. Legislation forcing renewal at market rents set independently is an alternative that has been proposed.

4. Comparisons between UK and Australia

In arguing the merits of security of tenure for retail tenants in Australia, both sides have referred to the system in the UK. In drawing comparisons, the difference in the usual length of leases must always be borne in mind. In Australia, prior to legislative restrictions, small retail businesses held their premises typically under three year leases with one or two options to renew for a further three years each. A five year lease without options to renew has become the norm since the 1980s retail tenancy legislation made this a minimum in most States. In the UK, fifteen year leases are now typical for prime retail premises to retail chains, although there is considerable variety of lease length (DETR, 2000, Vol 2, p54) and evidence of shorter leases to local companies (perhaps five to ten years would be typical). Therefore, regardless of security of tenure, retail tenants in the UK have a greater stake in their premises than their counterparts in Australia. This has been used to suggest that security of tenure is therefore more appropriate in the UK than Australia.

Another argument raised against introducing into Australia a system of security of tenure similar to that in the UK is that, in the UK, "there are fewer shopping centres due to shortage of land and heritage restraints. There is more focus on traditional high street shopping"

(Shopping Centre Council of Australia, 2001). The dominance of shopping centres in Australia is used to suggest that it is more important in Australia for landlords to retain complete control of tenancies. Landlords of High Street shops (under long leases) are less involved in active management of their investments than Australian landlords of shopping centres. This supports the notion that Australian landlords need full control at the expense of the greater incentive for tenants to build their businesses if lease renewal is assured.

A counter to this is that the lack of negotiating strength of tenants in shopping centres is more severe in Australia and protection of the tenants more important. The ownership of High Street shops in UK (and Australia) is more widely dispersed, lessening any oligopoly power of landlords. These points, together with the dominance of shopping centre retailing in Australia and the greater number of independent retailers in major shopping centres, all point to a stronger need for protection of small retail businesses in Australia.It may be impossible, and perhaps irrelevant, to determine whether security of tenure is more appropriate and viable in Australia or UK. However, the UK experiences may suggest the approach and regulations which are more likely to prove effective.

II VARIOUS APPROACHES TO SECURITY OF TENURE

Before considering the way in which compulsory rights of renewal operate in practice, it is useful to summarise the various approaches which are taken in the various jurisdictions to the issue of the statutory protection of tenants at lease end.

No protection at all

Both north and south of the equator there are some retail tenants who have no statutory rights relating to renewal at all. In Australia, most state retail tenancies legislation excludes very short term tenants, some types of retail business, tenants of larger premises, and public companies; some allow the parties to opt out of protection by agreement. In the UK, only very short term tenants are excluded from the Act; however, all parties can contract out of its security of tenure provisions. Although prior court approval is currently necessary, there are no grounds on which this can be refused.

Mechanisms to ensure fair bargaining at lease renewal

In the UK there is little or no specific statutory intervention designed to ensure that prospective tenants are given accurate and adequate information which is specific to their prospective tenancy on which to base their negotiations either for a new lease or at renewal. The Code of Practice on Commercial Leases seeks to provide tenants with general information on leases but even this has been shown to be almost completely ineffective (DETR, 2000). The property industry, under a continuing threat of statutory intervention, is currently trying to agree the draft of a new and more effective Code.

The position is very different in Australia where significant steps have been taken to try to ensure fair bargaining. All states in Australia impose detailed disclosure requirements on landlords (and some on tenants) during negotiations for the grant of any lease which falls within the relevant retail tenancies legislation. These generally apply where a lease is being renewed unless the tenant has a contractual option to renew. Hence, tenants do receive information to help in negotiating rent under a new lease but no assurance of renewal. A number of jurisdictions[4] are going further and have taken steps to prevent unfair or

[4] Notably, New South Wales, Queensland and Australian Capital Territory.

unconscionable bargaining; this has been achieved either by drawing down section 51AC of the Trade Practices Act 1974 (Cth) or by drafting specific provisions based on that section.

Minimum term for initial lease

In Australia, most states (save for Queensland) require retail tenants to be granted a minimum term of five years. This does not apply to any options to renew and does not recommence following an assignment. However, most states exclude very short term leases[5] and in some, but not all[6], it is possible to contract out of this requirement. In the UK there is no statutory limit on the shortness of the lease which can legitimately be granted to a retailer. While a lease of six months or less is automatically excluded from the 1954 Act, once the tenant has been in occupation for more than twelve months the lease becomes protected. Once protected the tenant has, in effect, perpetual rights of renewal so that the length of term granted at each renewal is relatively unimportant[7].

Advance notice of landlord's intention to renew/not renew

All jurisdictions in Australia now ensure that retail tenants whose leases are governed by the relevant legislation are given at least six months' notice of their landlord's intentions to offer to renew the lease. This is achieved either through the mechanism of a landlord's notice or as a result of a request from the tenant. In the UK, while tenants governed by the 1954 Act are entitled to at least six months' notice, those whose leases are contracted out have no statutory protection in this respect at all; given that all contracted out leases have to be for fixed terms which come to an end by effluxion, this means that they receive no notice at all.

Existing tenants given preference at renewal

Following the reviews of their retail tenancies legislation two jurisdictions in Australia have adopted statutory schemes which afford existing tenants preferential rights of renewal at lease end; these are South Australia and Australian Capital Territory. Both regimes apply only to tenancies granted after the commencement of the relevant Act (1997 in South Australia[8] and 2002 in ACT[9]). Hence, tenants in South Australia will begin to excise preferential rights in 2002 (at the end of their minimum terms of five years) and in 2007 in ACT. In both States, tenants can exercise these renewal rights at the end of successive leases. A single statutory option to renew is an alternative that was contemplated. In both instances it is only tenancies of units in shopping centres which qualify and, in both cases, the parties are able to exclude the operation of the scheme.

Preferential rights of renewal have beenrejected in New South Wales and Queensland. Consideration has been deferred in Western Australia but are currently being considered in Victoria.

Right of renewal

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5 Eg Victoria excludes leases of less than 12 months and South Australia excludes leases of 6 months or less.

6 It is not possible to contract out in either Victoria or Western Australia.

7 Indeed, during the UK property recession of the early 1990s there was clear evidence that retail tenants in particular were positively seeking short term renewals on the basis that this would give them the freedom to move out if trading did not improve while retaining their option to remain, via the next renewal right, should they wish to do so. Tenants employing this tactic do have to bear in mind that, at each expiry, the landlord has an opportunity to oppose renewal on one of a range of statutory grounds.

8 The Retail Shop Leases Amendment Act 1997 came into effect on 7 October 1997. In 1998 there was a failed attempt to amend the Act to ensure that it would apply to existing leases.

9 The Leases (Commercial and Retail) Act 2001 comes into effect on 1 July 2002.

In the UK, business tenants given full statutory right of renewal, irrespective of the nature of the tenant, the size of the premises and the location of the outlet. These can be exercised at the end of successive leases and result in a new lease generally on the same terms (except perhaps for length which cannot exceed 14 years). The lease will not be renewed if the landlord intends to occupy the premises or demolish or carry out substantial works of construction (but this may give rise to the payment of compensation to the tenant based on a formula).

Since 1969 the parties have been free to make a joint application to court, prior to the grant of the lease, for approval to contract out of these renewal rights. The court has no jurisdiction to refuse approval. There is little or no hard evidence on the extent to which contracting out is used but anecdotal evidence suggests that it has increased significantly (the implications of contracting out are explored further below).

III PREFERENTIAL RIGHTS OF RENEWAL

Although neither the South Australian or Australian Capital Territory schemes are fully operational yet, their approach and wording can be studied. since they apply only to new leases but that in South Australia, having been passed nearly five years ago, will come on stream in 2002. Victoria is currently considering its position but, after an initial display of cautious support (Issues Paper, 2001), it now appears to be less enthusiastic (Discussion Paper, 2001) following a vigorous campaign by landlords (Shopping Centre Council of Australia, 2001; Jebb Holland Dimasi, 2001).

A. OUTLINE OF THE EXISTING SCHEMES

The South Australian[11] and ACT[12] schemes are very similar. They display the following key features:

- only retail shop[13] leases in shopping centres are affected;
- a right of preference is afforded to existing tenants (who may be assignees), rather than an automatic right of renewal; in essence, the legislation prohibits landlords from granting a lease to a new tenant if the existing tenant is willing to renew on the terms offered by the new tenant;
- the leases will be renewed on terms agreed by the parties (and not necessarily for a further five years);
- the parties are free to contract out provided that the tenant has received independent legal advice;
- there is no right of preference in certain defined circumstances (described below);
- there is provision for the tenant to ask for the landlords' intentions up to a year before the lease expires; the landlord must presume that the tenant wishes to renew unless notice to the contrary is given;

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10 The Retail Shop Leases Amendment Act 1997 came into effect on 7 October 1997. In 1998 there was a failed attempt to amend the Act to ensure that it would apply to existing leases.

11 Retail and Commercial Leases Act 1995 (as amended by the Retail Shop Leases Amendment Act 1997).

12 Leases (Commercial and Retail) Act 2001.

13 The ACT legislation applies to "premises in the retail area of a shopping centre": Leases (Commercial and Retail) Act 2001, s 108(1).

- the landlord must commence negotiations (which must be conducted in good faith) for a renewal (or give notice of no right of preference) at least 6 months before the end of the lease;

- where a landlord breaches its obligations and the tenant is thereby prejudiced, the court (where mediation has failed) can order the landlord to grant a new lease (but not to the prejudice of any third party who has acquired an interest in the property) or to pay compensation (not exceeding 6 months' rent).

B. COMMENT

Given that neither statute has yet come into practical effect, any commentary on the way in which their provisions may actually operate is, necessarily, speculative. However, experience gained from the "pinch points" of the UK legislation may provide some useful pointers in some key areas.

1. The right of preference

In both South Australia and ACT the landlord is obliged to give preference to the existing tenant over other possible tenants of the premises, save in certain stated circumstances (most of which deal with specific situations and are discussed below). However, the South Australian Act provides that there is no right of preference if a renewal would "substantially disadvantage" the landlord. The ACT legislation seems to be imposing the same requirement by positively stating that the landlord can only let the premises to someone other than the tenant where it is substantially more advantageous to the landlord to do so. Both Acts go on to provide that the landlord cannot enter into a new lease with someone other than the existing tenant without first making a written offer to renew the lease on terms which are no less favourable to the tenant than those offered to the other person which must be kept open for a stated period which must be at least 10 days.

a. Substantial (dis)advantage

An immediate question which arises is how a substantial disadvantage of a renewal to the tenant (South Australia) or a substantial advantage to the landlord of granting a new lease to someone else impacts on the tenant's rights (ACT). If a renewal would "substantially disadvantage" the landlord, this deprives the tenant of any right of preference in South Australia; thus the landlord does not have to negotiate with the tenant or to offer him a new lease before being free to let to someone else. It will, therefore, be important to know what is meant by "substantially disadvantage", an issue which is addressed later in this Paper.

The drafting employed in the Capital Territory is different and poses other difficulties. Here, the tenant's right of preference is not excluded where it would be "substantially more advantageous" for the landlord to let to someone else. Accordingly, in such circumstances (whatever they may be) the landlord is still required to negotiate with the tenant and then make an offer which is "no less favourable" than that proposed to someone else. How then can the "substantial advantage" issue arise? If the tenant accepts the landlord's offer there is, presumably, a binding agreement for lease and the landlord cannot then argue that it would be a substantial advantage to let to someone else. If the tenant does not accept the offer which is then taken up by someone else, could it then be argued that the existing tenant's preference rights had been breached because there was no "substantial advantage" to the landlord?

b. The nature of a right of preference

Technical legal issues aside, what is the nature of a right of preference and does it differ in substance from the UK right of renewal? The right conferred by the new Australian legislation has been described by landlords as "an automatic right to renew and an indefinite right to renew. It effectively provides for leases in perpetuity at the tenant's discretion" (Shopping Centre Council for Australia, 2001). It is suggested that this rather over-states the true position. To an English eye, the tenant with a right of preference is in a very different position from a tenant with a right of renewal.

Most importantly, an automatic "UK style" right of renewal necessarily prevents the landlord from exposing the actual premises to the market and forces him to negotiate a renewal on a one to one basis with the sitting tenant. If those negotiations fail, a third party must resolve the terms of and the rent for the new lease; even where these are settled by reference to open market lettings for similar premises this is a very different process from real market negotiations and, in particular, is likely to impact on the rent (see Crosby and Murdoch, 1999).

The details of the UK scheme accentuates these artificialities. Where parties fail to agree the terms and rent for the new lease (which, to be fair, is uncommon) these matters are settled by a non-specialist court[14] guided by parameters set out in the Act as interpreted over the years by case law. Broadly, the new lease has to be at an open market rent[15]. Its duration can be anything up to 14 years; influential factors are the business requirements of the tenant and the landlord's future plans for the premises (especially where the latter may wish to use the property himself or to re-develop). Other terms are settled "having regard to" the terms of the existing lease; hence there is a strong tendency for renewals to be on the same terms as the old lease which, given the higher frequency in the UK of longer leases, is often out-dated. In particular, there is no scope for the landlord to change the use provisions in the lease in order to capture a higher rental value.

Rights of preference, on the other hand, expose the tenant to the full rigour of the market. The landlord is entitled to market the premises and to negotiate with others who, given the tenant mix exclusion, can effectively include those operating a very different and more profitable line of business. Once the best offer has been obtained, the sitting tenant must match it or go. There is no direct requirement that the rent be limited to open market rental value; hence an incomer may be prepared to pay a rent which is above that figure in order to gain access to the location which the existing tenant must then meet in order to preserve his tenancy.

There are many markets for commercial premises in which rents for new lettings and sitting tenants are different (the notion of "two tiered" rental markets has been acknowledged for many years: Refs, Crosby and Murdoch? Whipple?). Two factors may disadvantage an existing tenant even if the new tenant proposes the same use. The existing tenant may be forced to pay more than open market rent as defined in professional standards (API 2001) and tenancy legislation. The first arises when a new tenant offers more rent for the locational goodwill that the existing tenant has developed (if the same use is proposed). Under these circumstances, matching the new offer would result in the existing tenant paying rent for the locational goodwill. The second arises when there is temporary shortage of vacant premises when one new tenant may be willing to pay more than the rents expected of or affordable for the majority of existing businesses. These phenomenon may force the existing tenants to

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[14] Since 1995 parties can opt for resolution of these matters by specialist expert determination under the PACT scheme; however, this is voluntary and requires the agreement of both sides. To date there have been few referrals.

[15] If the parties are unable to agree this will necessarily be fixed by reference to rents for comparable premises.

surrender their preferential rights, whereas rights of renewal, as provided in the UK, would limit the rent to the current market level. However, when leasing markets are quiet, the preferential rights should protect sitting tenants who might otherwise feel obliged to pay more than new tenants to retain their businesses.

Although there are mechanisms for third party resolution of disputes, these seem to be unlikely to arise in practice in respect of the terms of renewal; the very process involves the making of a formulated offer which, if the tenant does not accept within the stated period, leaves the landlord free to let to someone else. A very obvious complaint that the tenant may have is that the landlord is not being above board and is making an offer to him which is in reality less favourable than the true offer made by a third party. Although the landlord is obliged to provide the tenant with a copy of the proposed lease and the disclosure statement, it remains to be seen whether this will necessarily preclude personal side agreements with a new tenant. Although the Australian legislation does positively require the landlord to negotiate "honestly" and in "good faith"; there appears to be plenty of scope for the dressing up of third party offers in ways which it might be difficult for a tenant to prove, at least while there is still an opportunity to protect his rights to a new lease.

The statutes require that the landlord makes an offer to the existing tenant on "terms and conditions no less favourable" to the proposed new lease.[16] Because each lease is a bundle of terms, there will often be uncertainty as to whether the existing tenant has matched the terms offered by a potential new tenant. This provision could be one that results in many disputes before the relevant tribunal in each jurisdiction.

2. Exclusion

Both Australian Acts allow the parties to exclude the right of preference by the use of a certified exclusionary clause which is endorsed on the lease[17]. This requires the tenant to have been given independent legal advice as to the effect of exclusion and to have told the lawyer that the tenant was not acting under coercion or undue influence in agreeing to its inclusion in the lease. The lawyer must sign and append a certificate to the lease. There appears to be some doubt as to what "coercion or undue influence" means under these circumstances. If a landlord only offers contracted out leases to new tenants, is this coercion? If a landlord offers contracted out leases at a lower rent, is this coercion? Landlords are concerned that "it is highly unlikely, for reasons of professional liability, that lawyers will provide such certificates as a result of the uncertain concept of 'apparently credible assurances' " as required in the South Australian but not ACT legislation (see the Lend Lease response to government consultation in Victoria, (Discussion Paper, 2001, p.48)). In the absence of any reported disputes and reliable statistics on the matter, it is impossible to determine whether there is or will be widespread use of exclusionary clauses.

In principle, allowing exclusion provisions is a serious limitation in any legislation conferring security of tenure. One of the main reasons for retail tenancy legislation is the imbalance in lease negotiations. If the imbalance arises from ignorance, the contracting out procedure ensures that tenants discover their rights. If the imbalance arises from the lack of bargaining power of small business tenants, it is very difficult to legislate against landlords using their negotiating strengths. When related to security of tenure, it is likely that most tenants will be willing to tell a lawyer that they are voluntarily giving up rights of renewal, if they are required to do so to obtain a lease. They may not be unduly concerned at that time that they will be negotiating a renewal five years later from a position of weakness.

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16 S.20E (2) of the South Australian Retail and Commercial Leases Act 1995

17 S.20K of the South Australian Retail and Commercial Leases Act 1995 and S.111 of the ACT Leases (Commercial and Retail) Act.

The Australian procedure is markedly more straightforward (and just as effective) as the current requirement in the UK for prior court approval of any contracting out. Indeed, it is similar to the scheme that the UK is proposing to introduce as part of the package of reforms to the 1954 Act. However, although the details of the new UK provisions have not yet been finalised, it seems clear that they will be stronger than the Australian model in two respects: it is probable that the tenant must normally be given at least 14 days warning that the lease is to be contracted out and that this warning will have to be in a prescribed form which makes clear to the tenant the benefits which are being given up.

Experience in the UK indicates that contracting out can become a policy either of a particular landlord, or of a landlord in a particular location[18]; where this is the case a tenant has no option but to "agree" if he wants to lease those premises. Hence, for example, the submission by Lend Lease to the Office of Regulation Reform in Victoria (Discussion Paper, 2001) in which it was stated that at Bluewater (the largest retail scheme in the UK) "in approximately 80% of the leases the parties have agreed to opt out of the Act" is somewhat misleading since contracted out leases will have been the only form of lease on offer to the vast majority of tenants.

If the exclusion provisions cannot be monitored publicly there is a greater danger of blanket exclusions by landlords. The inability of those implementing any form of security of tenure to gauge whether exclusion has become a standard practice is a fundamental flaw which goes to the root of any government policy on security of tenure. Contracting out was first introduced in the UK in 1969 and one advantage (and perhaps the only one) of the current requirement for a court application for prior approval was that these could, and were, tracked through the collection of court statistics. A change in the recording of court proceedings means that this has not been possible since the late 1980s (at which time a sharp increase in contracting out was occurring). Hence UK government policy on commercial leases, including changes to the security of tenure legislation including those relating to contracting out procedures, are being formulated in the absence of any reliable information on the degree to which the 1954 Act is actually being excluded. Under the Australian provisions, it would be relatively easy to require that a duplicate of the lawyer's certificate appended to the lease be provided to the registrar of the Tribunal that handles disputes under this legislation. However, this is not contained in the South Australian or ACT statutes.

3. Statutory exceptions

The Australian statutes each define the circumstances in which the tenant does not have a right of preference. These provisions, which bear some resemblance to those in the UK governing the circumstances in which a landlord is entitled to oppose the grant of a new tenancy, are clearly designed to meet landlords' concerns that they might be forced to renew where there is a good reason for not doing so. Both Australian Acts state that there is no right of preference where:

- the landlord reasonably wants to change the tenancy mix in the shopping centre;
- the tenant has been guilty of substantial or persistent breaches of covenant;
- the landlord does not propose to re-let the premises within the 6 months following the end of the lease and, during that period, requires vacant possession for the lessor's

[18] Although hard evidence is difficult to come by, public pronouncements by some UK landlords, eg Grosvenor Estates and Lend Lease are a clear indication of a landlord imposed policy of contracting out.

own purposes (but not to carry on a business of the same kind as that carried on by the tenant).

In addition, in South Australia there is no right of preference where:

- the landlord requires vacant possession of the premises for the purposes of demolition or substantial repairs or renovation; or

- the renewal or extension of the lease would substantially disadvantage the landlord.

It is thus clear that, despite landlords' protestations that security of tenure legislation protects poor and/or under-performing tenants, this is not the case. Such tenants are often in breach of covenant and, in practice, usually do not wish to renew. This is borne out by the JHD data (Jebb Holland Dimasi, 2001) which indicates that the tenants in 44% of the tenancies which were not renewed did not wish to do so because of the poor performance of their businesses. The dearth of case law on the very similar provisions in the 1954 Act, and the lack of complaint from UK landlords, supports this view.

The ability of landlord to avoid renewal where he requires possession for his own purposes is a wider and more ambivalent provision than its nearest equivalent in the UK (which applies only where the landlord wishes to occupy the premises for the purposes of operating his own business therefrom). The English version is regarded as almost invariably inapplicable in a shopping centre since the landlords of such premises do not wish to operate their own business from a retail unit. The Australian provisions are replete with safeguards - the preclusion on re-letting within 6 months means that they cannot be used as a ploy to prevent renewal and the landlord is explicitly prevented from effectively taking over the tenant's business. However, there is no other limitation on the purposes for which the landlord requires the premises and therefore the scope of this provision is both wide and uncertain.

The South Australian legislation allows the landlord to avoid renewal where he needs vacant possession for the purposes of demolition, substantial repairs or renovation. This is a wider and very much more landlord-friendly provision than its UK version (which, in practice, is the most commonly used ground of opposition to renewal). Importantly it will allow landlords to prevent renewal in order to facilitate major repairs and refurbishment, matters which, to the frustration of UK landlords, are not readily covered by the 1954 Act which is limited to structural works. The South Australian provisions leave room for disputes to develop over what constitutes "substantial repairs or renovation".

Unquestionably the most important and controversial circumstance in which the Australian landlord will be able to side step renewal is in order to change the tenancy mix in the shopping centre, a ground which is simply not provided for in the UK. This provision is designed to meet landlords concerns that shopping centres need to remain dynamic and adaptable if they are to fulfil the changing demands of consumers. It may be that this provision will not turn out to be as important as landlords imagine. As has already been pointed out, the very nature of a right of preference offers scope for a sitting tenant simply to be outbid by a more modern and fashionable incomer without any need for the landlord to establish that the existing tenant has no right of preference. However, given the structuring of the legislation, there will be advantages to a landlord in proving at the outset that there is no right of preference at all, if only to avoid the procedure imposed by the Acts. Where this is the case, it is hard not to conclude that there is plenty of room for argument on the scope of these provisions. While "tenancy mix" has a well recognised meaning in the property industry which is confined to a spread of uses, it is possible to argue that, in law, it could carry a rather wider meaning as to the features of the tenancy which can be mixed. It was suggested in parliamentary debates and in evidence to the Victoria Office of Regulatory Reform (Discussion Paper, 2001) that the wording may require a substantial, say, 20-30%

change in the tenancy mix before the provision can be relied upon by a landlord and that it cannot be relied upon in respect of a single tenancy. While this seems unlikely, such an interpretation would be serious for landlords. More realistically, there is bound to be uncertainty as to the degree of change to the particular tenancy which the landlord must be reasonably wanting: will a relatively small change of use warrant a denial of preference rights?

Finally, the South Australian provision, which has already been alluded to, under which there are no rights of preference if the landlord will be "substantially disadvantaged" by a renewal. Its drafting as an exception poses an immediate difficulty in that it is hard to see how a substantial disadvantage can be proved without a comparison being made between a potential letting to the sitting tenant and one to an incomer. However, an exception is supposed to avoid the requirement that a landlord negotiates with his sitting tenant. Even then, the wording of the exception is such that it could, in principle, cover almost anything. However, if viewed in the light of the overall scheme, its range narrows quite dramatically. It cannot refer to the terms of or rent for the renewal since the existing tenant must, in effect, match any offer from another person. It cannot be designed to cover a defaulting tenant since other provisions deny such tenants a right of preference. It would not appear to cover the situation where the landlord would otherwise be tied to an unfashionable use, since he is allowed to change the tenant mix. It may therefore only be applicable to the elusive issue of tenant quality. Hence it may provide a basis for the landlord to avoid renewal to an under-performing (yet compliant) tenant or to allow the replacement of an adequate tenant by one who is more attractive to investors. Alternatively, it may mean nothing at all and be designed purely to offer comfort to the landlord lobby.

4. Procedure and implementation

The procedure governing renewal imposed by the Australian legislation is relatively straightforward, especially compared with that in the UK where both the strictly time limited service of notices and the making of a court application are an essential part of the process[19]. Under the South Australian scheme, between twelve and six months before the end of the lease, the landlord must either offer terms of renewal or inform the tenant that the landlord does not intend to renew the lease (and give the reasons). If the tenant is not notified within this time, the lease is extended until six months after the landlord does give notice. In the ACT, the onus is on the tenant to serve a notice between twelve and six months before expiry, requesting that the landlord explain whether the renewal rights will be contested.

The landlord cannot let the property to anyone else without making a written offer to the tenant on terms no less favourable than those offered to that other person. This offer must be kept open for a stated period which must be at least 10 days. If not accepted within that time, the landlord is free to let to someone else.

However, the simple approach is not always best and one glaring omission appears to be the absence of any preservation of the tenant's status quo while any disputes are resolved. UK experience suggests that disagreements over whether or not the tenant has a right of renewal may drag on and can require court intervention; there is no reason to suppose that this will not also happen in Australia. Under the UK system, if delays of this kind overrun the contractual term date, the tenant's existing lease is continued. There appears to be no equivalent provision in either of the Australian Acts; once the landlord has given at least 6 months'

[19] Although it is this procedure, and notably the need to make a court application, which is to be re-modelled under the current review (DETR Consultation, 2001).

notice[20] that the tenant has no preference rights, it seems to be assumed that any dispute will be resolved within the remaining period of the lease. It is for the tenant to take positive steps to initiate dispute resolution procedures and if he does not do so before the expiry date of the lease, even where the matter ends up in court, there is no preservation of the existing lease.

The other reason for providing for the continuation of the existing lease under the UK system is the delays which may occur while the parties negotiate the terms of any renewal. The nature of a right of preference seems likely to minimise (but not necessarily eliminate) this problem. Provided that the landlord has someone else waiting in the wings, he can always put the existing tenant on the spot by making a written and "no less favourable" offer; the tenant must then either accept that offer or walk away.

One final aspect of the Australian schemes which merits comment concerns the sanctions for non-compliance. This is a matter which does not give rise to problems in the UK because of the one to one nature of the right of renewal and the preservation of the tenant's existing lease until any disputes are resolved. Both pieces of legislation allow a tenant who is prejudiced by any non-compliance by the landlord to take their dispute either directly to the Magistrate's Court (ACT) or to that court after trying mediation (South Australia). The court can order the landlord to renew the lease (or grant a new lease) on terms approved by the court. However this cannot be done where this would prejudice a third party who has honestly acquired an interest in the premises). Alternatively, the court can order the landlord to pay compensation, not exceeding 6 months rent, to the tenant.

Thus, the tenant is not automatically protected in his rights to the actual premises; if the landlord does not make a written offer by the end of the existing lease and then re-lets in defiance of the right of preference, the existing tenant may lose out unless the incomer can be shown to have been dishonest (a matter which, in the UK, is often very difficult to prove). Once the tenant is left to a compensation claim, this is capped at the equivalent of 6 months' rent, a figure which may bear no resemblance to the business losses, perhaps especially of a recent assignee.

IV CONCLUSIONS

A. DO THE NEW REGIMES CONFER A REAL BENEFIT ON TENANTS?

It has been shown above that preferential rights do not give tenants the same benefit as rights of renewal. Protected Australian tenants are completely exposed to any alternative bids for their premises at the end of their leases and cannot assume that they can remain if willing to renew at the open market rent. The procedure for renewal is relatively straightforward but it can require tenants to take positive steps to exercise their renewal rights, if the landlord ignores the legislation. Tenants appear to be handicapped because, first, they cannot overturn a lease over their premises granted to a new tenant and, secondly, it is not clear how their rights are preserved if a renewal has not be agreed by the date of expiry of the existing lease.

The use of certified exclusionary clauses may become the norm in shopping centres, making the provisions largely meaningless. The statutory exceptions in both South Australia and the Australian Capital Territory are broad but not entirely clear. Disputes can be expected over terminology such as substantial advantage of leasing to a new tenant, non-renewal for

[20] The South Australian Act does provide for a continuation where the landlord has failed to give notice that there is no right of preference, Retail and Commercial Leases Act 1995, s 20G(1); there is no equivalent provision in the ACT legislation.

substantial repairs and renovation, non-renewal in order to change the tenancy mix and the equivalence of offers by new tenants. Until these loopholes and the procedural looseness are clarified, either by legal decisions or legislation amendments, the degree of protection afforded to tenants is a little uncertain.

In summary, the rights of preference do improve the tenants bargaining position at the end of the lease but contracting out, the exceptions and the ceiling on compensation (if the tenant's renewal rights are wrongfully denied) all limit the benefits. Irrespective of the technical shortcomings of the schemes, they may give tenants more confidence in their right to remain. However, the tenants are likely still to feel vulnerable when negotiating lease renewals as they must match any bid by another tenant for any use of the shop.

B. DO RIGHTS OF PREFERENCE SERIOUSLY IMPEDE MANAGEMENT AND INVESTMENT?

Landlords have consistently held that renewal rights will seriously impede the management of and investment in shopping centres and have vigorously and, largely effectively, campaigned against their introduction in most states in Australia. The statutory exceptions (ie tenancy mix, defaulting tenants, and building works) meet the usual reasons why landlords do not wish to renew. However, the drafting of these provisions is loose in many ways. They will inevitably be tested in the courts and, in the meantime, create uncertainty and take up management time.

Substantial disadvantage as a ground for not renewing may be of little practical significance but the ability to take bids from potential tenants enables landlords to defeat most underperforming tenants' rights of renewal. Preferential rights are not as strong as the rights of renewal of UK commercial tenants because it appears easy for landlords to push an existing tenant into matching an outside offer. Renewal rents are not directly limited to open market rental value, leaving greater scope for landlords to massage rents upwards at renewal than under the UK system[21]. This assists in maintaining investment performance. Rights of preference do prevent a landlord from replacing an existing tenant with, first, an incomer who cannot yet match the existing tenant's offer but who may have more potential or, secondly, a tenant that might add more standing to the centre and as such might argue for a lower rent (unless these involve changing the tenancy mix).

The procedure for renewal is not onerous for landlords and does not result in automatic renewal if neither party follows the procedures. Compensation levels are capped. Both current Australian schemes allow contracting out. The UK experience suggests that the shopping centre environment is one in which it is particularly easy for landlords to adopt a blanket policy of up front exclusion. It is therefore arguable that rights of renewal are not greatly restrictive for landlords. However, they are an administrative burden.

It will be difficult to determine whether investors stun the ownership of shopping centres in those states in which preferential rights of renewal are available to tenants, as suggested by the Property Council of Australia (Victoria, 2000, p.9). There are two many differences between regulations, government policies and economic performance of the states to isolate the effect of security of tenure. Nevertheless, the threat that capital may be removed f security of tenure is granted is a potent factor causing other State governments to hesitate before following South Australia and the Australian Capital Territory. It is hard to imagine that landlords will be frightened away from shopping centres simply because on odd occasions they cannot remove a complying tenant who is weaker than a potential new one.

[21] It is not uncommon for landlords in the UK to buy in one or more leases in shopping centres when the other leases are approaching renewal (or rent review) in order to achieve a high open market letting which will then set the tone for the renewals.

C. IS SECURITY OF TENURE NECESSARY?

JHD data shows that 74% of shopping centre leases are renewed; of those that were not, 44% were cases where tenants did not wish to renew because their businesses were not sufficiently profitable and the second biggest category (nearly 16%) were refusals by landlords to renew because the shopping centre was being re-developed (Jebb Holland Dimasi, 2001). This data has been used by landlords to argue that renewal rights are not necessary because most leases are renewed anyway and most of those not renewed are at the tenants' wish. The data can also be used to confirm that preferential rights of renewal make very little difference to landlords.

If the current consultation in Victoria reflects present attitudes, there is some indication that tenants' bodies are less insistent on security of tenure, pressing instead for rules which will improve a sitting tenant's bargaining position at a negotiated renewal. The main allegation of the Australian Retailers Association (Discussion Paper, 2001) was not that renewals were not offered but that they were only offered on the basis of exorbitant rent increases. There was little evidence to support this or refute the JHD data indicating that rental increases were, on average, only 3.5%.

It may be that, if the main problem is the imbalance in the negotiation of rents and other terms of renewal, security of tenure is not the most effective way of controlling the landlord's dominance. It appears at this stage that the Victorian Government may well pursue alternatives such as a requirement for an independent rental valuation if the lease is renewed (Discussion Paper, 2001, p40).

It seems unlikely that any Australian state will currently go so far as to introduce rights of renewal, as opposed to rights of preference. Australian retailers have sought rights of preference and were perhaps not fully aware of the limitations that have been demonstrated above. If the JHD data is reliable, it is arguable that the administrative inconvenience and current uncertainty do not justify the "fair trading" gains of conferring preferential rights on tenants. The legislation, in carefully trying to appease an aggrieved minority of tenants and yet preserve the landlords' "property rights", is largely unsatisfactory to both sides. Because the current statutes were born out of extreme positions taken by landlord and tenant groups, rather than an attempt to jointly achieve effective regulations, they may be shortlived and unlikely to be replicated in other States.

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