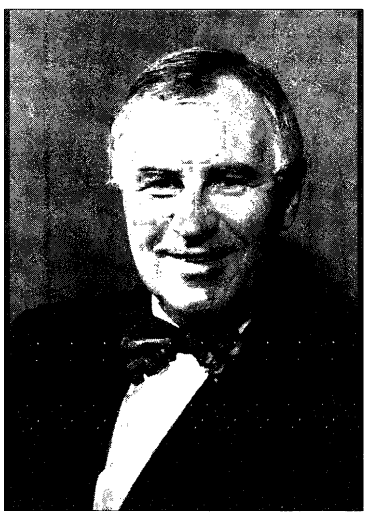
The Trade Practices Act and retail tenancy — is it working?



This is an edited version of a speech given by Commissioner John Martin at the Australian Retailers Association Conference, ARA Managing the Asset Retail Tenancy Forum 2001, on 27 February 2001. Commissioner Martin examines the unconscionable conduct provisions of the Trade Practices Act, especially the new provision introduced in 1998 — s. 51AC. He shows that the Act does have teeth when it comes to the landlord–tenant relationship, but urges all parties in any dispute to try to reach settlement before taking a matter to court.

Introduction

During 2000 retail tenancy was one of the priority areas for the Commission, particularly in light of some major developments in the law of unconscionable conduct.

The Commission has a dual role:

- as a national enforcement agency; and
- in educating and providing information for business and consumers to help them comply with the Trade Practices Act.

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

The Commission is currently persuing 44 cases. However, most of the these actions will not go to court but will end with administrative settlements such as court enforceable undertakings being provided by the offending party.

Commission's role with small business

Over the past two years the Commission has upgraded its education programs and information for small businesses. Its outreach program to small business evolved from the Government's decision in 1998 to strengthen the Act and provide resources to address unconscionable behaviour by larger business dealing with small business.

The activities of the Small Business Unit in the Commission and the appointment of a Commissioner responsible for small business are also to help small businesses avoid or manage problems well before they lead to litigation.

The Small Business Unit has developed a wide network of contacts for getting messages out to small business. These emphasise how understanding and compliance reflect good management practice and will help businesses succeed and be profitable. The messages are pro-business and effective.

Our communication with small business is not one-way. The Commission has also consulted with business and professional representatives and the Small Business Commissioner chairs the Small Business Advisory Group which meets regularly.

Testing the new unconscionable conduct provisions

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

In 2000 the Federal Court handed down decisions in two of these cases and another two under s. 51AA. Three were retail–tenant and landlord disputes; the fourth was on franchising but directly relevant to retail tenancy.

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

Well before the outcome of these cases, however, discussions with groups such as the Property Council had indicated that larger businesses are taking the unconscionable conduct provisions seriously. These businesses have developed comprehensive compliance arrangements to avoid breaching this area of the Act. But, it seems that awareness among second and third tier landlords is much lower.

Complaints and inquiries relevant to the new s. 51AC provision were almost the same in 2000 as in the previous year (507 compared to 492 in 1999). However, those relevant to s. 51AA increased to 263 in 2000 from 176 in 1999.

The numbers in 2000 were fairly consistent over the first half of the year and the fourth quarter. But there was a sharp increase during the third quarter, possibly from an increased awareness of the unconscionable conduct provisions after some recent cases. The Commission will continue to closely monitor trends over 2001.

Part IVA of the Trade Practices Act contains the three sections relating to unconscionable conduct.

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

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

The third, s. 51AC, is more narrowly focused. It specifically prohibits one business dealing unconscionably with another. Section 51AC was introduced in 1998 as part of legislation to improve the legal protection and remedies available to small business. It sets out factors the courts may consider that relate to bargaining strength, and a sample list of circumstances under which the smaller party is being required to submit to unreasonable conditions.

Cases under s. 51AC

Section 51AC has the greatest impact on the rights of retail tenants.

Leelee

This was the first case decided under s. 51AC.

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

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

On 15 June 2000 the Federal Court granted a declaration against Leelee, that it engaged in unconscionable conduct towards the Choongs. It also granted a declaration against Mr Pua Hor Ong, director of Leelee, that he aided or abetted or was knowingly concerned in the contravention. The court granted injunctions against the company and its director in relation to their future dealings with tenants at the food plaza.

The court declared that Leelee engaged in unconscionable conduct by:

- consenting to, or giving approval for, another tenant to infringe on the exclusive menu entitlements conferred by Leelee on one of its tenants; and

- specifying the price at which its tenant sold dishes in a manner that unfairly discriminated against, or inhibited, the tenant's ability to determine the prices at which its dishes were sold in competition with another tenant.

The court granted injunctions, for three years, restraining Leelee and Mr Ong in relation to matters concerning exclusive entitlements, tenants' pricing, lease negotiations and information disclosure.

This decision was a positive first step for retail tenants. It provides a concrete example of conduct by a landlord that is regarded as more than just tough commercial behaviour.

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

Simply No-Knead

The Federal Court expanded on the parameters of s. 51AC in *ACCC v Simply No-Knead*. Although dealing with franchising, the decision has implications for retail tenant/landlord relationships.

Simply No-Knead (SNK) was a franchisor that had signed up a number of small business franchisees. SNK supplied training and supplies for making bread and related products to franchisees. The operation of the franchise depended on the supply of products from the franchisor and group advertising for the franchise as a whole. A series of disputes developed between the franchisor and franchisees. As a result, the following complaints against SNK were found to have occurred.

SNK demanded that franchisees wishing to negotiate must put their requests in writing (facsimile was not sufficient). No joint meeting with franchisees was acceptable. Meetings had to be one-on-one and confined to specific matters. The 'price' of a meeting was to comply with SNK's directives. The court found this conduct to be 'unreasonable, unfair, harsh, oppressive and wanting in good faith'.

SNK had refused to supply some of the franchisees with products because they disputed either the content of advertising material or being supplied with double the quantity of flour requested. The court found this to be an unfair pressure tactic.

SNK demanded that franchisees distribute to customers brochures that referred only to the franchisor and not the franchisee. The franchisees paid for the advertising and were denied products if they failed to distribute. The court found this conduct to be 'unfair and unreasonable having regard to the franchisor–franchisee relationship, and oppressive'.

SNK directly competed within the franchisees' territories in a way calculated to damage the franchised business. The court found this demonstrated a lack of good faith by the franchisor.

When certain franchisees made written requests for the disclosure of information documents, SNK made it a condition that the franchisees had to indicate an intention to renew the franchise before the documents would be supplied. The court found this type of conduct to be bullying tactics that were harsh and oppressive.

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

This decision demonstrates that the Federal Court will consider the criteria specified in s. 51AC in deciding whether unconscionable conduct has occurred. Importantly, it establishes that those criteria do not limit what types of conduct the court may consider. This case showed they may include:

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

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

Cases under s. 51AA

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

Farrington Fayre

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

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

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

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

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

The court decided that circumstances in which a business operator on a lease may effectively lose the value of that business once the lease expires places the tenant at a 'special disadvantage' in dealing with the owner.

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

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

The Farrington Fayre decision is currently under appeal.

Samton Holdings

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

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

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

However, the tenant had to pay $70 000 to secure the extension.

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

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

This case is also under appeal.

What do the cases mean for retail tenants?

These cases represent some major developments in the law of unconscionable conduct that have major implications for retail tenancy.

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

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

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

The approach taken by the court to ss. 51AB and 51AC has established a wider definition of unconscionability and offers better protection against excessive conduct by big businesses or businesses with market power. It is hoped that, in the retail tenancy sphere, the new approach will make the small proportion of cavalier landlords think carefully about how they deal with their tenants.

Litigation is not the only way

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

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

The tenant repainted the interior and exterior of the motor inn during the last six months of the first term of the lease and the landlord was aware of this.

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

Subsequently, the landlord produced a new lease with some significant differences to the expired lease, including a substantial rent increase, additional maintenance responsibilities, removing the tenant's right of first refusal to buy the property, additional insurance requirements, and a guarantee making the guarantor liable for further terms and for defaults by future assignees of the lease.

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

The tenant then approached the Commission and was encouraged to participate in a mediation session with the landlord. When this was unsuccessful, the Commission began an investigation into whether the landlord had contravened s. 51AC. After several months of negotiation, the landlord and tenant reached a settlement late last year including several variations to the lease and a refund of approximately $16 000 in rent to the tenant.

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

The way forward: compliance and education strategies

In the Commission's experience, education is central to ensuring compliance with the Act, especially when the subject matter is as complex as unconscionability. The Commission's Small Business Program has focused on innovative, high impact and user friendly ways of training and informing the small business communities.

Competing Fairly forums

Competing Fairly is a program of local forums held in regional towns in all States throughout Australia that uses video presentation and discussion via satellite.

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

The pilot program was successful and the next forum will be held in May 2001, linking around 70 towns across Australia. Its main topic will be unconscionable conduct.

For further information, see p. 40.

Corporate video

The Commission has also prepared a corporate video to explain the legal concept of unconscionable conduct.

The video will be released ahead of the next Competing Fairly forum and will serve as a primer to help the convenors and the audiences in each town understand the key issues that arise in unconscionable conduct.

Ongoing law reform

The Commission strongly encourages developments in the law that improve the protection of small businesses such as retail tenants.

In March 2000 the small business safeguards reference group in Western Australia released a report *Small business in Western Australia: adequate fair trading protection?* The report recommends, among other things, the enactment of a small business unconscionable conduct provision that mirrors s. 51AC in the WA Fair Trading Act and the *WA Commercial Tenancy (Retail Shops) Agreement Act 1985* (CTA). To do that, the WA Government has now drafted the Fair Trading Amendment Bill 2000. It has also produced a discussion paper on the adequacy of current fair trading protection for small business in Western Australia.

The report notes that the reference group did not directly uncover substantial unfair conduct in small business retail tenancy relationships in Western Australia. However, it did uncover significant examples and concern about small business retail tenancy matters from other government agencies and reports.

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

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

The proposed amendments would extend the application of s. 51AC principles to those businesses not captured by the Trade Practices Act and would provide for rapid mediation of such disputes.

The Commission made a submission to the reference group broadly supporting the recommendations of the report.

Conclusion

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

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

A recent assessment by a leading national law firm noted that to avoid allegations of unconscionable conduct, landlords would need to ensure that a tenant seeks independent legal

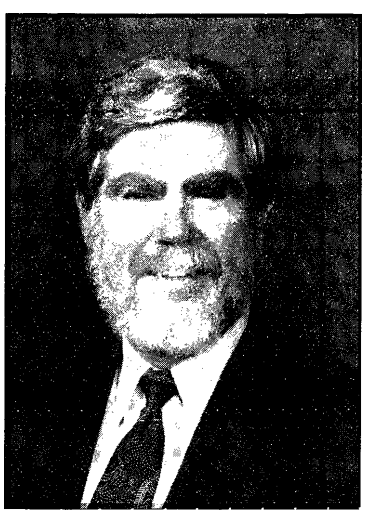
or financial advice. This is mandatory under some State-based retail legislation (for example, in Queensland as a result of the passing of the *Retail Shop Lease Amendment Act 2000*).

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

This is sound advice.

The full version of this speech will be available soon on the Commission's website at <http://www.accc.gov.au>.

Lessons from California for Tasmania and the NEM



This speech was made by Commissioner Rod Shogren, at the 4th annual Victoria Power and Gas Conference in Melbourne on 20 February 2001. Mr Shogren draws parallels between the market in California, which recently experienced an electricity crisis, and the market in Tasmania, which will soon join the national electricity market (NEM). While the differences between both markets are significant, useful lessons can be learnt.

Introduction

It has been a traumatic couple of months for electricity industries and regulators around the world. All eyes have been on California. The electricity crisis there has reignited debate about electricity market reform. Does electricity market reform work? How fast should it be implemented? What is the best market design? What is the best structure to avoid abuse of market power? How can we improve our own markets to ensure that a California-type crisis doesn't occur here?

Today I'd like to discuss some of these issues and rather than say that our market is too different from the Californian market to make any direct comparisons meaningful, I'd like to focus on some issues that have been part of the Californian debate — market structure, market rules and market power. I think these issues are all pertinent in the Australian context.

Tasmania's entry to the national electricity market (NEM) provides governments, market participants and regulators with an opportunity to refocus on getting the market structure and market rules right. California is the extreme result of getting the market rules wrong. It also provides an opportunity to assess the potential for the exercise of market power both in the Tasmanian market and its likely effect on market power in the Victorian market.

California background

On 16 January the state of California declared a state of emergency as hour-long blackouts rolled across its northern part. As a result California, which has long been held up as an innovative and dynamic market, was forced to pass new laws to allow the state to purchase electricity on behalf of the two largest retailers, Southern California Edison (SCE) and Pacific Gas & Electric (PG&E). This drastic measure was required because both utilities had had their facility to buy power with credit withdrawn because they had defaulted on payments. Generators had been exporting electricity to retailers in other states that could pay for it, making the supply situation even worse.

The Californian retailers bore the immediate financial cost of a failed market structure that did not allow them to recover costs, set prices to customers or hedge against risk. Of course the energy crisis in California has much larger financial ramifications. Without a reliable electricity supply, companies are now questioning whether they will remain in California.