Retail and Commercial Leases Act 1995 (SA)

Issues Paper – December 2014

Background

The Retail and Commercial Leases Act 1995 (the Act) was enacted on 6 April 1995 and commenced operation on 30 June 1995. The Act was introduced to regulate the leasing of retail shops and replace Part IV of the Landlord and Tenant Act 1936. Since the commencement of the Act, significant amendments have been introduced. These include implementation of rules in relation to the granting of a preferential right of renewal to shopping centre lessees when their lease expires (Sections 20A to 20 N), limiting the liability of a lessee when their lease is assigned (Section 45A) and the introduction of rules to govern the leasing of shopping centre mall space on a casual basis (Section 62A).

The Retail and Commercial Leases Regulations 1995 were due to expire on 1 September 2010. As a result, the Regulations were revoked and the Retail and Commercial Leases Regulations 2010 commenced on 1 September 2010. The most significant amendment of the 2010 regulations was to raise the rent threshold from $250,000 to $400,000 (from 4 April 2011).

The Small Business Commissioner (SBC) is responsible for the administration of the Act. In the event of a dispute, the Act provides for an efficient and cost effective procedure for the resolution of disputes between parties to a retail shop lease. Either party or former party may apply to the Small Business Commissioner for mediation of the dispute.

Purpose of Issues Paper

The purpose of this paper is to offer a direction to discussion about issues raised relating to the Act and to elicit public comment on these issues. The issues raised are not intended to be exhaustive, and stakeholders are invited to identify other issues in their submissions.

Process

The State Government is calling for submissions on the issues raised in this paper, and on any other issues relating to the Act that may not have been identified.

The review will be undertaken by Mr Alan Moss – a former Deputy Crown Solicitor, Chief Magistrate, District Court and Youth Court Judge.

Submissions should be sent to:

The Office of the Small Business Commissioner

GPO Box 1264

ADELAIDE SA 5001

Closing date for submissions is Friday 13th February 2015.

Any inquiries should be directed to (08) 8303 2026 or 1800 072 722
1. Main Issues with the Act

1.1 Application of the Act

Preliminary Part 1 (4) Application of Act

A key measure of whether a lease is deemed to be covered by the Act is whether the rent payable under the lease exceeds the relevant rent threshold. However it is unclear whether the increase in the rent threshold applies to existing leases only, or only to new leases entered into after 4 April 2011.

Further confusion has arisen with regard to what happens to a lease when it begins within the relevant threshold, and over the course of the lease falls outside of the threshold and vice versa.

Many representations have been made to the Office of the Small Business Commissioner (OSBC) requesting that this be clarified so parties can have more certainty in their dealings. Some of these representations have included the suggestion that it would be preferable to use lettable area, rather than rent payable to determine whether or not a lease is covered by the Act.

An alternate to the rent threshold of $400,000 per annum for smaller lessees could be to adopt a floor space threshold of, for example, 500 square metres.

A floor space threshold overcomes variances in rents and occupancy costs that currently exist with a premises being below the occupancy cost threshold at lease commencement but exceeding it during and at the end of the lease.

Another issue identified with the rent threshold is that there are differing opinions as to whether rent is inclusive or exclusive of GST. If it is deemed that rent is inclusive of GST, the coverage and therefore the protections under the Act will be available to a smaller pool of stakeholders over time.

There currently is no definition of a public company, does this only include companies listed on the Australian Stock Exchange or does this include any publicly traded company internationally?

In addition, there is a lack of clarity surrounding when a company transitions from a private company to a publicly listed company during the lease, and vice versa.

When the lease is entered into

There may be uncertainty as to when a lease is entered into. Part 1 (6) of the Act currently deems this to be the case when both parties have executed the lease or when a person enters into possession of the retail shop as lessee under the lease or when a person begins to pay rent as lessee under the lease or proposed lease.
It is not clear what happens in the instance where there is:

(a) no lease document; or

(b) a draft lease document; or

(c) an agreement to lease document or (d) an assignment of the lease.

There is no specific redress for the lessor or lessee if a verbal agreement entices the other party into an “informal” non-documented lease whereby a party takes possession of the premises, and the other party then attempts or proposes to change or modify the agreement.

In the case of a lessor, they may have provided substantial assistance to the lessee and may be reticent to agree to terms that they had not originally agreed to prior to the lessee taking possession of the premises.

Similarly, the lessee may be at substantial disadvantage after taking possession of the premises and may have spent large sums of money on fit out etc., they may find themselves in a situation where they have no choice but to accept a lessor’s “revised” offer of lease.

Can this situation be addressed by a more effective penalty regime for the non-supply of a Disclosure Statement?

Does the relevant section of the Act – Part 1 6) – When the Lease is entered into require modification?

1.2 Before the lease is entered into

Part 3 – Before the lease is entered into

Copy of lease to be provided at negotiation stage

Part 3 (11) of the Act currently provides that a copy of the lease be provided at the negotiation stage. The penalty for non-compliance is $500. This penalty is not a remedy for the lessee and whether there should be any remedy for the lessee for non-compliance may be an issue for consideration. This could include an amount of rent forfeited by the lessor. It could also include an opportunity to terminate or void the lease on behalf of the lessee.

Currently there is no definition as to what constitutes the negotiation stage.

Disclosure Statement

Under Part 3 (12) of the Act, a Disclosure Statement must be provided to the lessee before a lease is entered into or renewed. The Disclosure Statement must contain the prescribed information, including details of the outgoings that the lessee will be liable for.

The Act does not specify:

(a) whether a Disclosure Statement should be provided with an agreement to lease or with a draft lease; or

(b) that the Disclosure Statement be signed by the lessor or lessor’s representative.
In the event of non-compliance, there is no penalty for the lessor or remedy for the lessee. A possible remedy for the lessee if the disclosure statement is not signed by both parties, may be that it is taken that a disclosure statement was not provided in the first instance.

Should penalties be introduced for provision of incomplete Disclosure Statements?

Do the current prescribed requirements of information in the Disclosure Statement cover contemporary leasing arrangements?

Should the Disclosure Statement contain all information relating to incentives, allowances, rent free periods, fit out allowances and so on?

Is there merit in having separate Disclosure Statements e.g. non shopping centre retail premises; shopping centre retail premises; renewal of lease; and assignment of lease?

Capital Expenditure

There are limited circumstances where an obligation may arise on the lessee to make or reimburse capital expenditure. There is no definition in the Act for what constitutes capital expenditure. The Act does not provide any remedy for lessees when a lessor does not undertake capital expenditure.

Lease preparation costs

Part 3 (14) of the Act deals with lease preparation costs. In instances where the lessee is liable to pay expenses incurred by the lessor for lease preparation costs, it is not clear whether this applies to renewals or extensions of a lease.

It is also uncertain as to whether these costs should be limited in any way, for example to costs incurred in making amendments proposed by the lessee.

Should there be a cap on lease preparation costs listed in the Disclosure Statement?

Lease documentation

Under Part 3 (16) of the Act, the lessor must provide the lessee with an executed copy of the stamped lease within 1 month and, if the lease is registered, the lessor must lodge the lease for registration within 1 month after the lease is returned to the lessor.

In the event of non-compliance, there is no penalty for the lessor or remedy for the lessee.

Should it be mandatory to register a retail shop lease?

Warranty of Fitness for Purpose

Under Part 3 (18) of the Act, if the lessor had notice from the lessee that the premises were required for carrying on a particular business, the lease is taken to include a warranty that the premises will be structurally suitable for the purpose. However, the Act subsequently allows a lessor to exclude this obligation if the lessee is given a notice of exclusion in the form prescribed by regulation. Thus the premises no longer carries a warranty of fitness for purpose and the lessor is not responsible for any structural repairs and maintenance.
One option for consideration is that the lessee establish the scope of works required to the lessors property and include an estimate of costs within the Disclosure Statement along with a clear description of “make good” upon vacating the premises.

1.3 Security

Part 4 (19) of the Act allows a lessor to secure performance of the lessee’s obligations under the lease by requiring a security bond or a guarantee.

The value of a bond is limited to the equivalent of four weeks rent and the bond must be lodged with the Small Business Commissioner. At the end of the tenancy either or both parties can make a claim to the Small Business Commissioner for return of the bond.

The value of a guarantee is not limited and is not held by the Small Business Commissioner. For these reasons, lessees in shopping centres are often asked to provide a guarantee, not a security bond. Common industry practice has been to ask for a guarantee equal to 3 months’ rent, but now some lessors are asking for the equivalent of 6 months rent, sometimes more.

This results in the lessee having a considerable sum of money tied up for the duration of the tenancy. Furthermore, unlike bonds, the Act does not prescribe a process by which the guarantee can be paid out. This allows lessors to unnecessarily delay the release of the guarantee or make unreasonable claims against it.

Lessees can also refuse to release a guarantee when a lease is assigned, even though the lessor obtains another guarantee from the assignee. Thus the lessor is afforded double (or sometimes more) the protection contemplated under the legislation. When a lease is assigned, the lessee’s guarantee is not accessible to them for a further two years.

A substantial amount of bond and guarantee disputes have been received by the Small Business Commissioner since taking over administration of the Retail and Commercial Leases Act 1995. Conciliation by the Small Business Commissioner may remedy many of the issues involved with bonds disputes. If the scope of the bond was expanded to allow up to 3 months’ rent held only by the Small Business Commissioner this could eliminate the need to offer a guarantee.

1.4 Term of lease and renewal

Minimum 5 year term

Under Part 4A Division 2 (20B), the term for which a retail shop lease is entered into must be at least 5 years. This statutory right of tenure may be excluded by a certified exclusionary clause which requires a certificate signed by a lawyer. This can be a costly process for a lessee and perhaps a more cost effective alternative option for certification could be considered, possibly with the Small Business Commissioner.

Rules of conduct at end of term

Under Part 4A Division 3 Sub Division 2 (20D) of the Act, preference is to be accorded to the existing lessee of a retail shop lease of premises in a retail shopping centre at the end of the
lease term if a lessor proposes to re-let the premises and the existing lessee wants a renewal or extension of the term.

Does this provision balance the interests of the lessee and lessor effectively? Is the lessor disadvantaged given they may have significant capital invested in a single location? Without the ability to relet, it may impede the lessor’s ability to successfully manage the centre to the detriment of the lessee and other lessees.

For lessees of retail shop lease premises not located in a retail shopping centre, the same preference does not apply and the lessor is only required to give the lessee between 6 and 12 months written notice with an offer of renewal or extension or to inform the lessee that the lessor does not propose to offer a renewal or extension of the lease.

The Act does not provide any penalty on the lessor for non-compliance with these provisions. The Act specifically provides that except as expressly provided (within the lease), there is no civil remedy for non-compliance with Part 4A of the Act relating to term of lease and renewal.

Once the timeframe has lapsed the lessor may then allow the agreement to expire. This is quite common and has been shown to be the case with disputes dealt with by the Small Business Commissioner. The lessor then has a choice as to whether they would like to remove the lessee or to renegotiate the lease on substantially one-sided terms, often the lessee has the choice to sign a new “unreasonable” agreement or to leave the premises and to forfeit any capital they had previously invested in their business.

1.5 Rent and outgoings

**Fitout**

When a lessor has fitout obligations under the lease (Part 5 (21) – Payment of rent when lessor’s fitout not completed of the Act), the lessee is not liable to pay rent before the lessor has substantially complied with the lessor’s fitout obligations. There is no definition in the Act for ‘fitout’ or what constitutes ‘substantially complied’. The Act does not specify what happens regarding fitout obligations during a lease or on extension or renewal of a lease. There is no remedy for the tenant in instances where the fitout is inadequate.

**Adjustment to base rent**

Part 5 (22) of the Act does not require any formal notification of a rent increase. Many leases prescribe that even if the lessee does not receive any notification of a rent increase, it is still enforceable against the lessee at some future time.

For the more informed lessors and lessees this is not a problem. For those parties who are less informed this can be a problem, as the parties may overlook the fact that a rent increase was to be implemented. The construction of most leases is such that the lessor is able to claim back rent without any time restriction. Thus a lessee could be faced with serious cash flow issues or worse when the lessor demands payment of the rent arrears. This is not consistent with the Act’s approach in relation to outgoings where a lessee is entitled to receive notification of the estimate of budgeted outgoings for the following year. In the event of non-compliance with these provisions, there is no penalty for the lessor or remedy for the lessee.
Land Tax

A retail shop lease cannot require the lessee to pay land tax under Part 5 (30) of the Act. There is some uncertainty as to what happens in cases where a lease was previously outside of the Act’s relevant rent (and other) thresholds and then changes so that the lease falls within the Act’s relevant rent (and other) thresholds and vice versa, and whether land tax provisions under the relevant lease still apply.

Outgoings

Part 5 of the Act sets out the process of how outgoings are to be disclosed and accounted for. The main requirement is that for each accounting period the lessor must provide the lessee a written estimate of the outgoings for the following year. Within 3 months after the end of the accounting period, the lessor must provide the lessee with a report that enables the lessee to readily compare the actual expenditure on outgoings with the original estimate. There is no definition for accounting period. In the event of non-compliance, there is no penalty for the lessor or remedy for the lessee.

Repairs and maintenance

In shopping centres it is common for lessees to contribute to a Sinking Fund (Part 5 (29) of the Act), established by the lessor, to fund major repairs or maintenance of the premises. However this cannot be used for capital expenditure (though there is no definition of what is capital expenditure).

In other premises, leases will either provide that the lessor can recover the cost of repairs and maintenance as an outgoing, or the lessee is directly liable for the maintenance of the premises. Leases that provide for the lessor to be liable for repairs and maintenance are the exception.

Issues with repairs and maintenance often run contrary to what lessees generally expect to be the position regarding maintenance of the premises. The Act does not require that retail premises should have to meet some minimum standard regarding their condition and the facilities provided, the majority of leases are let on an “as is” basis.

Subject to the terms of the lease, and if the lessee has been given the prescribed notice regarding the Warranty of Fitness for Purpose, the lessor is not obligated to repair or maintain and this often leaves lessees with unexpected financial burden regarding repairs and maintenance.

The Small Business Commissioner fields a very high number of enquiries, from lessees in particular, with regard to responsibility of lessor and lessee and maintenance and repairs of the premises. Often the lessee has no choice but to pay for the repairs or maintenance in order to continue operating their business or to directly negotiate with the lessor in the hope that they will assist.
1.6 Alterations and other interference with the shop

Lessee to be given notice

Under Part 6 (37) of the Act, a lessor must not commence or carry out an alteration or refurbishment before notifying the lessee in writing at least 1 month before commencement. In the event of non-compliance, there is no penalty for the lessor or remedy for the lessee.

Demolition

Under Part 6 (39) of the Act, the lease cannot be terminated unless the lessor has provided the lessee with details of the proposed demolition with at least 6 months written notice of termination. If a retail shop lease is terminated on such grounds and demolition of the building is not carried out within a reasonably practicable time after the termination date notified by the lessor, the lessor is liable to pay the lessee reasonable compensation. There is no mention of whether the lessor is liable to pay any of the lessee’s relocation or fitout costs. Should there be more specific reference to these costs in the Disclosure Statement?

Damaged premises

Under Part (6) 40 of the Act, the lessee is not liable to pay rent or any amount payable to the lessor in respect of outgoings or other charges if the retail shop is damaged. Termination of the lease by the lessee or lessor under this provision of the Act does not take into consideration the lessee’s financial burden associated with relocation and fitout costs. The lessor is able to terminate the lease if the lessor considers that the damage is such as to make its repair impracticable or undesirable. There has been concern that this may provide an opportunity for a lessor to terminate a lease by avoiding carrying out repairs and running the premises down over the term of the lease. There is no provision for an independent assessment to determine whether the repair is impracticable or undesirable.

1.7 Assignment and termination

Consent to assignment

Part 7 of the Act prescribes the respective rights and obligations of the lessor and lessee in dealing with the assignment of a lease. This includes a requirement that the lessor must deal expeditiously with a request for an assignment.

Under the assignment provisions, if the lessor decides the assignee is not adequately skilled to take on the business, there is no recourse for the lessee to dispute the lessor’s determination.

Provided the lessee has fulfilled all their obligations under the assignment provisions, under Part 7 (45d) of the Act, the lessor has 42 days in which to deal with the request. If the lessor fails to meet this obligation, it is deemed that the lessor has consented to the assignment. However the Act fails to prescribe on what terms the assignment is effected and the assignment is in limbo unless the lessee applies to the Magistrates Court for a determination. There is no penalty for non-compliance by the lessor.

While the lessor is not permitted to charge a premium for the granting of consent (Part 7 (44) of the Act), they can require payment of a reasonable sum for legal and other expenses
incurred in the process. There is no definition for what is considered reasonable and these costs often amount to several thousand dollars. This is often seen as a de-facto premium by many lessees, who may have no choice but to pay these fees in order to secure the assignment.

**Liability of lessee following assignment**

If the lessee assigns the retail shop lease (Part 7 (45A), the lessee will not be subject to any obligations or liabilities under the lease on or after the relevant date. The relevant date means the second anniversary of the date on which the lease was assigned, or the date on which the lease expires, or the date on which the renewal or extension of the lease commences, whichever occurs first. There is no reference in the Act as to whether the liability of the assignor continues if the assignee sublets with the lessor’s permission.

**Lessor’s right to refuse sublease or mortgage**

Under Part 7 (46) of the Act, a retail shop lease may contain a provision that allows the lessor the right to refuse consent to grant a sublease or consent to the lessee mortgaging the lessee’s interest in the lease. This is inconsistent with assignment of a lease where a lessor is only able to withhold consent under specific circumstances. It is also unclear what happens in circumstances where the sublease is not a retail tenancy.

**1.8 Additional requirements for retail shopping centres**

**Relocation**

Under Part 8 (57) of the Act, there are specific requirements whereby a retail shop lease contains provisions that enable the lessee’s business to be relocated. The lessee is entitled to payment by the lessor of the lessee’s reasonable costs of the relocation, including legal costs. There is no clarification as to what constitutes reasonable costs and whether the cost of fitout is included. The lessee is entitled to be offered a new lease of an alternative shop. There is no clarification of what constitutes an alternative shop and what this means in relation to the location and access of such shop.

The lessee may be offered an alternate shop in a less desirable location within a retail centre.

**1.9 Miscellaneous**

**Abandoned goods**

If a retail shop lease terminates and goods are left on the premises, the lessor may, when at least two days have passed, remove and destroy or dispose of the goods. This is inconsistent with the process for the disposal of distrained goods under the *Landlord and Tenant Act 1936*. 
2. **Main issues not covered by the Act**

2.1 Termination

The Act does not cover how a lease can be terminated for a breach by either the lessor or lessee. The *Landlord and Tenant Act 1936* which is assigned to the Attorney General, but not administered by any agency, does cover the issues of re-entry and distress for rent (commonly referred to as a lockout/distrainment).

This process is very complex and costly. A lessor can be substantially disadvantaged incurring legal and other costs exceeding several thousand dollars, at a time when a substantial debt may already be owed by the lessee. The only way for the lessor to recover both amounts is then to follow-up the distrainment action with civil litigation, costing the lessor and lessee further.

This worsens the lessor and lessee’s financial position and makes the resolution of the dispute more difficult.

Once distrainment/termination has occurred the only avenue for redress for the lessee is with the Supreme Court. In most cases this is out of the lessee’s reach, as they may owe a considerable amount to the lessor, and having been removed from their business premises they may no longer be receiving an income.

It is desirable to have a process that clearly sets out what constitutes a breach, what notice should be given and what redress is available for non-compliance. This process may be better conciliated within the OSBC at no cost or low cost to the parties, and may include conciliation with connection to bond disbursement to cover further costs to either party.

2.2 Condition reports

Many leases have provisions that require a lessee to “make good” the premises at the end of the tenancy. Concern often arises from lessees who are worried that the lessor, in their opinion, is making unreasonable demands in relation to make good requirements. For example, issues often arise in relation to (i) painting the inside and outside of the premises without taking in to account the condition at the start of the tenancy and fair wear and tear, (ii) removal of flooring installed by the lessor regardless of quality and age, and (iii) make good issues which a former lessee had not been asked to rectify. The Act does not require inspections at the start and end of a tenancy or the completion of Inspection/Condition reports. One option is for a photographic condition report to be incorporated as part of the Disclosure Statement along with a description of the scope of works required upon vacating the premises. This would enable clear comparisons to be made of the condition of the premises at the start of the lease and after “make good” works have been undertaken.

2.3 Lease Documentation

A lessor is required to provide a copy of the proposed lease to any prospective lessee when negotiations begin.

It is common practice for lessees to be provided a copy of an agreement to lease, followed by a formal lease at a later stage rather than the proposed lease, as required. The
agreement to lease has no standing under the Act, but it seems that under contract law, the lessee can be tied to a tenancy without having received the proposed lease.

Disputes arise when the formal lease contains terms which are different to those contained in the agreement to lease. The Act does not clarify the status of an agreement to lease.

Many leases are voluminous, contain legalistic terms and jargon, and are not user friendly. It is not uncommon for lessors, who have had the leases drafted (let alone lessees) to misunderstand them. Thus, clarification of the parties’ respective rights and obligations requires legal advice and/or court action to resolve and this can be expensive, time consuming and frustrating process.

Consideration could be given to providing a pro-forma lease, if not for shopping centre tenancies, then certainly for strip and stand-alone tenancies.

2.4 Dispute Monetary Limits

When a dispute between the lessor and lessee is referred for mediation under the Act, there is no monetary limit set down for the Small Business Commissioner to facilitate negotiation.

The costs for lessee fitouts are, in many instances, substantial. Should there be an upper limit for the Commissioner to mediate over and, if it is exceeded, the dispute is heard by the courts? An amount of $400,000 has been set in NSW.