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## Looking after small business tenants with voluntary codes or statutory intervention: A comparison of Australian and UK experiences.

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## I. INTRODUCTION

Crosby, Murdoch and Markwell (DETR, 2000) recently completed a review of commercial lease structures and the voluntary Code of Practice for Commercial Leases for the UK Government. This Code was put in place by the UK property industry in response to Government suggestions in 1993 that legislation might be necessary to protect tenants from landlords' demands for onerous lease terms. The use of upwards only rent reviews, standard practice in the UK commercial lease, was singled out as giving rise to particular concern. The Code of Practice was an alternative to the statutory outlawing of this aspect of the lease which was perceived by landlords to be an important feature underpinning the current price and funding of investment in UK commercial property.

The findings of the DETR research indicated significant differences between the small business tenant and the corporate occupier. It found that small business tenants were often unrepresented in lease negotiations, had a poorer understanding of the implications of the terms of the lease than corporate occupiers and were therefore far more likely to take the first terms offered. It also found that the Code had virtually no effect on the market and was not reaching the small business tenant, at whom it was primarily aimed (Crosby, Murdoch and Rowland, 2000).

Most Australian States now have legislation in place offering some protection to small businesses operating retail outlets (but very few restrictions on the relationships between landlords and business tenants outside shopping centres). The protection conferred includes pre-letting disclosure statements, initial lease terms of at least five years, restrictions on the basis of reviewing rent (including banning upwards only rent reviews) and some restrictions on the recovery of operating expenses. Despite recent revisions to the retail tenancy laws following a Parliamentary report (Commonwealth of Australia, 1997), many landlords and tenants remain dissatisfied.

In Australia, there is pressure from retail tenants for the introduction of statutory rights to renew. Landlords are resisting and are contending that the granting of such rights would adversely affect investment values. In most parts of the UK, statutory renewal rights are available for business tenants. Although these can be excluded by agreement, landlords are nevertheless pressing for the repeal of this legislation.

Contrasting the regimes in the UK and Australia may shed some light on the effects of statutory renewal rights and other legislative controls on the operation of leasing markets. The operation of the laws protecting retail tenants in Australia at the start of and during leases could inform the current debate in the UK concerning the possibility of further legislative interference, which might be directed at small business tenants. The UK experience of statutory rights to renew business tenants may indicate how such rights would influence property investment markets in Australia.

Comparing the effects of legislative intervention into property markets in the UK and Australia is made easier by the shared common law heritage. Although there has been some convergence of leasing practices, notably the recent trend to shorter leases in the

UK, comparisons cannot overlook the difference between the typical commercial leases in the UK and Australia.

The major aim of the paper is to review the current legislation in a number of different States of Australia and in the UK and to compare the impact of each statutory regime on the landlord and tenant relationship.

The objectives of the paper are to:

- review the debate concerning the protection of small business tenants and their relationship with landlords in both Australia and the UK;
- compare the outcomes of the debate in the form of statutory intervention and/or Codes of Practice and examine the reasons for each outcome; and
- discuss the implications of the comparison for the future relationship of small business tenants and their landlords in each jurisdiction.

## **II. THE PROTECTION OF BUSINESS TENANTS: THE DEBATE**

### **A. The arguments for and against protection**

Most countries in which business premises are leased have at some stage considered whether or not to intervene between landlords and business tenants. The arguments for limiting the freedom to contract are based largely upon the (perceived) excessive power of many landlords. Tenants in many markets claim that landlords are able to dictate the terms of leasing when the lease is being negotiated and when it is being drawn up (usually by the landlords' legal representatives). Subsequently, many tenants view their leases as instruments that limit the prospects for their businesses for the benefit of their landlords, rather than contracts for the mutual benefit of both parties.

Rather than the lease being a long term "relational" contract which the parties leave flexible for their business relationships to develop (as would be predicted by Goldberg, 1980 and MacNeil, 1978), unregulated leases tend to be highly prescriptive. The tenants' businesses often become more dependent upon the premises the longer they remain in occupation, leaving them in a progressively weaker bargaining position as the end of the lease approaches.

Some markets exhibit the characteristics of an oligopoly with a few landlords offering most of the premises. The landlords may use their position of control to impose lease conditions that are unfavourable to tenants. This meets less resistance from most tenants than increasing initial rents because tenants concentrate on gaining entry to open business (Barnett, 1990:64). When the lease is being negotiated, tenants are inclined to overlook those lease provisions that do not affect the operations of their businesses until the later years of and at the end of their leases. It may be either that some tenants do not understand the implications of lease provisions until they are invoked by their landlords

or that the tenants are subjected to pressure from their landlords to take the lease on standard terms.

However, the case for control over commercial tenancies must overcome the generally accepted principle (in market-driven economies) that the parties to any commercial contract should be left free to form whatever agreements enable them to operate effectively. Economic theory tells us that this freedom should result in the lowest costs of goods and services for the consumer.

Further, landlords point out that on many occasions tenants have the stronger bargaining position (such as when the tenant is a major company or when demand is slack). Landlords contend that universal protection leaves them vulnerable to abuse by powerful tenants.

## **B. The range of the protection**

The “protection” offered to a tenant of business premises could consist of no more than the effective enforcement of the contractual terms which were negotiated by the parties. However, in many jurisdictions there is government intervention, to a greater or lesser extent, with this basic freedom of contract. Not surprisingly, this intervention varies in its form, its scope and its nature. Before examining how the protection conferred has developed in the UK and Australia, it is useful to outline both the issues raised and the range of measures which have been either considered or actually adopted.

### **B. (i) The form of any intervention**

In common law jurisdictions a limited incremental change in the legal status quo can be achieved through judicial decisions. However, traditionally, judges have refrained from intervening in private contractual rights. Particularly in the first half of the twentieth century, this stance allowed those with the dominant bargaining power in developing market economies further to strengthen their position by the imposition of one-sided contractual arrangements. The contractual aspect of leasing arrangements meant that this approach tended to be applied equally to leases of land, while its proprietary nature operated as an even more constricting force. Furthermore, because of the retrospective effect of case law, judiciaries have tended to be very reluctant in the real property law field (in which long term arrangements are frequently entered into) to develop the law in this way and prefer to leave reform to Parliament.

Accordingly, the debate always used to be the relatively simply one of whether or not there should be any outside intervention in private contractual arrangements. If so, it would always be expected to take the form of legislation. However, legislation consumes valuable parliamentary time and is expensive to enforce (an expense which is ultimately borne mainly by the community). It also tends to be divisive and may hinder the co-operation between landlords and tenants that can enhance the performance of their property over others, such as in the marketing of a shopping centre or the presentation of an office building. As a result, in both the United Kingdom and Australia, there has been some tentative use of voluntary codes of practice. For governments these can avoid

confrontation with the often economically powerful interest groups representing landlords. Not surprisingly, landlords and their organisations often maintain that such codes are sufficient to avoid the poor practices of a few unrepresentative landlords and to ensure that tenants are better informed about the implications of the leases that they sign. However, there will always be doubts that the behaviour of a recalcitrant minority can be corrected by a voluntary code. A cynic might suggest that landlords support codes in the hope that these will diffuse pressure for legislation; voluntary codes can be ignored once the disquiet has died down.

### **B. (ii) The scope of protection**

All jurisdictions have had to consider the type of business tenants to whom protection is to be given. Protection can be afforded to tenants of particular types or it can extend to premises of particular kinds. Either of these may be defined according to size (for example, company profits, breadth of business ownership, floor area or rental value) or usage (business category, building type, current use or zoning).

There are a variety of factors which are likely to be regarded as relevant when seeking to identify particular groups of tenants who are most at risk. First, some form of protection is usually considered for those tenants who have little bargaining power in lease negotiations. This leads to pressure to take steps to restore some balance to lease negotiations between small businesses and more experienced and substantial landlords. However, it is clear that such imbalances may occur irrespective of the size of the business. For example, negotiations will be imbalanced whenever a tenant has little understanding of the nature of his lease or whenever there is a grave shortage of suitable premises.

Second, those tenants whose business depends heavily upon the location of their premises will always be anxious to be given security of tenure because they inevitably become vulnerable towards the end of their leases. Because retail businesses create more locational goodwill than office or industrial users, the case for security for retail leases is always strongest. However, it is clear that the consequences of being forced to re-locate at the end of a lease can be severe, not just for non-retail businesses but also for other users such as professional tenants or non-profit making organisations. The lack of a right to renew will encourage longer leases particularly in good retail locations but in the UK, even where the right to renew exists, landlords have been reluctant to grant shorter leases because of the perceived effect on asset capital value and funding of transactions by lenders.

Third, consideration has to be given to whether, where security of tenure is conferred, this should be confined to those who have operated their businesses for a minimum period of time and whether the security given should be personal to the particular tenant or whether it can be transferred along with the lease. Those jurisdictions which do impose a minimum period of occupation as a pre-requisite of protection have found that this results in a distortion of their property markets as landlords tend to insist on leases which fall below that minimum. Where security is proprietary rather than personal, it must

inevitably add what landlords will regard as unmerited value to a lease for the tenant even when it is approaching expiry.

### **B. (iii) The nature of the protection**

Most reasonably developed legal systems in which the leasehold system operates has at some stage considered a variety of ways in which to intervene in the contractual relationship between landlord and tenant. In the context of commercial leases, the elements of protection can be classified as follows.

- **Protection during the negotiation**

The objective of intervention dictating how leases should be negotiated is to ensure that tenants are made aware of their long term commitments. The rationale for such interference is the same as the protection given to consumers who may not appreciate the implications of contracts they sign. It is designed to correct the imbalance in the understanding of the leasing process between tenants, who frequently enter the leasing market on only an occasional basis, and landlords, who are often regularly and professionally involved in the grant of leases.

The intervention in this area, which can be by way of common law principles, legislation or codes of practice, tends to fall into three categories. First, that of a quasi contractual nature such as the common law controls on misrepresentation. Second, there is consumer type protection, such as minimum disclosure requirements, or the imposition of cooling off periods, or best practice guidance provide by codes of practice. Finally, some jurisdictions impose criminal liability in respect of property misdescriptions.

- **Protection during the lease**

The purpose of controlling what occurs between the parties during the course of the leases can be either to outlaw conditions or practices that are considered undesirable or to impose standard covenants that are regarded as objectively “fair” and readily understandable. The legislature or the courts may insert covenants where these have been overlooked by the parties, may make certain covenants void or voidable by the weaker party, or may control the way in which lease obligations can be enforced.

- **Protection at lease end**

Because it is generally believed that the position of a tenant becomes weaker towards the end of a lease, consideration is often given to providing legal safeguards at this point, particularly against demands for possession by the landlord. Legislation which, at the very least, ensures that a tenant is compensated for any loss of goodwill or for the value of improvements, but preferably confers security of tenure is sought keenly by tenants whose businesses are tied to their existing premises. However, it is resisted by landlords, who argue that the proper management of their investments, particularly if they are multi-tenanted complexes, is hindered if they cannot change the businesses to suit the needs of consumers and other users.



### **III. THE EVOLUTION OF PROTECTION**

#### **A. The United Kingdom**

##### **A. (i) The form of intervention**

As already indicated, most outside intervention in commercial leases has taken the form of primary legislation. It is worth noting that the UK Government is intending to implement its current proposals for reforming the Landlord and Tenant 1954 Act (the main legislation in the UK providing security of tenure for business tenants) by means of the proposed Regulatory Reform Bill. This measure will extend significantly the circumstances in which primary legislation can be amended without the need to go through the full parliamentary scrutiny procedures. If this happens, these lease reforms will not be exposed to the level of public debate which might otherwise have occurred.

Although the traditional approach has been through the imposition of legal binding rules, in the last few years there has been some tentative use of voluntary codes of conduct. In 1994 the property industry initiated and drafted a code of conduct on service charges – Service Charges in Commercial Property – A Guide to Good Practice. Furthermore, in 1995 the Government was actively involved in persuading the property industry to experiment with the use of a more wide ranging voluntary code - the Code of Practice for Commercial Property Leases in England and Wales. To date, as we discuss further below, it cannot be said that these experiences have been successful (see DETR, 2000; Hughes, 2000).

##### **A. (ii) The scope of protection**

In the UK, from the outset of pressure for protection for business tenants in the nineteenth century right up to the present day, the language of those seeking intervention and those considering it (notably, government committees, government department consultations and the Law Commission) have almost invariably talked in terms of the needs of the “small” business tenant. However, closer examination of the debate reveals that it was only in the very early days, when business tenants who also lived on the premises were given the benefit of legislation designed to protect residential tenants, that protection was confined to “small” tenants by placing rateable value limits on the premises to which the scheme could apply. Once tenants of commercial premises were given their own discrete system of protection, the suggestion that it should be limited to small businesses was summarily rejected (see the Leasehold Committee, Interim Report 1949) and, perhaps surprisingly given the increasing divergence between the corporate and small business occupier in the second half of the twentieth century, and the continuing governmental expressions of concern for the small business tenant, this issue has never re-surfaced (see Crosby, Murdoch and Rowland, 2000).

Limitations on the type of business to be protected have been imposed at some time and in some parts of the UK and Eire. So, for example in England and Wales, until 1954, business tenants could only qualify for protection where they had carried on the business at the premises for at least five years; in Eire, there remains a requirement for a similar

period of prior business occupation before any intervention can arise. Furthermore, the pre-1954 Act form of protection in England and Wales was dependent upon proof of adherent goodwill; this effectively excluded manufacturers and non-profit making organisations, while professionals and tenants of on-licensed premises were expressly excluded. Whilst the pre-condition of adherent goodwill and the exclusion of professional tenants was removed in 1954 (and tenants of on-licensed premises brought within the fold in 1989), this opening up of protection to virtually all types of business (as is the case in both Northern Ireland and Eire) has never been a feature in Scotland; there it is only retail tenants who have the benefit of some very limited statutory intervention.

### **A. (iii) The nature of protection**

#### **A. (iii) a. Protection during lease negotiations**

Although over many years various UK Government and Law Commission reports have acknowledged the inequality of bargaining power between landlord and tenant generally, it was not until relatively recently that there has been any attempt to level the playing field at the negotiation stage. Even now, the only measure in place specifically aimed at negotiations for business leases differs markedly from its more toothsome versions in other fields of law such as consumer sales, hire purchase and credit bargains.

Prospective business tenants have, to a limited extent, benefited from some legislation aimed primarily at protecting consumers during contract negotiations. English law has long offered civil law remedies to those who have been induced to enter into *any* contract by a misrepresentation whether fraudulent, negligent or innocent. However these were grossly inadequate until the improvements introduced by the Misrepresentation Act 1967; it is clear that this area of the law now offers some genuine protection to all contracting parties, including business tenants. Those offering goods for sale or hire to consumers have for some time been subject to criminal liability in respect of misdescriptions. (Whilst a criminal prosecution does not result in compensation for the victim, its threat does operate as a significant incentive to eliminate the offending behaviour.) In 1991, these principles were extended to those buying or leasing real property.

The measure most directly affecting business tenants during the course of lease negotiations is non-legal - the Code of Practice for Commercial Property Leases in England & Wales. Its origins can be traced back to the Burton Report (Burton, 1992) which had highlighted anxieties that the increasingly non-negotiable nature of the institutional lease (a set of standard lease terms which dominated the UK good quality commercial property market up to the property crash of 1990; a 20-25 year term, upwards only five year rent reviews to market rent and full responsibility for repairs and insurance with the tenant amongst others) was posing particular problems for the retail sector generally. The issues raised (which were not primarily concerned either with small retail businesses or the inequality of bargaining power) provoked the Department of the Environment into issuing a Consultation Paper dealing with various aspects of the standard commercial lease which were giving rise to concerns; notably the upwards only form of rent review clause, the use of confidentiality clauses and the procedures for resolving rent review disputes. Whilst the results of this consultation exercise persuaded

the Government to hold its hand for the time being on legislative intervention on the content of leases, it only did so on the understanding that the property industry would draw up and operate a voluntary code of practice for commercial leases which was expected in particular to draw tenants' attention to the implications of upwards only rent reviews and to encourage flexibility on other lease terms.

Perhaps surprisingly, given the lack of emphasis in the Consultation Paper to inequality of bargaining power between landlord and tenant, especially in the context of small businesses, the Code of Practice for Commercial Property Leases in England & Wales (Commercial Leases Group, 1995) was very much designed to help the small business tenant through lease negotiations (see the Ministerial Statement at the launch of the Code on December 14 1995). Its stated aims include:

- To “improve practice ... when the grant of a lease is being negotiated ...”;
- To “encourage greater flexibility and choice through improved awareness of the alternative terms and conditions which may be negotiable”;
- To “promote greater openness and disclosure in the property market so that negotiations ... are conducted with the benefit of more complete and accurate information”;
- To “ensure that businesses know more about how the market in commercial leases operates”.

Ill-named, this document was never really intended by either the Government or the property industry to operate as a code of practice in the sense of requiring, for example, landlords to make a clear statement of letting policy to prospective tenants, or compelling the disclosure of specific information (say, on service charge costs) to prospective tenants, or of giving prospective tenants time to consider their position by insisting on a “cooling off” period. Rather, it emerged as a measure designed simply to produce a better informed prospective tenant who could then more readily fend for himself at the negotiation stage of a commercial lease. As we shall see, it has turned out to have little or no impact.

#### A. (iii) b. Intervention on lease terms

##### **Content of lease terms**

English law has always been slow to intervene so as to imply additional contractual terms or to outlaw or modify existing terms in general and this reluctance is even more marked in respect of land contracts. Broadly, contractual terms will only be implied in order to give the bargain “business efficacy”; terms will not be added in order to render the deal more fair or more reasonable. This has meant that any serious inroads into the principle of freedom of contract has had to be imposed by legislation.

To date, consumer orientated legislation in the UK has concentrated on intervening in consumer contracts for the sale or supply of goods and services. Thus, the Unfair

Contract Terms Act 1977 positively excludes contracts insofar as they dispose of an interest in land and the court have been unwilling to accept the argument that the 1977 Act could apply to the “non-dispositive” provisions in leases. The drafting of the far more wide ranging provisions of the Unfair Contract Terms in Consumer Contracts Regulations 1994 (which implemented the European Community Directive on Unfair Terms in Consumer Contracts) was widely, but not necessarily correctly (see Bright and Bright, 1995) perceived as not applying to land contracts at all. However, the wording of the current form of these Regulations (which came into effect in 1999), although far from perfect, makes it tolerably clear that “consumer” land contracts are now covered (Bright, 2000).

Despite this reluctance to intervene on any general basis in the content of lease terms, there is a significant history of both considering and implementing controls in respect of specific lease terms. Whilst, inevitably, these are almost always developed through the medium of legislation, the courts have recently shown some limited signs of creativity.

Ever present on any list of specific provisions giving rise to concerns have been covenants restricting dispositions, improvements and user. The extent to which landlords should be allowed to restrict tenants in these areas has been reviewed by Government Committees in 1920 and 1950 and by the Law Commission in 1985 and 1987. This has led to the imposition of legislative controls in 1927 and 1988. The other major area of concern relates to repairing obligations. The need for statutory intervention has been considered by the Jenkins Committee in 1950 and by the Law Commission in 1975 and 1992 and 1996. However, the only legislation which has actually been brought into operation relates to residential property. By way of contrast, there has been no consideration of statutory intervention on behalf of business tenants in other important areas, notably insurance provisions and service charges generally even though these areas of the law have seen significant legislative protection in respect of residential leases.

The most recent concern of government has been the almost universal employment, since the 1970s, of the upwards only form of rent review in business leases. Its allegedly deleterious effect on retailers was a central plank of the Burton Report (1992) and these concerns were taken up in the Consultation Paper on Commercial Leases issued by the Department of the Environment in 1993. It was hoped that the introduction of the Code of Practice in 1995 would have an impact on its use but, as we discuss further below, this has not materialised.

The one area of leasehold obligations in which the courts have shown signs of initiative has been that of non-derogation from grant and quiet enjoyment. The ambit of the landlord’s liability under these closely related principles has been significantly broadened. As a result, business tenants in particular are now better protected against activities of both their landlord and fellow tenants which adversely affect their commercial operations.

### **Enforcement of lease terms**

The third area in which it can be necessary to restrict the parties' freedom of contract is in the actual enforcement of lease obligations since the over-zealous landlord can either prematurely determine the tenant's lease, or drive the business to give it up. In addition, that unique feature of the UK (excluding Scotland) institutional lease – privity of contract – has enabled landlords to enjoy the luxury of being able to enforce lease obligations not simply against the current tenant but also against the original tenant (and, in practice *any* former tenant) for the whole duration of the lease.

The unrestricted use by landlords of their remedies of forfeiture, distress for non-payment of rent and the pursuit of substantial damages whilst a significant period of the lease is yet to run have all been matters of concern for some considerable time. Statutory controls on the use of forfeiture were first imposed in 1925; a cap on the damages recoverable by a landlord for a tenant's breach of repairing covenant was put in place in 1927 and the procedural hurdles erected in 1938 for landlords seeking either to forfeit or to seek damages for a tenant's breach of repairing covenant were extended to business tenancies in 1954. A far more radical reform of the law of forfeiture was proposed by the Law Commission in 1985 and 1994, but this has not been implemented.

The English law on privity of contract in leases has been subjected to increasing criticism for a number of years. A Report by the Law Commission (Law Commission, 1988) revealed many tales of woe from former tenants who had been held liable for the default of current tenants many years after they had parted with the lease. The Commission proposed the abolition of the principle but the landlord lobby staunchly resisted the implementation of its recommendations. This was a battle which was always going to be lost but the reform, when it came in the shape of the Landlord and Tenant (Covenants) Act 1995, was as good as landlords could have hoped for. While tenants do now cease to be liable when they assign a lease, this Act does permit landlords to extract, as a condition of consent to the assignment, a guarantee of the incoming tenant from the outgoing tenant.

A. (iii) c. Protection at the end of the lease

### **Security of tenure: England and Wales**

The history of the development of a system conferring security of tenure in England and Wales has been exhaustively reviewed by Haley (Haley, 1999; Haley, 2000) who also compares this with the position in Scotland (as do Musto and Martin, 1988), Northern Ireland and Eire (on which see also Wylie, 1998). Haley demonstrates that, in England, the debate concerning the vulnerability of business tenants at lease end started as long ago as 1889 when the Select Committee on Town Holdings acknowledged that some landlords were demanding high rents as the price of renewal which, if not satisfied, was causing tenants to be evicted with a resulting loss of the value of any improvements which they had carried out and of any goodwill. It was recommended that tenants should qualify for compensation for the loss of improvements and goodwill in the expectation that an effective scheme of compensation would, in practice, encourage most landlords to

offer a renewal instead. Although these suggestions were never implemented, this approach – of providing compensation rather than renewal rights – was to dominate the debate for the next fifty years.

Although tenants of low value premises used for mixed business and residential purposes were given the benefit of personal security of tenure and rent control from 1915 onwards, it was recognised by the Salisbury Committee in 1920 that this was not suitable for business tenants who needed separate consideration. Despite recommendations for the implementation of immediate, but temporary, measures by the Select Committee on Business Premises (which perceived any problems to be the product of a post-war shortage of premises), it was not until 1927 that permanent legislation was enacted.

Part I of the Landlord and Tenant Act 1927 was brought into effect after continuing pressure from business tenants. However, it was a compromise measure designed to “appease the business community while assuring lessors ... that reform would do no more than codify the current practices of reasonable landlords.” (Haley, 2000). It reflected a compensation based approach under which tenants could, on quitting the premises, claim compensation for their improvements and for their loss of goodwill. It was hoped that the availability of compensation would persuade most landlords to offer a renewal instead.

The Act allowed a business tenant to claim compensation, on quitting the property, for approved structural improvements which added to the letting value of the premises. However, the procedure for both qualifying for compensation and then making a successful claim was cumbersome in the extreme.

The 1927 Act also set out the basis on which the tenant could claim compensation for loss of goodwill. In order to qualify, the tenant had to prove that, as a result of the carrying on of the business at the premises for the previous five years, its letting value had increased. This concept of adherent goodwill had serious deficiencies. Concentrating on the landlord’s gain rather than the tenant’s loss meant that no compensation was payable if the premises were to be demolished or re-let for a different purpose. Furthermore, manufacturers and non-profit making organisations were necessarily excluded, while professionals were expressly excluded. The procedure for claiming compensation was complex and subject to time limits; given that the landlords were under no obligation to inform tenants of their rights many tenants must have lost their entitlement through ignorance.

There was only one, limited, circumstance in which a tenant could claim a renewal. This was where a tenant who had proved adherent goodwill could then demonstrate that the statutory compensation would not be sufficient to cover the loss of his personal goodwill. The claim to a new lease could only be defeated if the landlord could show certain statutory grounds. If successful, the tenant could obtain a single renewal for a term not exceeding fourteen years at a market rent.

Whatever its deficiencies, as Haley points out, the 1927 Act did go “some distance in rationalising reform options”. It provided, for the first time, machinery “whereby, in

admittedly rare circumstances, the tenant could be awarded a new lease ... It laid to rest the notion that controls be restricted according to the size of the premises or rateable values and (by omission) served to highlight the need of professional tenants for some protection. It also rejected the idea of a system of rent control ... and ensured that the tenant's entitlement was to be proprietary in nature and not to take the form of a personal statutory tenancy." (Haley, 2000).

The problems created by the Second World War provided the next impetus for further intervention. The lengthy period in which there had been no new building and during which heavy bombing had caused a serious depletion of existing premises coupled with the post war revival in business activity served to highlight the deficiencies in the 1927 Act. Competition for commercial premises created a climate in which landlords were able to exploit sitting tenants. The Leasehold Committee was set up in 1948 to investigate the need for business tenants to be given security of tenure and to consider whether it was desirable or practicable to control the rents of business premises. It issued an Interim Report in 1949 and a Final Report in 1950 and the divergent nature of the recommendations of the respective reports well illustrates the basic political divide of its members. Some believed that it was the tenant who had the better right to possession so long as the landlord's investment in the property was protected; for them depriving the landlord of its right of possession did not represent a serious interference with the latter's property rights. For others, it was the landlord who had the basic right to possession and any restriction on this amounted to a fundamental interference with property rights and one which would significantly discourage the provision of new premises for businesses.

The Interim Report acknowledged that the compensation based approach of the 1927 Act was not working satisfactorily, at least in the economic circumstances of the immediate post war period. It accepted that, while the scale of the problem was difficult to assess (due to the fact that the number of tenants with leases approaching expiry is always a small proportion of the total number of businesses - a question which remains equally valid today), there was clear evidence of demands for very significant rent increases or large premiums for very short renewals. It was noted that, at that time, all major European and Commonwealth countries had in place legislative provisions offering some protection to business tenants, usually both security of tenure (save where suitable alternative accommodation was available) and rent control in the form of some sort of cap on rent increases. It concluded that, on the basis of the evidence put to it, business tenants were more interested in security of tenure than rent control. Taking the view that the current difficulties for tenants were likely to be due to the exceptional economic conditions, it was recommended that a temporary scheme be introduced (which could be extended if necessary) under which business tenants should have a general right to renew which would only be excluded in limited circumstances. The scheme should apply to tenants engaged in all types of business activity (including professional and non-profit making) irrespective of the size of the business, length of lease or period of occupation. There should be no contracting out (save where the landlord could make out a specific case in advance) 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.

However, at the Final Report stage the Leasehold Committee, now under a new chairman, took a very different view. In a fundamental ideological shift, the final recommendations, while preferring rights of renewal rather than compensation, concluded that there should be no general right to renew. It was proposed that the tenant should be able to apply for a new tenancy without having first to establish any right to compensation, but that the application could only be considered where the tenant had been in occupation for at least three years and where he could establish that no suitable alternative accommodation was available. Even then, it was suggested that a renewal should only be granted where this was reasonable and that this should depend on whether a failure to renew would either substantially diminish the value of the business or its profitability, or lead to a substantial increase in its costs.

The inconsistent recommendations of these Reports hampered any immediate statutory intervention, apart from a stop gap measure - the Leasehold Property (Temporary Provisions) Act 1951 - which gave retail tenants the right to apply to the county court for a new lease not exceeding one year. In 1953 a Government White Paper, while accepting the general proposition that business tenants be given security of tenure, rejected the detailed recommendations of both the Interim and Final Reports. What emerged from this was the scheme set out in Part II of the Landlord and Tenant Act 1954 and which (subject to some amendment) has continued to apply to business tenancies in England and Wales ever since. The essential features of this scheme were that it was intended to be permanent, that no contracting out was to be permitted, that it applied to all tenants engaged in commercial, professional and non-profit-making activities, that it conferred a general right of renewal which could only be opposed on limited statutory grounds and that the new lease should be at a market rent on terms similar to the existing lease.

The workings of the 1954 Act have been reviewed on a number of occasions: by the Law Commission in 1969 and 1992 and by the Department of the Environment in 1984. It was the subject of a Department of the Environment Consultation Paper in 1996. It was amended by the Law of Property Act 1969 and is set to be amended further in the current parliamentary session (ie 2000/2001). It has been regarded by both the Law Commission and the Government as "successful" and "working well". Any amendments have been regarded as "fine tuning" or "procedural" and have been said to be specifically designed not to upset the balance which the Act is perceived as achieving between landlord and tenant. This does not mean that some changes to the Act have not been important; the introduction of interim rent and the broadening of the scope of tenants' improvements which can be disregarded when fixing the rent under the new lease clearly fall into that category. However the received wisdom on both the amendments that have taken place, and of those which are about to be implemented, is that the changes have been incremental, non-controversial and non-fundamental.

It is therefore something of a surprise that one very radical change to the Act has taken place. It originally appeared almost by stealth, its effects are little researched and it looks to be about to be further extended by the most recent proposals. This was the introduction in 1969 of a mechanism for contracting out of the security of tenure provisions of the Act. Up until then, any Government Committee which had considered the matter had resolutely rejected the notion of contracting out (except, possibly, with prior court



approval and in extremely limited circumstances). The possibility of introducing contracting out did not feature at all in the original Law Commission Working Paper which carried out the first review of the Act in 1967; it merited one short paragraph in the Law Commission's 1969 Report in which it was perceived merely as a device for encouraging short lettings of premises which might otherwise not be utilised; it was not debated in Parliament during the passage of the 1969 Act; and its introduction was barely noted by either academic or practitioner commentaries of the time (see Macintyre, 1970; Wilkinson, 1969).

Despite this apathy, section 38(4) in fact allows the contracting out of any length of tenancy subject only to the rubber stamp of prior court approval. Case law has made it clear that the court has no jurisdiction to withhold approval of the lease; its only function is to ensure that the tenant is aware that statutory rights are being foregone. This unheralded 1969 amendment has, in truth, rendered the 1954 Act optional and, as we shall see, the process for contracting out is set to be relaxed even more.

### **Security of tenure: Northern Ireland, Scotland and Eire**

It may come as some surprise to many outside the UK and Eire that the schemes of protection for business tenants vary quite markedly in the different jurisdictions, despite the very obvious similarities in terms of legal systems and property markets. It is very difficult to see any rational explanation for these differences.

That which is most similar to England and Wales is the scheme operating in Northern Ireland. The Business Tenancies Act (Northern Ireland) 1964 put in place provisions very like those contained in Part II of the 1954 Act. The most notable differences were that, in Northern Ireland, it was impossible to contract out of the Act and that the exclusion of short tenancies was limited to those of three months or less (plus one renewal). The 1964 Act was reviewed in 1994 by the Law Reform Advisory Committee for Northern Ireland which made recommendations which, not surprisingly, leaned heavily on the English Law Commission proposals in respect of the 1954 Act. Strikingly, however, the Northern Ireland Committee flatly rejected any suggestion that contracting out provisions similar to those in England be introduced: "Even with the safeguards proposed by the Law Commission we consider that contracting out would become the norm and that the 1964 Act would quickly become meaningless. The prohibition against contracting out is at the heart of the legislation and we recommend strongly that it remains there." Also, interestingly, while the Committee accepted the case for some extension of the short term lettings exclusion, it was mindful of the experience in Eire. There, business tenants cannot qualify for protection unless they have been in continuous occupation for at least five (formerly three) years. This has resulted in landlords evading the Act by the use of short term leases, a practice which has caused "a significant distortion amounting to petrification of the commercial property market". Accordingly, the Northern Ireland Committee recommended that the short term tenancy exclusion should simply be extended to tenancies of no more than 9 months (plus one renewal). These proposals have now been enacted by the Business Tenancies (Northern Ireland) Order 1996.

Business tenants in Eire enjoy, in theory, extensive security of tenure under the Landlord and Tenant (Amendment) Act 1980. Originally this entitled tenants who had been in continuous business occupation for three years to apply for a new lease for 35 years or such lesser period as nominated by the tenant. Furthermore no contracting out was permitted. Not surprisingly, landlords were anxious to avoid these provisions and the use of “caretaker” agreements and licences (both of which sought to ensure that the requisite period of occupation as a tenant was not accumulated) became common. However, the efficacy of these sham agreements was open to doubt and the safer course was simply to grant leases of less than three years. By the early 1990s the impact on the property market of the widespread use of these very short leases was giving rise to considerable concern. The Law Reform Commission considered the matter and this duly resulted in the Landlord and Tenant (Amendment) Act 1994. This has raised the required period of business occupation to 5 years and has altered the term of any new lease to a maximum of 20 years and a minimum of 5 years (still at the election of the tenant). The 1994 Act has also introduced limited contracting out; it is now possible for a tenant who has received independent legal advice to contract out the Act by way of prior renunciation in the case of a lease of premises to be used wholly and exclusively as an office. These provisions have been strongly criticised (Wylie, 1998) as being generally unsatisfactory and, in some respects – notably in being restricted to offices – as “frankly absurd”.

### **Compensation for tenants’ improvements**

Although the first proposals in England that business tenants should, on quitting the premises, be eligible for compensation in respect of their improvements to the property were made in 1889, legislation was not forthcoming until 1927. Part I of the Landlord and Tenant Act 1927 set out the scheme which, while amended in 1954, has remained in place ever since.

It has been commented that “the primary weaknesses of the existing provisions concern the inherently wasteful, complicated and cumbersome nature of the claims procedure; the unrealistic manner in which compensation is calculated; and the ease with which landlords can circumvent the scheme” (Haley, 2000). Furthermore, the introduction in 1954 of comprehensive security of tenure for business tenants inevitably reduced the importance of the statutory scheme providing compensation for tenants improvements.

The compensation provisions were reviewed in a Law Commission Working Paper (Law Commission, 1987) which recommended a number of ways in which they could be made very much more satisfactory. However, the Commission’s final Report (Law Commission, 1989) concluded that the scheme should be abolished. Whilst this proposal has been cogently criticised (Haley, 2000), it was accepted by the then Government. However, the present Government has made no move in this area and it seems likely that the present, almost unworkable scheme will simply be left in place.

Both Eire and Northern Ireland (but not Scotland) have had schemes for providing compensation for business tenants’ improvements. That in Northern Ireland bore marked similarities to the English model. It, too, was heavily criticised by the Law Reform Advisory Committee (Law Reform Advisory Committee, 1994) which recommended its

abolition. Unlike in England and Wales, this proposal has been implemented by the Business Tenancies (Northern Ireland) Order 1996.

## **B. Australia**

### **B. (i) The form of intervention**

Prior to the 1980s, commercial tenancies in Australia were largely controlled by the common law of landlord and tenant. Bradbrook (1989: 115) describes how tenancy law that had closely followed English precedent started to develop independently from the time of the Second World War. The provisions for rent control and security of tenure tenants that was introduced during the war applied only to residential or partly residential premises. It should be noted that tenancy legislation is the domain of each State government (although during the Second World War, the Federal government used its defence powers to implement residential rent control). This paper traces the emergence of government regulation of commercial tenancies throughout Australia. As such, it does not provide a comprehensive review of the laws in each State but it illustrates the type of protection given to tenants with examples from each State.

At the end of the 19<sup>th</sup> century or early in the 20<sup>th</sup> century, the parliaments in most Australian states had passed laws that implied some clauses into leases in the absence of explicit covenants to the contrary. For example, tenants were deemed to be responsible for repairs except for fair wear and tear if there was no repair covenant; and in any lease permitting assignment, it was to be assumed that the landlord's consent would not be unreasonably withheld. In all states except for South Australia and Tasmania, the remedy of distress for rent was abolished.<sup>1</sup> There was virtually no further interference in the ability of landlords and tenants to negotiate leases of business premises until the mid 1980s (with the exception of some leases of agricultural premises). Minor protection was given to residential tenants in the private housing market in all States in the 1970s.

Some elements of the Trade Practices Act 1974, particularly following the 1977 modifications, apply to certain restrictive covenants in leases and misleading conduct inducing one party to enter a lease. As a federal Act, the restrictions limit the actions of corporations only. In most States, there is now similar legislation that would protect tenants against restrictive, misleading or unfair conduct by either landlords or tenants (such as the Unfair Contracts Act 1997 WA). However, these statutes have not been used to seriously challenge the structure of business leases.

In the early 1980s, there was pressure from small retail businesses for a fairer deal in their leases from shopping centre owners. They felt that they had little scope for negotiating changes to the "lengthy standard form leases" drawn up on behalf of the owners or developers (Bradbrook, 1989: 127). As examples, some leases at this time permitted the landlord to claim a percentage of the price of the sale of the business as a

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<sup>1</sup> For example, Landlord and Tenant Amendment (Distress Abolition) Act 1930 (NSW); s.2 Distress for Rent Abolition Act 1936 (WA); s.12 Landlord and Tenant Act 1958 (Victoria).

condition for granting assignment; some permitted the landlord to move the tenant to another position in the shopping centre; and some absolved landlords from any liability in the event of failure to provide building or marketing services for the centre.

Following a report to the Queensland government, the Retail Shop Leases Act 1984 was passed. Similar legislation was passed in Western Australia, South Australia and Victoria in 1985 and 1986. This legislation (described further below) modified the common law by making some lease clauses void and others voidable by the tenant under certain circumstances. This is in contrast with the residential tenancy laws in each State which replace the common law with statutory codes governing most aspects of the agreement between landlords and tenants.

When the pressure from small businesses in shopping centres had mounted in the early 1980s, the then Building Owners and Managers Association (now the Property Council of Australia) developed a code of practice for the leasing and management of shopping centres. A Western Australian Parliamentary Commission was satisfied of BOMA's willingness to encourage fair practice but concluded that "persuasion unbacked by sanctions does not influence the worst offenders against a code of good practice" (Clarke, 1984: 7). Legislation was introduced in Western Australia but in New South Wales the government conferred with landlord and tenant groups to promote a voluntary code of practice.

The 1991 Retail Tenancy Leases Code of Practice was a result of "three years of unsuccessful negotiation to develop a mandatory code" (Carkagis, 1997: 4). Although the Property Council of Australia and the Retail Traders Association of NSW urged their members to adopt the Code, it was apparently not adhered to in the vast majority of lease transactions. When introducing a Retail Leases Bill, the government said that the decision to legislate was "only taken after it was clearly established the voluntary code of leasing practice .....had not worked" (media release 16 May 1994, quoted by Carkagis, 1997: 4).

#### **B. (ii) The scope of protection**

In contrast with the UK laws, the Australian legislation offers protection to specific groups of tenants. In all States, the legislation does not apply to leases to public companies or their subsidiaries. Although this exception is achieved with different wording in the various States, in principle, it relies on the distinction between private or proprietary companies which are registered differently to public companies under the Unified Corporations Law. All States limit the protection to shops with a floor area of no more than 1,000 square metres, although the definitions of floor area have been amended in many states. Both these limitations are consistent with the belief that it is the small business tenant that needs protection. National chains of retailers and retailers taking leases for department stores, supermarkets and other extensive users of retail space are presumed to negotiate their leases with reasonable understanding of their implications and to be capable of defending their own interests.

The definitions of which premises are "retail" are somewhat different in each state. All the legislation provides definitions of shops and retail shopping centres. The latter is a

group of 5 or more shops used predominantly for retailing and in one ownership.<sup>2</sup> The legislation protects tenants in shopping centres (whether or not they are retailing) and retailers elsewhere.<sup>3</sup> It is not entirely clear why the legislation covers retailers not in shopping centres as they do not appear to be dissatisfied with their leases. It may be that retail tenants outside shopping centres are less well organised into groups which can represent their grievances.

In some States, some premises are specifically excluded (such as service stations operated by oil companies in Western Australia). In New South Wales, Schedule 1 to the Retail Leases Act 1994 lists protected retail shop businesses excluding such uses as professional consulting rooms and cinemas. Each Act enables other businesses to be included in the definition of shops by prescribing regulations.

There has been virtually no pressure to extend protection to tenants in office buildings (although many are small businesses obliged to accept close to standard-form leases drawn up by the building owners), nor to industrial premises (where, although there is much less institutional ownership there remains the potential for unscrupulous private landlords to take advantage of small businesses unaware of the perils of entering the leasing market).

This lack of pressure for intervention in the tenancy agreements covering other premises can be explained in two (related) ways. First, almost all non-retail tenants can move their businesses to other premises without suffering major permanent loss of profits. There is an approximate balance between the landlord's loss through temporary vacancy and the tenant's costs of moving. Secondly, landlords are less likely to wish to limit the activities of or remove tenants than in shopping centres where a poor mix of tenants (either by use or by quality) can seriously affect investment performance. A shopping centre owner may be able to improve the turnover of the majority of occupants by removing traders that are no longer suitable for the mix, although this may destroy the livelihood of the unsuitable retailer.

### **B. (iii) The nature of protection**

#### **B. (iii) a. Protection during lease negotiations**

The availability of information for tenants prior to their commitment to lease was a feature of the unsuccessful NSW Code of Practice and is one element of the Tasmanian Code of Practice for Retail Tenancies. Retail tenancy laws in Western Australia and

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<sup>2</sup> In Western Australia, 1998 amendments extended the definition of a retail shopping centre to a cluster of shops on the same strata title but not necessarily in the same ownership (s.4(1)(d) of the Commercial Tenancy (Retail Shops) Agreements Amendment Act 1998). A similar provision is found in the Retail and Commercial Leases Act 1995 in South Australia. Groups of investors owning the strata titles of leased shops in a centre with more than four shops must therefore comply with these laws.

<sup>3</sup> It may be that the Victorian Retail Tenancies Reform Act 1998 only protect retail tenants in shopping centres (Lowenstern, 1998: 5.3).

Victoria in the 1980s included mandatory provisions that each shop tenant should be provided with a Disclosure Statement, summarising the key provisions of the lease, the features of the centre and its operating expenses. Similar disclosure statements were introduced in New South Wales and Queensland in 1994 and South Australia in 1995. For leases from July 1999 in Western Australia, tenants must also be provided with a Tenant Guide within their lease. The Tenant Guide outlines the tenant's rights under the Act. In most States, new leases which do not result from options to renew must also be preceded by a Disclosure Statement. In Victoria, a tenant planning to assign a lease can request a Disclosure Statement from their landlord.<sup>4</sup>

It is evident that various State governments have faith in mandatory disclosure prior signing the lease as a means of diffusing the complaints by tenants that they have been misled about their obligations. However, the sanctions against landlords who fail to provide Disclosure Statements have not always been sufficient to ensure compliance. In Western Australia, where a tenant who had not received a Disclosure Statement is given 60 days to terminate their leases<sup>5</sup>, some shopping centre owners decided not to bother to issue Statements. The 1986 disclosure provisions in Victoria were also largely ignored (Redfern, 1999: 24).

Tenants in all States now have rights to compensation for any damage arising from the lack of disclosure but there have been very few successful compensation claims under these provisions. Since 1998, tenants in Victoria have the right to withhold rent if they have not received a Disclosure Statement; they are not liable for rent until they receive the Statement; and they may terminate their lease at any time until up to 7 days after they receive the Statement.<sup>6</sup>

In Queensland, landlords may request a Disclosure Statement from tenants and can also insist upon a financial advice certificate where the tenant has less than 5 shops in Australia.<sup>7</sup> In Victoria, the tenant must provide the landlord with a business plan endorsed by a financial adviser.<sup>8</sup> These provisions appear to be of practical significance only if a landlord should come under undue pressure to grant leases without vetting the tenant in the usual manner but may have been introduced as an attempt at impartiality.

#### B. (iii) b. Intervention on lease terms

##### **Content of lease terms**

The reluctance of the English courts to imply additional terms into contracts and, in particular, leases was inherited by the Australian courts. It is only the introduction of

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<sup>4</sup> s.23 of the Retail Tenancies Reform Act 1998.

<sup>5</sup> The equivalent provisions in Queensland and New South Wales are for 2 and 3 months respectively to terminate the lease; s.22 Retail Shop Leases Act 1994 (Qu) and s.11(2) Retail Leases Act 1994 (NSW).

<sup>6</sup> s.8 Retail Tenancies Reform Act 1998 (Victoria).

<sup>7</sup> s.22A and s.22D of the Retail Shop Leases Act 1994 (Queensland).

<sup>8</sup> s.9 Retail Tenancies Reform Act 1998 (Victoria).

retail tenancy legislation that has significantly restricted the freedom of landlords and tenants to agree their lease terms. In the following paragraphs, the laws governing lease assignments, recovery of operating expenses, trading hours, quiet enjoyment and rent reviews are outlined.

Most States have legislated to limit the grounds under which landlords can refuse consent to assign. For example, the South Australian provisions<sup>9</sup> limit grounds for refusal to an unsatisfactory change of use, doubts about the assignee's ability to meet the financial obligations of the lease, inferior retailing skills of the assignee or failure to follow the procedure required in the Act. In Western Australia, a right for the tenant to assign any retail lease is inserted subject to the landlord's right to withhold consent on reasonable grounds and, if the landlord does not object to a request for assignment within 28 days, consent is assumed.<sup>10</sup>

In response to complaints that landlords were seeking to recover illegitimate expenses from tenants, all the 1980s retail tenancy legislation required that the extent of the recovery of operating expenses was carefully defined. The use of sinking funds and the operations of promotional funds were singled out as causing suspicion amongst tenants. Each Act listed the types of operating expenses that could be recovered, leaving very little scope for expenses that did not fit into the recognised categories. Expenditure of a capital nature cannot generally be recovered. Tenants could insist on itemised budgets and annual statements audited by qualified accountants. The amendments in each State in the 1990s tinkered with these requirements. For example, sinking funds which had been barred in Victoria are now permitted for defined purposes.<sup>11</sup>

Since the 1990s, several States have prohibited recovery of particular operating expenses. These exclusions were largely to appease tenants' arguments that these items were for the landlords' benefit. In some States, Land Tax cannot be recovered<sup>12</sup> and in others management fees cannot be recovered.<sup>13</sup> Most States have also revised their laws to limit recovery to "specifically referable" operating expenses. The main rationale was to prevent landlords making a tenant responsible for operating expenses that are not recoverable from other tenants (such as the major tenants) nor that refer to vacant areas. However, it appears that, in new lettings, an approximate adjustment is made which

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<sup>9</sup> s.43 Retail and Commercial Leases Act 1995 (SA)

<sup>10</sup> s.10 of the Commercial Tenancy (Retail Shops) Agreement Act 1985.

<sup>11</sup> The contribution to a sinking fund is one of the 27 specified headings of the Retail Tenancies Reform Act 1998 (Victoria) but was prohibited under the old 6(1)(b) Regulation (Devine, 1999: 68).

<sup>12</sup> s.7(3) of the Retail Shop Leases Act 1994 (Queensland) and s.30 of the Retail and Commercial Leases Act 1995 (SA); all other statutes permit the recovery of single holding land tax only, which can be considerably less than the Land Tax payable by an owner of several properties, particularly if the shopping centre has strata titles for each shop.

<sup>13</sup> s.12(1f) of the Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA) as amended in 1998; Regulation 7(1)(b) under the Retail Tenancies Reform Act 1998 (Victoria) prohibits recovery of the management fees paid for collecting rent but not the fees for managing the center (Davine, 1999: 68).

leaves the tenants paying a similar gross rent, thus largely defeating the purpose of such provisions.

Retail trading hours have been a source of controversy between landlords and tenants. As well as the general pleas from shopping centre owners for the relaxation of controls over shop opening hours that remain in some states, some leases used to permit the landlord to determine trading hours for each tenant. In some States, lease covenants allowing landlords to dictate trading hours are void<sup>14</sup> and in other States, compulsory “core trading hours” must be approved by a secret ballot of 75 per cent of the retailers.<sup>15</sup>

A further complaint of tenants in shopping centres was that landlords had reserved rights to relocate the tenant to another shop within the centre. Under many leases, tenants had agreed that they would not be entitled to any compensation should their trade be disrupted by the actions of the landlord (such as reducing pedestrian flows during alterations to the malls and failing to provide the usual services for shoppers). All the retail tenancy legislation contains provisions for reasonable notice and compensation for relocation and any disruption to trade. These provisions have done little more than restore and clarify the tenants’ rights to quiet enjoyment. In South Australia, retail leases are assumed to include a warranty that the premises are “structurally suitable for the purpose” unless the lessor gives a written notice to the contrary.<sup>16</sup>

There have been no attempts to fix or limit rents at the start of the lease, except that all statutes outlaw the collection of “key money” at the start of the lease (or as a condition of giving consent to an assignment). However, clauses resulting in changes in rent during the lease have been viewed with suspicion by tenants and various government commissions. Government reports (such as Commonwealth of Australia, 1997: 56; Carkagis, 1997: 22) have stated that tenants have a right to a reasonable degree of certainty over their occupancy costs. Many practices that had become common in the 1980s in Australia are now outlawed in all States. Reserving rights to one party to pick one of two or more bases of rent review and reserving rights to one party to elect to review the rent are not permitted in most States.<sup>17</sup> Some States have set a minimum period between rent reviews of 12 months.<sup>18</sup>

From the time of the early pressure for statutory protection of retail tenants, upward-only rent review clauses have been threatened. The Clarke report (1984: 11 and 38) in Western

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<sup>14</sup>For example, s.12C of the Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA).

<sup>15</sup> For example, s.61 of Retail and Commercial Leases Act 1995 (SA) and s.61 of the Retail Leases Act 1994 (NSW).

<sup>16</sup> s.18 of the Retail and Commercial Leases Act 1995 (SA).

<sup>17</sup> The rent review provisions can be found in s.18 of the Retail Leases Act 1994 (NSW); s.27 and s.36 of the Retail Shop Leases Act 1994 (Queensland); s.22 of the Retail and Commercial Leases Act 1995 (SA); s.12 of the Retail Tenancies Reform Act 1999 (Victoria); and s.11 of the Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA).

<sup>18</sup> For example, s.18(2) of the Retail Leases Act 1994 (NSW) bars more frequent rent reviews unless the amount is fixed when the lease is signed. s.27(9)(a) of the Retail Shop Leases Act 1994 (Queensland) bars more frequent rent reviews except in the first year of the lease.



Australia recommended provisions that rent should not be able to decline on reviews should be made void but this was not enacted. In 1986, the Victorian government attempted to bar upward only rent reviews but their wording left two loopholes that were exploited by landlords. First, the Victorian Supreme Court upheld a clause specifying that rent should not decline by more than \$5 per annum.<sup>19</sup> Secondly, the Act did not prohibit clauses which gave only the landlord the power to trigger a rent review and hence clauses could be drafted as an option which the landlord would not, in practice, exercise in a declining market (Davine, 1999: 157). However, all the statutes now contain what appear to be effective bars on upward only rent reviews. They also contain mandatory definitions of market rent to be used for market rent reviews and options to renew the leases. These statutory definitions replace the “assumptions and disregards” that many landlords utilised in the past to ensure the most favourable outcome of market rent reviews.

### **Enforcement of lease terms**

Apart from the abolition in most States about 50 years ago of the landlord’s right to distraining for rent and some common law changes in the 1980s to the recovery of arrears and methods of terminating leases (Bradbrook, 1989: 138; Bradbrook and Croft, 1997: 357-382), the enforcement of commercial leases was scarcely altered by legislation until the retail tenancy legislation. Because shop leases are invariably prepared by the solicitor acting for the landlord, the typical shop lease of the early 1980s contained ample methods for the landlord to enforce the covenants but very few rights for the tenant. In most States, leases cannot be forfeited for breaches of any covenant except non-payment of rent without serving a notice on the tenant.<sup>20</sup>

The retail tenancy laws spelled out the rights for tenants described in the previous section. They also introduced the compulsory use of mediation and low cost commercial tenancy tribunals to settle disputes. The objective was to overcome the fear of many tenants that, in legal proceedings, they could not afford to take on their landlords. In some jurisdictions, private mediation sessions must precede an appearance in the Tribunal, where legal representation may not be permitted.

In 1990, the Western Australian Act was amended in a way that appeared to prohibit any ongoing liability for an assignor. However, although this might have been the intention of the amendment, its wording did not prevent the landlord suing the assignor on the original covenant (Bales, 1998: 5). Further amendments in 1998 appear to operate to prevent any damages being recovered from the assignor.<sup>21</sup> Because these leases are rarely more than five years long, landlords do not appear to have been unduly concerned about the loss of privity of contract with these retail tenants.

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<sup>19</sup> Cameron and Simpson (1997: 542) summarising the unreported case of *Peppercorn Nominees Pty Ltd v Loizou*.

<sup>20</sup> For example, s.81 of Property Law Act 1969 (WA).

<sup>21</sup> s.10 of the Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA), as amended in 1990 and with new subsections s.10(3) to (5) inserted in 1998.

### B. (iii) c. Protection at the end of the lease

Commercial and industrial tenants in Australia have not had substantial rights of renewal nor rights to compensation for loss of goodwill nor tenants' improvements. Security of tenure has been consistently demanded by retailers associations but has not been granted by any of the State governments. Various options have been considered that generally amount to giving the sitting tenant the first refusal if the landlord intends to relet the premises unless the tenant has been in breach of covenant. This was recommended in Western Australia (Clarke, 1984: 26) but not adopted by the government.

In all States with retail tenancy legislation except for Queensland, tenants are entitled to receive a minimum term of five years, possibly including options to renew.<sup>22</sup> In New South Wales and South Australia, the tenant can obtain an independent lawyer's certificate to contract out of this minimum. In Queensland and Victoria, the tenant can obtain to at least six months notice that the landlord requires the tenant to vacate.<sup>23</sup> The Tasmanian Code of Practice for Retail Tenancies prescribes a minimum five year term although the tenant can waive this entitlement after being advised by a solicitor not acting for the landlord.

Prior to the introduction of the minimum five year term, many leases of specialty shops were granted for three years with two 3 year options for the tenant to renew. Since the legislation, many leases in shopping centres are granted for five years without any options to renew. It would therefore appear that the tenants are actually worse off as a result of this statutory intervention.

### C. The triggers leading to government intervention

As might be expected, tenants seek protection only several years after they have voluntarily signed leases. The loudest cries for tenancy legislation come from those whose businesses have suffered but it is often unclear whether to attribute this to the lease covenants or economic conditions. Two example can be cited. The complaints against upward only rent reviews in the United Kingdom were strongest in the early 1990s from those tenants competing against businesses with new leases at much lower rents than their own (Crosby et al., 1996). The lobbying to protect tenants in shopping centres in Australia was most vocal after the proliferation of shopping centres in the 1980s, which led to much greater competition for existing lessees (Clarke, 1984: 2).

In contrast to the economic power of many landlords, tenants have more political power. Owners (and employees) of small businesses make up a significant portion of the voters and the support for small business development has been a policy supported widely in recent years by political parties and governments in many countries. In an effort to

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<sup>22</sup> s.16 of the Retail Leases Act 1994 (NSW); s.66A of the Landlord and Tenant Act 1936 (SA), as amended; s.

<sup>23</sup> s.46 of the Retail Shop Leases Act 1994 (Queensland); s.16 of the Retail Tenancies Reform Act 1998 (Victoria).

appease small business tenants, many governments have explored the need to intervene in the leasing process.

## **IV. THE CURRENT STATE OF PLAY**

### **A. Business leases in the UK**

#### **A. (i) Lease negotiations**

As already indicated, prospective business tenants who have been misled during the course of negotiating their leases do have the benefit of the general law on misrepresentation. Although, as we have said, the remedies for misrepresentation have improved, it remains difficult for claimants to bring themselves within the fairly strict legal requirements necessary to establish liability. A couple of notable recent cases involving the same large landlord offering tenancies of public houses revealed what were clearly regarded by both judges as hard selling tactics designed to take advantage of over enthusiastic prospective tenants with little or no business experience. Although the courts had great sympathy with the tenants it was held that the landlords were not liable because technically no misrepresentation had been made.

The Property Misdescriptions Act 1991 has imposed criminal sanctions against agents who misdescribe property. While the Act undoubtedly does apply to lettings of commercial property, its greatest impact appears to have been in the context of residential sales; virtually all of the prosecutions to date have involved domestic property. However, the absence of prosecutions relating to business property may simply indicate that higher standards of practice apply in the commercial sector.

As has already been discussed, the Commercial Leases Code of Practice was clearly intended to impact on lease negotiations and to produce more flexible lease terms. However, the limitations of the Code were obvious from the outset. Its voluntary nature and its content – very little of it can be described as a genuine code of desirable behaviour for landlords and their advisers – are fatal flaws. Its strength, as a well-drafted document providing useful basic information on business leases, depended on its effective dissemination especially to those tenants most in need of it, namely the small business tenant. This, as the Government's monitoring exercise has shown (DETR, 2000) has simply not taken place.

A survey of landlords, tenants and professionals conducted as part of this research suggested that the impact of the Code has been virtually nil and that many participants do not even know that it exists. The marketing of the Code has therefore failed miserably. Only approximately 70% of large landlords and experienced property market professionals active in the area of commercial landlord and tenant had even heard of the Code and only 14% of tenant respondents (the group it was designed to inform) knew about it. Only 10% of professionals drew their client's attention to the Code and this only rises to 13% when acting for landlords against unrepresented tenants.

Virtually all those tenants who were aware of the Code had taken professional advice and had learnt of the Code's existence through their advisor. They were also operating from larger properties, with more employees, were more likely to be national plcs and were paying higher rents than the tenants who were not aware of the Code. Those tenants who were not aware of the Code were more likely to be operating small businesses and were less likely to take professional advice. They were, therefore, precisely those tenants at whom the Code was aimed and who would most have benefited from its guidance.

In addition to the awareness of the Code, questions concerning the impact of the Code on negotiations gave further evidence that it was having no effect. Only two tenants thought it had an influence and one of those said it was slight.

Despite its manifest lack of effect, it is clear that the Code is not yet being abandoned. As things stand, the Government appears to be committed to trying to ensure that it is strengthened and that its dissemination amongst small business tenants is improved (Raynsford, 2000).

#### **A. (ii) Control of lease provisions**

##### **A. (ii) a. Content of lease terms**

We have already noted the general reluctance of English courts to imply terms into contracts. A good illustration of this in the business tenancy context is the refusal of English courts to apply the doctrine of unreasonable restraint of trade to user clauses in leases. Furthermore, any tentative indications in the 1970s that judges might readily construe provisions in commercial leases governing tenants' contributions to insurance premiums or service charge outgoings as being subject to a test of reasonableness have been shown to be misplaced by recent Court of Appeal decisions.

There is still no consumer style legislative protection in place on which even a small business tenant can rely. The newly drafted Unfair Contract Terms in Consumer Contracts Regulations 1999 are concerned with the substantive fairness of contractual terms (unlike the Unfair Contract Terms Act 1977 which, despite its name, only applies to exclusion clauses) but they are limited in scope. In particular, the Regulations apply only to terms which have not been individually negotiated and which are not "core" to the transaction. Furthermore, in the context of leases, the landlord would need to be "trading" in land and the tenant a "consumer" (defined broadly as someone who is acting other than in the course of business) ; this makes it unlikely that this legislation can have any real impact on the terms of a business lease.

By contrast, there is significantly more legal intervention on specific lease covenants. The form and effect of disposition, user and alterations covenants are all controlled to a greater or lesser extent by legislation. Despite recommendations to the contrary (Leasehold Committee, 1950; Law Commission, 1985) landlords are still legally permitted to employ covenants absolutely prohibiting dispositions by the tenant; however, the adverse rental impact of such provisions (at least when included in leases long enough to contain a rent review) means that total prohibitions are rarely used in practice. Ever since 1927, qualified disposition covenants (ie those simply requiring the

prior consent of the landlord) have been automatically converted into fully qualified ones; as a result, tenants have almost invariably been free to dispose of their leases save where the landlord can provide grounds for refusing consent which would be adjudged by a court to be reasonable. In the light of evidence that landlords were effectively avoiding the reasonableness test by delaying decisions on consents (Law Commission, 1985), the law was amended by the Landlord and Tenant Act 1988. A landlord is now under a statutory duty to give consent where it is reasonable to do so and must inform the tenant of any decision within a reasonable time. Where a tenant suffers loss as a result of a breach of either of these duties the landlord will be liable in damages.

The law on consents to dispositions has now been further amended in respect of post-1996 business tenancies by the Landlord and Tenant (Covenants) Act 1995. As a *quid pro quo* for the abolition of privity of contract in leases, landlords were able to procure a total abandonment of the reasonableness test in respect of factual conditions imposed for the giving of consent to assignments and sublettings so long as these are set out in the lease. Consequently it is now usual for commercial leases to set out often stringent conditions which must be satisfied before a consent will be forthcoming. In particular, survey work by Crosby et al (DETR, 2000) suggests it has become standard for landlords to insist that outgoing tenants must automatically enter into an authorised guarantee agreement in respect of their assignee.

While landlords are free to impose absolute covenants against the making of alterations (and often do so, at least in respect of structural alterations), ever since 1927 business tenants who wish to make improvements which add to the letting value of their premises have been able to override these, if necessary by going to court. As with disposition covenants, qualified covenants against alterations are automatically converted into fully qualified covenants provided the intended alteration amounts to an improvement. The framing of the legislative provisions mean that, in practice, a landlord will find it very difficult to establish reasonable grounds for refusing consent to a tenant's improvement.

Parliament has been less willing to intervene in the case of restrictions on use, recognising that these often serve wider, or more complex, purposes than restrictions on dispositions and alterations (Law Commission, 1985). Accordingly, landlords can impose absolute, qualified or fully qualified restrictions on use; the only statutory control is that the landlord is not permitted to charge for the giving of consent, a requirement which, as is well known, can readily be avoided. In practice, the advent of rent reviews has caused landlords to frame user provisions as generously as possible since the seriously adverse effect on rent of a narrow and absolute user provision is clear. The only circumstances in which tight user restrictions are used is where landlords are seeking to maintain tenant-mix. In this situation, the tenant is often able to negotiate a near monopoly position for his own business. Where this occurs, the rental disadvantage of the tight user provision is offset for the landlord and, at least if things go well, the business prospects for the tenant are improved.

The prevalence of the upwards only form of rent review, often in the shape of the more rigorous ratchet (as opposed to threshold) form, continues to concern Government. Whilst Crosby et al. have shown in their recent Report (DETR, 2000) that the shortening

of lease lengths in the UK means that many business tenants in secondary and tertiary properties are now free from review altogether, there is also clear evidence that, in leases long enough to contain rent reviews, these remain of the upwards only type. Government statements (see Raynsford, November 2000) suggest that legislative intervention remains very much on the agenda.

While we have noted that, on the whole, the English judiciary is reluctant to push forward the frontiers of leasehold obligations, there is one area in which the courts in England have recently been active in developing the law in a way which is of some benefit to business tenants. This is in the field of non-derogation from grant and the landlord's covenant for quiet enjoyment. On the down side (for tenants) they have re-iterated their refusal to regard the principle of non-derogation as preventing a landlord from letting premises for a business purpose which competes with that of an existing tenant; a tenant who wishes to be protected from competition still needs to extract an express covenant to this effect. However, in a series of cases the courts have held landlords liable to tenants for failing to take steps against other of their tenants whose activities have in other ways (such as mode of trading or excessive parking) seriously interfered with the claimant's business operations. In addition, one case suggests that a landlord who had let an area of a shopping centre to tenants on the expectation that it would have a particular theme (in that case quality ladies' fashions) might be liable for departing from that without paying proper regard to the interests of its existing tenants. These developments are causing landlords of retail centres, business parks and industrial estates to re-consider some of their management practices.

#### A. (ii) b. The enforcement of lease obligations

We have seen that the Law Commission has been active in proposing reform in the area of some of the more archaic and draconian of the remedies available to landlords. However, progress on their implementation has been non-existent. Its proposals (Law Commission, 199\*) for the abolition of a landlord's right to effect forfeiture by peaceable re-entry (which is, for most practical purposes confined to business premises) received such a hostile reception from the commercial property industry that the Commission has now back tracked (Law Commission, 1998) and settled for proposals designed to improve the process, notably by seeking to ensure that a tenant is given prior warning. The Commission has also consulted on (Law Commission, 1986) and then recommended (Law Commission, 1991) the abolition of the remedy of distress for non-payment of rent (which is commonly used in the commercial sector). However, despite this recommendation and the consistent judicial criticism of this anachronistic remedy, distress is still regarded by landlords as quick and effective and no legislation has been forthcoming.

Although there is relatively little scope for the courts to develop the law on the enforcement of lease obligations, three recent areas of litigation are worth noting. First, over the past twenty years it has become clear that when considering tenants' applications for relief against forfeiture, the original equitable notion that this would not be given in cases of "wilful" breaches has all but disappeared. Today, the courts are demonstrably unwilling to deprive tenants of a valuable asset and even those who have quite

deliberately broken the terms of their lease will be given relief so long as the breach can be, and is, actually remedied.

Second, during the past few years the courts have quite clearly accepted the principle that where one party to a lease seriously breaches its terms, the other may be able to treat the lease as at an end. Given the availability of the remedy of forfeiture to landlords, this notion that a lease may be terminated by repudiation is one that is only of real importance to tenants. Although, to date, there have only been two reported successes for tenants, the principle that a tenant may be able to walk away from a lease where a landlord is in serious breach is a highly significant development.

Finally, the English courts have had a fresh look at whether or not they will compel a business tenant who has covenanted to keep open for trade to abide by its obligations. Traditionally, a mandatory injunction has never been available in such circumstances but, in 1999\* the Court of Appeal ordered a magnet store in a shopping centre which had closed down in breach of such a covenant to re-open. However, this decision was overturned by the House of Lords leaving retail tenants (for whom keep open covenants are quite common) free from this threat although they do, of course, remain liable in damages wherever the landlord is able to establish loss. It is worth noting that the courts in Scotland take a quite different view; there, keep open covenants are positively enforced without any apparent difficulty.

The implementation of the new “privity free” regime for leases at the beginning of 1996 has, to date, caused few ripples. Although it was anticipated that the abolition of continuing tenant liability would cause commercial property values to fall (Stoy Hayward, 1993; Peto, 1993; CIG, 1994) there is no evidence that this has materialised. This is almost certainly because, in the event, the legislation was more landlord friendly than the Law Commission proposals. In particular, the 1995 Act allows landlords to require authorised guarantee agreements of outgoing tenants. As we have noted, the imposition of an automatic guarantee appears to have become standard practice. Furthermore, the 1995 Act also gives commercial landlords very much more control over assignments. When coupled with the evidence (DETR, 2000) of the much greater incidence of shorter leases in the UK property market, the signs are that, in practice, many landlords are no worse off under the new rules relating to privity.

#### **A. (iii) Protection at the end of the lease**

##### **A. (iii) a. Security of tenure**

The statutory security of tenure regime which applies in England and Wales is, in theory at least, wide ranging and comprehensive. Tenants across all the commercial sectors, together with professional tenants and those engaged in non-profit making activities, qualify for protection so long as they remain in business occupation. Furthermore, it is not necessary for the use of the premises to be directed exclusively to business use since mixed user tenancies also fall within the 1954 Act. However, it is possible for the parties to agree in advance that their lease be contracted out of the Act. In order for this agreement to be effective there has to be an application to the court for its approval

before the lease is granted. There is no restriction on the type of lease which can be contracted out and the court has no jurisdiction to refuse approval once it is satisfied that both parties have received legal advice.

The scheme ensures that, until the current tenancy is terminated in accordance with the Act, it simply continues in place, at the same rent. Either the landlord or the tenant can trigger the statutory termination procedures and this will entitle the tenant who so wishes to apply to court for a new tenancy. The application for a new tenancy can be opposed by the landlord but only on limited statutory grounds. In practice, those most commonly relied upon are either those relating to tenant default, or where the landlord wishes to re-develop the premises or to occupy them for his own use. Where a tenant is denied a new tenancy on grounds which do not involve tenant default or the provision of suitable alternative accommodation, he is entitled to compensation for disturbance. This compensation is based on the rateable value of the premises and doubles for those whose businesses have operated from the premises for at least fourteen years.

The tenant is entitled to any number of renewals, each being for a maximum of fourteen years (unless the parties agree a longer lease). The terms of the renewed lease tend to reflect those of the existing lease, although there is scope for updating lease provisions either where the parties agree to do so, or where the party proposing the change can prove that it is reasonable. The rent is based on current open market rental value, disregarding the tenant's occupation, goodwill and certain tenants' improvements. If the parties are unable to negotiate the terms of the new lease, these will be settled by the court (although there has, since 1995, been an option to go to arbitration under the PACT scheme). Where the renewal process runs over the date originally set for termination of the existing lease, the tenant is allowed to continue in occupation, but the landlord can then seek an interim rent; this is normally set at a figure somewhere between the existing rent and that which will be payable under the new lease.

We have already noted that the Act was amended in 1969 and that there are likely to be further amendments made later this year. Most of the current proposals are technical and procedural although, inevitably, the opportunity is being taken to tidy up a number of relatively minor glitches in the operation of the Act which have emerged over the years (such as the fact that a tenant cannot at the moment apply for interim rent – a product of the misguided view that rents only ever move upwards).

The prime objective is to simplify the procedure for terminating the existing tenancy and applying for a new tenancy, a matter which has become more pressing in the light of the recent and radical reform of the civil litigation process in England. It is clear that the current system of statutory notices, strict and unforgiving time limits and the necessity for an automatic application to court has resulted in the arbitrary loss of rights by those who are not familiar with the rules, the blatant manipulation of statutory notices for rental advantage by those who do know the rules, and an unnecessary use of court time when evidence shows that most renewals are settled by agreement. Suffice to say that the bulk of the proposed reforms are designed to address these problems and should do so quite satisfactorily (although whether the significant changes to procedure will be welcomed



by professional property advisers, for whom the current system is like an old glove, remains to be seen).

The one change which, while billed as merely procedural, may have more dramatic results, is that relating to contracting out. In its Working Paper the Law Commission (Law Commission, 1988) rightly drew attention to the inadequacy of the current contracting out provisions. As things stand court time has to be wasted on an application over which the judge has virtually no control. Not surprisingly, the Commission sought views on whether section 38(4) should be amended so as to provide the court with guidelines for approving contracting out, or whether to persist with the approach of simply ensuring that the tenant is genuinely aware of contracting out and replacing the need for a court application with a requirement that the tenant signs a statutory declaration. Its Final Report (Law Commission, 1992) makes no reference to any respondents who opposed contracting out, only to those who favoured unrestricted contracting out. While this was firmly rejected by the Commission, opted for the declaration route, a view with which, subject to minor amendments, the then Government agreed (DETR, 1996). It appears that this proposal is to be implemented in 2001 (DETR, 2000).

As we have already noted, the issue of contracting out is key to any system of statutory security of tenure. Its prohibition was regarded as crucial to the original formulation of the 1954 Act and is still so regarded in Northern Ireland; in Eire, its recent introduction is limited in scope. As we have shown, the introduction in 1969 of contracting out into the English system was scarcely considered and certainly not subjected to any debate.

It is almost impossible to gauge the level of contracting out in England and Wales. Up until 1989 Judicial Statistics for England and Wales were available to show the number of applications for court approval of contracting out. (While these figures show that not all such applications succeeded, any failures could only have been for technical deficiencies in the application since the court cannot refuse approval.) These statistics demonstrated a steadily increasing number of applications; in 1986 there were just over 11,500 applications of which nearly 9000 were successful; by 1989 these figures had increased to just over 24,000 and nearly 19,000 respectively. However, since 1989 the way in which Judicial Statistics are collected means that applications for contracting out can no longer be isolated and it is now impossible to tell how many business leases are being contracted out.

Crosby et al (DETR, 2000) addressed this issue in the questionnaire surveys and the answers given indicate that contracting out is not increasing and stands at about 25% of all lettings. However, this information may not be reliable. Anecdotal evidence suggests that some major landlords are adopting contracting out as a standard policy. Certainly, a number of landlords who are publicising their policies of new style flexible leases, see for example Grosvenor Estate Holdings and the British Property Federation (BPF) Model Lease are all opting for contracted out leases. The truth of the matter is that neither the Government nor anyone else has any real handle on how widely contracting out is used; all that can be said is that its current use is substantial rather than minimal.

## **B. Business leases in Australia**

Despite amendments to retail tenancy laws throughout Australia in the 1994 and 1995, retail tenants remained dissatisfied with their leases. Although property laws are enacted by each State, the Federal Minister for Small Business and Consumer Affairs requested in 1996 that the House of Representatives Standing Committee on Industry, Science and Technology investigate “major business” dealings including retail tenancies. The resulting report (Commonwealth of Australia, 1997) described “sub-optimal economic outcomes” that arise if some market players have inordinate power and/or there is a wide disparity in the information available (p.6). A further round of amendments have been enacted in 1998 and 1999 without significantly improving relationships between landlords and tenants.

### **B. (i) Lease negotiations**

The objective of the mandatory Disclosure Statements is to ensure that tenants receive information that should enable them to make reasonably informed decisions about their leases and the shopping centres that they are entering. However, there is little evidence that tenants are being more cautious before making commitments to lease. Assignees are particularly at risk as they are not entitled to Disclosure Statements nor a minimum term. They may pay substantial amounts for businesses with little knowledge of the landlord’s plans for the centre. It is of concern that retailers continue to pay large amounts for businesses trading from premises held under leases with very short unexpired terms (such as a year or two) without receiving assurances from the landlord that the lease will be renewed (Commonwealth of Australia, 1997: 36).

The information that must be disclosed is often insufficient for potential tenants to fully evaluate the opportunities for their businesses. The details which landlords are required to provide are generally facts which are publicly available to prudent business people. More helpful information which might indicate the success of the shopping centre is considered confidential to the owner’s and other tenants’ businesses and never likely to be released.

Except in those States where failure to give a Disclosure Statement gives an indefinite right to terminate the lease and to receive compensation, a few landlords continue to ignore these rules. However, the experience from New South Wales and from England and Wales suggests that mandatory Disclosure Statements are more effective than voluntary codes in informing tenants before they enter leases.

### **B. (ii) Control of lease provisions**

#### **B. (ii) a. Content of lease terms**

Although some landlords have asserted that the current restrictions are onerous, leases remain largely the result of market-driven negotiations. However, because the business environment for lease negotiations had been unfettered, the current regulations infuriate some landlords and yet most small business retailers still feel at a significant disadvantage. There is no evidence that the gulf between shopping centre owners and their speciality shop tenants is any narrower than it was when the Commonwealth of

Australia report was compiled. The Shopping Centre Council of Australia felt that the major threat to their industry in the year 2000 was “to ensure that changes to lease legislation around Australia don’t choke our industry any further” (Fairweather, 2000: 20).

The 1998 and 1999 amendments to legislation have not introduced substantial new provisions in any State. They revised many provisions that had been challenged in courts and tribunals and their effects nullified or diminished. Each State has learnt from the mistakes of others and, by following some of the recommendations of the 1997 Commonwealth report, ensured that the same lease terms are now regulated in each State, albeit in slightly different manners.

The limits on the way in which rent can be reviewed are now similar in each State although it must be questioned whether the objective of removing the uncertainty of rental levels after reviews has been achieved. Market rent reviews, other forms of indexation and turnover rent are all permitted and yet none can be predicted in advance.

#### **B. (ii) b. The enforcement of lease obligations**

There have been no major pressures to restrict the powers of landlords to forfeit leases nor to sue for damages, despite the fact that non-residential leases are drafted with more remedies for default by tenants than by landlords. For retail leases, tenants are empowered by those laws strengthening their entitlement to quiet enjoyment (see Part II B (iii)c above). For commercial and industrial leases not covered by the retail tenancy legislation, tenants may now find that it is easier in future to bring action for some breaches by their landlords under negligence than under the terms of their leases (as has been the case for residential lettings; Stansfield, 1996: 28).

#### **B. (iii) Protection at the end of the lease**

The lack of security of tenure at the end of relatively short retail leases remains an issue of concern to the Federal government and in most States. The Commonwealth of Australia Committee recommendations (1997: 39) for a tenant’s right to a second five year term and a subsequent right of first refusal have not been acted upon in any State. Nor are there any moves to provide compensation for loss of goodwill nor compensation for the improvements by the tenant. Consideration continues to be given to ways in which tenants can receive longer notice that their leases will not be renewed. There remains an immediate need to better educate those setting up or buying existing retail businesses to the danger of capitalising locational goodwill beyond the expiry of the lease.

There has been virtually no pressure from tenants of office or industrial premises for security of tenure, although most small businesses operate under leases which are often shorter than the minimum five year term for retail leases.

## V. THE WAY FORWARD?

Although it is interesting to make comparisons between the government intervention in business tenancies in the UK and Australia, the differences in leasing practices and the business environment should not be overlooked. In the final section of this paper, some potential changes to tenancy legislation are reviewed.

### A. England and Wales

#### A. (i) Voluntary codes or legislation?

The UK experience of the use of voluntary codes of practice mirrors that of NSW; it has not been a successful one. However, while doubts must remain over the lack of sanctions inherent in this type of approach, it is clear that it is not to be abandoned in England. The code on service charges has just, in 2000, been revised and issued in a second edition and the Government has re-convened the working party which drafted the commercial leases Code in order to consider how it can be further strengthened (Raynsford, 2000).

The current methods of protecting those negotiating leases remains unsatisfactory. Legalistic remedies dealing with misrepresentation can only ever be of limited value. However, voluntary codes of practice, at least of the type adopted to date have proved ineffective. The Code of Practice for Commercial Leases is not even achieving its own objectives of producing better informed negotiations; this is for the very good reason that those most in need of the information it provides do not know it exists. Research has shown (DETR, 2000) that those most in need of support through the negotiating process, ie the small business tenant, are often unrepresented in lease negotiations. In comparison with larger tenants they are less aware of the existence of the Code of Practice, have a poorer understanding of their lease terms, and are far more likely either to take their leases on the first terms offered or to negotiate simply on the level of rent.

In marked contrast to the position in most States in Australia, the application to at least some business leases (or some classes of tenant) of the consumer protection approach adopted in, say, credit agreements, has never been considered in the UK. Hence there is no legal requirement for prospective tenants to be given in advance at least some hard and comprehensible information about the commitments being undertaken; for example, even the Guide to Good Practice on Service Charges in Commercial Property (which is not, of course legally binding) does not include any recommendation that prospective tenants be given advance information about the likely cost of services. Furthermore, there is no imposition of any "cooling off" period during which a tenant can withdraw from a tenancy agreement.

#### A. (ii) Who should be protected?

The other issue which is not being addressed in the UK (nor has been in the past fifty years) is the question of whether or not we are right to persist in a universal approach to the imbalances which can exist between landlords and tenants in the commercial sector. The language of both government and the law reform bodies has always reflected

concern for the “small” business tenant and recent research has shown the vulnerability of such tenants in a number of areas (DETR, 2000). However, neither legal intervention nor the voluntary codes of practice draw any distinction between the “corporate” and the small business tenant. There seems little doubt that the needs of each of these groups are very different and that the sort of measures which would properly address the problems faced by the smaller and less experienced tenants would be quite out of place if applied to corporate occupiers. The formulation of any relatively straightforward definition of a small business tenant would be far from easy but this is the approach in Australia and could surely be considered for the UK.

In shopping centres, there is a relatively clear divide between the specialty shops and the major or anchor traders which can be encapsulated in legislation. This is not so for office and industrial premises should it be decided to protect small business occupants of other uses than shops. It also appears that shopping centres in the UK contain very few of the small businesses that tend to dominate the specialty shops in Australian centres. If similar exceptions for national chains were adopted in UK legislation as contained in the Australian laws, protection would be offered to few tenants.

The DETR (2000) research established that leases differed by property type and location but did not differ by tenant type. For example, tenants in the same shopping mall would have similar leases regardless of whether they were single outlet small businesses or national multiple chains. The fact that the same type of lease is offered to national and local retailers in UK centres would suggest that the Australian model of retail protection would be inappropriate. However, it is true that the national firms did tend to occupy the larger premises, which in turn commanded the longest leases.

However, the DETR research did show that the small business tenant was less well informed regarding leases than the corporate occupier who used internal or external professional advice. Many small business tenants in the UK conduct lease negotiations unrepresented. All the retail tenancy legislation in Australia has been aimed at ensuring the small business tenants are better informed of the long term implications of their leases.

#### **A. (iii) Changing the nature of the protection?**

In certain respects, English law is little different from other jurisdictions in being reluctant to interfere, in the commercial context, with the hallowed principle of freedom of contract. Hence, there is relatively little regulation of commercial lease terms. That said, some well entrenched features of the UK institutional lease (which apart from its length has remained essentially unchanged since the 1970s) such as the full repairing lease under which tenants are responsible for structural repairs and other capital outlay on the premises and the ratchet style upwards only review to open market rent raise eyebrows elsewhere in the world where such features are rare. In fact, both of these provisions have been outlawed by Australian retail tenancy laws.

There has been some concern since the 1980s about service charges in commercial leases. “It is therefore somewhat surprising that, unlike residential premises, service charges

related to commercial property have not been subject of legislation” (Silman, 1998: 116). However, this does not appear to be a burning issue at present.

The only area in which the UK Government is threatening intervention is in respect of the upwards only rent review. Whether this is a genuine statement of intent or simply part of a strategy to push landlords into adopting different forms of rent review remains to be seen. What is clear is that any suggestion of prohibition will be fiercely resisted by landlords (see Ratcliffe, 2000 and responses to the “Great Rent Review Debate” in Property Week in September 2000) who will no doubt revive the arguments deployed in 1993 when this threat was first made; namely that upwards only rent reviews are not inflationary (see IPD, 1993) and that capital values would fall, while rental values would marginally increase (Crosby, Baum and Murdoch, 1996).

In the Australian environment of short (typically 5 year) leases, the banning of upward only rent reviews was resisted by landlords but appears to have had no impact upon capital values or the desirability of shopping centres as investments. However, in an investment market in which single tenancy investment property let under a long lease with an assured minimum net income is a common occurrence as in the UK, landlords feel threatened by potential legislation that might outlaw upward only rent reviews. Should such legislation be introduced, there are lessons from the Australian States as to how to prevent landlords circumventing the restrictions.

In the area of enforcement of lease obligations, reform of English law is long overdue. The law on forfeiture and distress is a disgrace to any mature legal system. Largely sensible reform proposals have been on the table for far too long and the failure to implement them is a reflection of the lamentable record of successive Governments in taking the Law Commission seriously.

However the key area of concern for business tenants in the England and Wales ought to be the future of the system of security of tenure. While successive governments have declared their determination not to undermine or unbalance the 1954 Act, there has, without debate, without serious consideration of the policy issues, and without any empirical study of the incidence of contracting out, been a sea change from a compulsory system of security of tenure for business tenants to an optional one. Furthermore, it is hard not to conclude that the reforms currently in train will not hasten that process. This is in marked contrast to the position in Northern Ireland and Eire.

Whilst the evidence indicates that the original introduction of contracting out in 1969 came out of the blue, it would be unfair to suggest that its maintenance has taken place behind closed doors. Both the Law Commission and the DETR have “consulted” on the current proposal to make contracting out more routine and there is little doubt that certain interests are well protected by a consultation process. The major landlords, the big retailers and large occupiers of business space are well represented by knowledgeable, energetic and vociferous interest groups with well-honed lobbying skills. However, it is almost certain that the 1954 Act is not a serious issue for this type of tenant; these big boys and girls can well look after themselves and scarcely need statutory security of

tenure. As always, it is the small business tenant who most needs others to consider his interests and who may not have the loudest voice when policy decisions are being taken.

It is, of course, quite possible, that the 1954 Act has had its day and that it is ripe for repeal; its abolition has not only been advocated by the British Property Federation (which represents the major landlords), but also by a well respected High Court judge with many years experience in the commercial landlord and tenant field (Neuberger, 2000). What is unacceptable is the suspicion that a surreptitious repeal of the 1954 Act may be taking place without an open debate on the matter and on the basis of very little hard information.

As we have noted, there are no remotely reliable statistics on the level of contracting out since 1989. Little or no UK research has been done on the impact which statutory protection has on commercial property markets (although work in the USA indicates that sitting tenants in retail shopping centres certainly pay more for a renewal than new tenants; Fisher and Lentz, 1990). One of the reasons for this dearth of research is the lack of lease data which differentiates between statutorily renewed leases and open market lettings. That held by the Valuation Office Agency is in theory able to do so and IPD is starting to gather this information. However, the VOA data is not in the public domain and is, at the moment, not altogether reliable on the identification of statutorily renewed leases (see DETR, 2000).

The need for an open consideration of the future of security of tenure appears glaringly obvious. Whilst a cogent case for its abandonment has been made (Neuberger, 2000) this is based largely on broad economic principles and on a desire for some consistency with the effective withdrawal of statutory protection from both residential and agricultural tenants. However, the suspicion must be that security of tenure remains of very real significance, notably in the retail sector. If that is the case, those who need this protection to continue will have to engage in the debate.

There will be many who argue that the proposal to relax the machinery for contracting is indeed purely procedural and will have no impact on the level of contracting out; indeed, this is the most likely explanation for the universal silence on this topic. This may well turn out to be right. However, it is quite possible that, once landlords appreciate the radical changes that are to be made to the old familiar procedures of the current statutory scheme, they may be sorely tempted to take the easy way out by insisting that their leases are contracted out of the Act, at least wherever that can be achieved without serious resistance from the tenant. Furthermore, with the removal of the need to apply to court for approval, any last vestige of a mechanism for monitoring the level of contracting out will disappear.

## **B. Australia**

### **B. (i) Informing small business tenants**

It is commonly reported that small business tenants of all types of premises do not realise the commitments that they make when signing leases. All State governments have done

what they can to make tenants of shops aware of these obligations, through Disclosure Statements and dissemination of information by government departments and bodies such as the Small Business Development Corporation. It is difficult to know what other steps can be taken to protect retail tenants, except for more severe penalties for failure to provide pre-leasing information and more funds to educate potential tenants. Although there is no reason why such regulations should be limited to retail tenants, there is little pressure to better inform other business tenants of their obligations. It would appear from the UK experiences that voluntary codes are unlikely to significantly improve tenants' knowledge unless the code is heavily promoted. Many solicitors would be happy to see it compulsory for tenants to obtain legal advice before leasing.

### **B. (ii) Protection by imposing lease covenants**

The terms of reference for the Commonwealth report were to examine options to address improper dealings by such measures as voluntary codes, self-regulation and dispute resolution mechanisms as well as legislative remedies (Commonwealth of Australia, 1997: iii). The resulting report scarcely mentioned self-regulation of retail tenancies and all of its recommended changes required legislation. There appears to be little faith in the effectiveness of voluntary codes and self-regulation to correct market imbalances. If the imbalance results purely from lack of understanding, it should surely be possible to fund educational campaigns. However, if one party has inordinate power due to its size, lack of competition or by collusion with other parties, simply spreading information is unlikely to redress the imbalance. For retail tenancies, further legislation is probable.

Two particular elements of shop leases are the subject of continuing debate and possibly more government interference. First, several government reports have suggested that mid-term market rent reviews are inappropriate in retail leases (for example, Commonwealth of Australia, 1997: 56). There is a belief that market rent reviews create too much uncertainty in the running costs of tenants' businesses and that the necessarily better informed lessors should carry the risk of fluctuations in values. In fact, the Commonwealth report (1997: 57) recommended banning mid-term market rent reviews entirely from retail leases. Market rent reviews have lost much of their popularity with commercial and industrial landlords since the early 1990s when it became more difficult to control their outcomes by carefully drafted rent review clauses. It is possible that they may be prohibited for shop leases in the foreseeable future.

The second issue that continues to cause controversy in shopping centres is whether specialty shop tenants can or should be involved in the planning for the centre. They argue that the success of their businesses depends upon the tenancy mix, the promotion of the centre and other factors over which the landlords retain tight control. Landlords do not accept that their role is to simply coordinate the needs of all tenants but that their management skills, if unrestricted, will maximise turnover and profits from the centre. Current legislation does give tenants some rights to notice when refurbishment or major alterations are planned. It is possible that further legislation will require some sharing of the management of the centre and its promotional strategies. This has occurred in some States where "core trading hours" must be approved by a 75 per cent majority of the tenants (see Part III B. (ii) a above).



**B. (iii) Protection at the end of the lease**

The main legal issue confronting shopping centre owners in Australia at present is the continuing pressure for security of tenure for retail tenants. Legislation is being prepared in Victoria and the Australian Capital Territory that will give tenants rights to renew their leases (Fairweather, 2000; 20). Owners see this as a major dent in their freedom to manage the tenancy mix and remove poorly performing tenants for the benefit of the centre and the remaining tenants. This pressure for renewal rights is occurring at a time when security of tenure is being threatened in England and Wales (see Part III A. (iii) a above). The UK property investment market has been able to operate satisfactorily under a regime of security of tenure for all commercial premises. The pressure for shorter leases has probably had more adverse consequences upon the perception of property risks than the tenants' renewal rights. In the UK, contracting out of statutory renewal rights may be becoming the norm for short leases, especially for those of non-retail premises.<sup>24</sup>

It is unclear whether, in an environment of short business leases, security of tenure would be an unworkable burden for landlords in Australia. The Federal report recommended such protection and it is likely that other States will be watching the progress and effects of the legislation proposed in Victoria and the Australian Capital Territory. It does appear that the Property Council of Australia recognised that the current position of existing tenants seeking lease renewals requires attention (Commonwealth of Australia, 1997: 35). The UK history of protection of tenants at the end of their leases offers some alternatives for Australia which may be more appropriate than granting renewal rights. For example, landlords could be required to compensate tenants for loss of goodwill and/or the value of tenants' improvements if the leases are not renewed. This is likely to meet with resistance from landlords but it does give them the freedom to alter the tenancy mix which has been their main argument against renewal rights.

Many of the complaints against lack of renewal rights come from assignees who may have been in occupation for much less than the minimum five year lease term. A legislative provision that extends leases to five years from the time when consent to an assignment is given would overcome this complaint but would need to be carefully drafted to avoid abuse by tenants.

There are a variety of ways in which lease expiry can be regulated, such as compensation to tenants, rights of first refusal to existing tenants, longer minimum terms, minimum terms for assignees or some form of statutory option to renew. It is not clear which of these measures landlords will find more palatable but it might be helpful if they considered the alternatives, rather than simply objecting to any form of protection for retail tenants at the end of their leases.

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<sup>24</sup> The BPF Short-term Commercial Lease is envisaged as suitable for leases up to three years long and provides only for lettings without security of tenure (BPF, 1999: 1). Three year leases are considered temporary in the UK but are common for commercial lettings to small businesses in Australia except where laws grant a minimum of five years.

The nature of retailing is such that the issue of the right to continue trading in the current location will continue to be a high priority for Australian tenants. Office and industrial tenants can more readily change locations without adverse effects on their businesses. Therefore, there is little case for extending security of tenure to these tenants.

## VI. Conclusion

This paper has reviewed the arguments for, the history of and the current laws protecting business tenants in the UK and Australia. Comparisons between the two systems can help those involved in the current debates in both countries to clarify the need for changes in the degree and nature of government intervention. Comparisons must always bear in mind the economic, cultural and physical differences. In retail tenancies, the different structure, particularly the length of leases in the two countries and the organisation of retail tenants within shopping centres (usually small UK business tenants occupy high street rather than shopping mall locations) are all factors which lead to different needs and attitudes. However, some useful observations can be made.

This review shows that, in all jurisdictions, intervention has usually been designed to assist the less knowledgeable and experienced tenant. However, in sharp contrast with Australia, the UK has never drawn any distinctions between different kinds of tenant. Although lines are always difficult to draw, given that experiences in both jurisdictions indicate that landlords do not readily participate in voluntary initiatives, it would appear that confining mandatory intervention to smaller tenants would help to diffuse landlord resistance. Imposing regulation where it is not needed undermines the whole system.

However, data from the UK suggests that differences in lease structures are at the property rather than the tenant level. In Australia, the property size based indicators used to distinguish between protected and unprotected tenants (coupled with exclusions for tenants which are public companies) coincides reasonably with the distinction between corporate and small business retail tenants. However, the same would not apply for commercial or industrial tenancies in Australia, nor for most UK business tenancies. The UK data also clearly shows the different knowledge levels of corporate and small business tenants so it is necessary to devise means by which these tenant groups can be defined and these definitions should be based on business rather than property criteria.

While the Australian experience suggests that small business tenants remain prone to entering into leases without fully appreciating the nature of their commitments, it is clear that mandatory disclosure requirements imposed by most States are a more effective tool for ensuring that tenants are better informed during lease negotiations than the voluntary code employed in the UK. The UK Commercial Leases Code of Practice also suffers from its failure to prescribe modes of conduct for either landlord or tenant. Accordingly, its function can only be a primarily educative one. In this it is currently failing because tenants, particularly small business ones, remain ignorant of its existence. While the present Government policy of trying to encourage better methods of dissemination will have some impact on this front, it is hard not to conclude that a radical change of tack is needed. All the evidence from both countries is that codes of practice do not work.

For the UK reader, the most interesting aspect of the Australian approach on the control of lease terms is the outlawing of upwards only rent reviews and the control of service charge costs. It appears that the Australian legislatures have cracked the technical legal difficulties of prohibiting upwards only rent reviews and that, in the context of shorter leases, the measures have not provoked too much hostility from landlords. Although leases in the UK have become shorter, it is clear that abolishing upwards only reviews would have a serious impact on the significant proportion of longer leases which remain prevalent. Accordingly, if the UK Government does decide to intervene, it will meet fierce resistance, especially from institutional landlords who will be concerned over the effect on investment values.

The Australian experience of intervention on service charges highlights the timidity of the UK legislature. Even if, as has been suggested, the result of statutory control is to encourage higher all inclusive rents, many tenants would find this preferable to the uncertainty and aggravation caused by fluctuating service charges.

The biggest single difference between the two jurisdictions lies in the approach to security of tenure. There is no evidence that the wide ranging rights of renewal conferred in England and Wales has any serious impact on investment values; indeed, the bland but generally held view that the 1954 Act works well strongly suggests otherwise. While there is some pressure from landlords for the Act to be repealed, it is not strong and may be no more than a negotiating tool in a strategy of resisting more intervention, particularly on upwards only rent reviews. However, the lack of lease data which differentiates between new open market lettings and statutory renewals means that this assumption of no impact on values has never been tested. Furthermore, the inability to track the level of contracting out of the 1954 Act, particularly in recent years, means that it is impossible to judge whether the system is dying, or about to die, on its feet. However, existing research in the US does tentatively suggest that, where rights to renew do not exist, existing tenants pay higher rents in sought after locations than new tenants. In contrast, UK research suggests the opposite is true where security of tenure is present. The results from similar Australian research are ambiguous.

The desire by Australian retail tenants for, and the resistance of their landlords to, the introduction of any security of tenure is understandable. It would appear that the pressure for intervention has been brought about, at least in part, by evidence of ruthless tactics by the larger landlords. Statutory rights of renewal would curtail this, and would protect the position of assignees. However, in a retail economy which operates on the basis of short leases, perpetual rights of renewal would have a considerable impact. However, the UK experience indicates that this might not be as great as may be feared. Properly drafted legislation does not give automatic rights of renewal; tenants in default can still be weeded out and poorly performing tenants often do not exercise their rights to renew at what will usually be an enhanced rent. It does give good tenants greater stability and a greater share in the asset which their efforts have helped to create. Experience in the UK and Eire suggest that trying to protect tenants by alternative means, usually by compensation for the loss of goodwill and improvements, is not satisfactory; the mechanisms are cumbersome and the outcome is often a very crude measure of the tenant's loss. Overall, the comparison of the two regimes suggests that a compromise on

security of tenure is hard to achieve with tenants seeking protective legislation while landlords resist. Perhaps the compromise is that legislation should be confined to those tenants who have been shown to be less well equipped to understand and resist onerous lease terms. If that occurred, and was based on business rather than property definitional distinctions, interesting questions are raised on whether two-tier rental and capital value markets are created.

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