HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Reference: Fair trading

CANBERRA

Monday, 10 February 1997

OFFICIAL HANSARD REPORT

CANBERRA

HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Members:

Mr Bruce Reid (Chair)

Mrs Bailey	Mr Jenkins
Mr Baldwin	Mrs Johnston
Mr Beddall	Mr Allan Morris
Mr Martyn Evans	Mr Nugent
Mr Richard Evans	Mr O'Connor
Mr Forrest	Mr Zammit
Ms Gambaro	

The committee will inquire into business conduct issues arising out of commercial dealings between firms, including claims by small business organisations that some firms are vulnerable to and are not adequately protected against 'harsh or oppressive' conduct in their dealings with larger firms.

1. The committee is asked to investigate and report on:

the major business conduct issues arising out of commercial dealings between firms including, but not limited to, franchising and retail tenancy;

the economic and social implications of the major business conduct issues particularly whether certain commercial practices might lead to sub-optimal economic outcomes.

2. The committee is asked to examine whether the impact of the business conduct issues it identifies is sufficient to justify Government action taking into account, but not limited to :

existing State and Commonwealth legislative protections;

existing common law protections;

overseas developments in the regulation of business conduct.

3. The committee is asked to examine options and make recommendations on strategies to address business conduct issues arising out of dealings between firms in commercial relationships, taking into account, but not limited to:

the potential application of voluntary codes of conduct, industry self-regulation and dispute

resolution mechanisms, including alternatives to legislation and court-based remedies, and mechanisms to support these measures;

legislative remedies.

4. In developing options, the committee will seek to ensure certainty in the market place, contract dealings and other commercial transactions, minimise the regulatory burden on business, and keep litigation and costs to a minimum.

WITNESSES

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Fair trading

CANBERRA

Monday, 10 February 1997

Present

Mr Reid (Chair)

Mrs Bailey	Mr Jenkins
Mr Beddall	Mrs Johnston
Mr Richard Evans	Mr Allan Morris
Ms Gambaro	Mr Zammit

The committee met at 9.02 p.m.

Mr Reid took the chair.

CHAIR—I declare open this public hearing of the inquiry into fair trading. Last year, the committee took evidence from small businesses at public hearings in capital cities around Australia. Allegations were made at those hearings by many small business people of harsh business practices, particularly in relation to retail tenancy and franchise arrangements.

The committee aims to wind up the evidence gathering stage of the inquiry this month with a series of four public hearings. Today, the committee will hear from the Australian Competition and Consumer Commission, the Department of Industry, Science and Tourism, the Australian Institute of Business Brokers, the New South Wales Registrar for Retail Tenancy Disputes and the Australian Institute of Valuers and Land Economists.

The aim of this February round of hearings is to 'test' policy options for addressing concerns of small businesses prior to the committee's consideration of what recommendations it will make in its report to parliament.

ASHER, Mr Allan, Deputy Chairman, Australian Competition and Consumer Commission, Chan Street, Belconnen, Australian Capital Territory 2616

DEE, Mr William Gerard, Director, Liaison, Australian Competition and Consumer Commission, PO Box 19, Belconnen, Australian Capital Territory 2616

CHAIR—Welcome. The committee's proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings of the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence that they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded however that false evidence given to a parliamentary committee may be regarded as a contempt of parliament.

The committee prefers that all evidence be given in public but should you at any stage wish to give your evidence in private you may ask to do so and the committee will give consideration to your request. The committee has received your supplementary submission providing information on how the state fair trading authorities handle small business complaints, in reply to an issue raised at a public hearing in November last year. The committee has authorised publication of this supplementary submission. I now invite you to make an opening statement before we commence questioning.

Mr Asher—The commission set out its general views in its submission and at the last appearance there were a number of questions raised by members of the committee. The questions seemed to touch on issues such as the enforcement profile of the commission, our experience in dealing with small business complaints and a number of other matters.

Since that time, the commission has been reasonably active in establishing a liaison group with small business interests so that we can discover more clearly from representatives of that sector just how they perceive the problems and how we can make our own communications with them more effective.

In addition to that, the commission has been active in complaints investigation and there have been a number of court actions that bear on the subject matter of this inquiry. I thought it might be useful to touch on a number of the issues raised at that meeting, just by way of introductory comments. They might answer a few questions or provide a little further background information.

At the core of it, I see something of a tension in the Trade Practices Act. That tension being that successive governments in Australia and, indeed, the whole OECD world have been anxious to improve the economic efficiency of manufacturing and the service sector. To do that, there has been a process of deregulation, a focussing on development of export oriented industries and things like that, all of which have exposed the forces of competition as the preferred vehicle by which governments are wanting to improve allocated efficiency.

That means, of course, that there is often quite fierce competition at various sectors. Needless to say, those economic entities with smaller market power—typically, small to medium sized enterprises—often find themselves at the wrong end of their lack of bargaining power. This has led, in many of the cases that have come to our attention, to those smaller enterprises failing. Inevitably, where a business is failing, the

proprietor will be looking to find any remedy, political or legal, to save their position.

The problem is that the Trade Practices Act is not about preventing the closure or failure of small enterprises; it is about preventing behaviour which goes past a certain line. The key provision in the Trade Practices Act, section 46, is about the misuse of market power. Unfortunately, it is a complex area of law and it is one that is not easy to prove. On the face of it, most small businesses who are dealing with a much larger corporation feel that they have been the victim of unlawful conduct where most often they have simply been the victim of commercial conduct. That is why, over the last couple of years, the focus has shifted more to trying to define those areas in which the use of the power by a larger corporation might breach principles of conscience, hence the focus on unconscionable conduct. Indeed, that had been the goal of the bill that was before the parliament last year.

The commission, in its evidence last time, pointed out that, generally speaking, about half of the complaints that come into the commission concern issues between a small trader and a large trader. Of those, a very small proportion—down to perhaps just 100 or so a year—are matters which could even raise breaches of the law. That is because the current test for unconscionable conduct is set out fairly clearly in the court authorities and does require a form of disadvantage that is a fairly high test.

I think the inquiry has heard a fair bit from various authorities, from business interests and others, about just what that test is. Also the commission, in its earlier submission, spoke of economic duress as a possible way of extending section 51AA of the act, while others have spoken about adding harsh and oppressive conduct as the test.

In my view, whichever words are used in any amendment to the statute is largely a matter of indifference. The important thing is more likely to be the way in which it is described in the act, whether there is an indicator list provided of what constitutes either economic duress or harsh and oppressive conduct and, perhaps, in the language that would go into any second reading speech. I know that there are some eminent academics who have put evidence to you—Frank Zumbo, for example—but my view on this is however that, really, the courts in constructing the statute are going to be looking for a little bit more.

Indeed, there is also a debate about whether the current formulation of section 51AA, is even constitutional, following a decision of the court in interpreting elements of native title legislation. That is because, last time around, the government chose to use a slightly vague formulation to bring unconscionable conduct into the act. Whether this committee would recommend and whether the parliament would subsequently change it simply by adding or deleting a few words to section 51AB, might be the easiest way of dealing with it and could bring in that degree of certainty if that was felt necessary.

I would like to say just a brief word about what seems to be the constant catchcry of many in the business community that, if you do anything further to the law, it will generate uncertainty—that any contract entered into in commercial conduct will no longer be certain.

I might point out that for all of this century, these very same principles of unconscionability have already been in the law. The laws have not extended those at all so far. It is simply that by codifying it in a Commonwealth statute you would provide a better platform on which small to medium size enterprises could

actually litigate their rights. I take it that, in a free society, legal rights which are not able to be used are worse than having none. As to those arguments of uncertainty, I think the committee should look at those with a very critical eye.

Indeed, the commission has recommended that one way of assisting small business is by allowing a wider general power in the commission to bring actions on behalf of businesses. You may or may not know that already the commission can bring actions as a representative party under 51AA—that is the unconscionable conduct clause—although we cannot bring an action on behalf of small business anywhere else in the competition provisions of the law.

That means that for monopolisation or agreements between competitors or any of the other anti-competitive provisions we do not have the power that we do to represent consumers or that we do to represent small businesses under some existing provisions of the act. I think that is a point that we covered in our earlier submission. I will not go into it any further now.

Finally, the recent events in relation to the Franchising Code Council and the petroleum industry are both examples of where problems are not getting better but are getting worse, and the recommendations of the commission concerning the development of codes of practice and early intervention and conciliation methods become more, not less, important. If I can just finish on this note—which was the note on which I started last November—in the view of the Australian Competition and Consumer Commission, simply adding a few words to a statute will not and cannot overcome the problems of small business in Australia.

Any approach to an answer—and of course there can never be a complete answer because it is a dynamic economy with entry and exit—has to be a more sophisticated one, has to be about making markets work more effectively, about the timely provision of usable information, about providing remedies for those affected by unlawful conduct and by establishing a much clearer picture for those initially investing and recontracting in the franchise sector or the shopping tenancy area with people so that they more clearly understand their rights and responsibilities. There is, in my view, a need to change the law but it would be entirely inappropriate in my view for the committee to see that as the answer. It is only a backstop. It is only the thing that could underwrite more effective negotiation by the parties and more effective dispute resolution in their own interests. They are the only remarks I would like to make.

CHAIR—Would Mr Dee care to add anything at this stage?

Mr Dee—Yes. The one thing the commission has been doing recently has been convening a round table of large and small business interests and alternative disputes resolution experts. This grew out of our consultative committee. Our consultative committee is made up of large and small interests and the consumer movement. We had our first meeting on 19 November. We had a discussion paper there, and the round table agreed to meet again. The gravamen of that particular initiative by the commission is to see if we can come up with some dispute avoidance measures. That has happened in the case of these codes of conduct although, as we have seen, they can be sort of hostage to fortune, but we have set down there some benchmarks for disclosure in the small and large business relationships. We are coming up with other benchmarks for dispute avoidance, concept by partnering like conflict management, other issues like that, so we are trying to develop ways in which the culture changes in large companies so it is less adversarial.

Other issues we are dealing with there are dispute avoidance, particularly in mediation and conciliation which are a lot more cost effective, and it is an access to justice issue. At the end of the day we are looking at exploring ways in which these benchmarks can actually be applied in the marketplace. For example, we are coming up with tossing around the idea of an Australian business disputes council. That development is still in its early stages. We have been consulting with alternative disputes resolution experts. We look upon this hopefully as a more market sensitive, cost-effective way of dealing with the problem.

I think it is important to note that the commission can only have the role of an honest broker in getting the parties together. At the end of the day I think it is up to the large and small business interests to make sure that it happens. Our next meeting of that round table is some time in March, and the committee staff have been invited to come along.

CHAIR—Thank you. Mr Asher, as part of your opening address and statement, you have touched on probably one of the major concerns of small business, that is, their ability to protect their rights and be able to take some legal action against some apparent action by a large trader in respect of their activities.I wonder if you would address part IV of the Trade Practices Act (Restrictive Trade Practices), including section 46, the misuse of market power? Does it really offer any protection for small business in its dealings with large businesses?

Mr Asher—It does, but the circumstances in which it does are clearly defined. At the heart of section 46, which is the misuse of market power provision, is that you need to find that the purpose for which the larger corporation, or any corporation, sought to damage the other was to deter competition, was to act in a way that the market would not normally allow, whereas it is obvious that in the case of shopping centres, captive franchisee situations or small suppliers in dealing with a large retailer that, generally speaking, it is not in the interests of the large enterprise to cause the bankruptcy of the smaller one. What they are trying to do is to maximise their own take, their own profits, and that of itself is really the heart of competitive conduct in the economy.

It is only when, as in the case of BHP and Queensland Wire, that BHP set out to destroy their competitor and refused to supply them that that line is crossed. So the competition laws, as I was saying before, are not there to give small enterprise a guaranteed good deal when dealing with larger enterprises; instead it is there so that when an enterprise actually tries to wipe out a competitor or to prevent competitive entry into the market that that conduct is stopped. The way that many people have described it is to say, 'The law is about preserving competition, the process of competition, not individual competitors.' Of course, competition is made up of a series of individual competitors and it is often a difficult question. So does the law protect small business? It does, but in a limited defined area.

CHAIR—I follow that up with a comment that we have received quite regularly in this inquiry from small business that they do not have the resources at their disposal to pursue an action. I wanted to ask you about the ACCC's role in this. If there is a complaint from a small business about a possible breach of the act, is the small business required to furnish you with all of the information and details and in fact do all of the legwork before the ACCC will intervene in the matter?

Mr Asher—I think that I can understand the frustration of many small businesses where we constantly go back to them and say, 'But what about this?' and 'What about that?' The fact is, though, for the commission to take a complaint—and remember that we do not have any executive power—we have to be prepared to prove that in court, and we may need to present evidence to a court against, often, very sound legal representation on the part of a respondent. So we need to have a fairly solid case.

The commission has shown over the years that it is not afraid of litigation. Indeed, in the last two years now, the commission has won 95 out of every 100 cases that it has taken. That is partly because we are very careful in evidence gathering, and we believe that we would not be thanked by taxpayers or the government if we took actions where there was no real basis on which to do so.

CHAIR—What support can you give to a business in the investigation side of it?

Mr Asher—At the last hearing, there were questions about independent film distribution. At that time the commission was investigating complaints against some of the large film distributors. I undertook to again look at some of those questions.

What we have done since then is to look far more carefully at those issues. The way it appears to us is that it comes down to this issue again of the larger enterprises simply acting in a way which maximises their own profits and is commercially sensible action, rather than set out to damage others. So what we do when dealing with small complainants firstly make initial contact and we will often provide project officers. We will often actually send our project officers out to see a complainant to firstly explain the provisions of the act.

Unfortunately, this area of the law is not simple. It is complex and it is one where you can generally expect any action that we bring to be hard fought. Many small business persons assume that, if there is damage caused to them, it is necessarily unlawful. As I have pointed out before, that is not the case. That is not what the law says and many become quite agitated if we tell them that we just do not think the conduct that they speak of has broken the law.

The biggest task that we have is to convey in simple terms what the requirements of the law are. We produce guidelines and things. But I can understand that if you are in a business that is failing, you have got a mortgage and perhaps your house is on the line, that you are obviously going to be wanting to take any action you can.

The commission under section 46 is not entitled to seek damages for small business. We are, under the unconscionable conduct provisions, but as we have discussed earlier, those are far narrower even than section 46. So the commission could be far more helpful to small business if the law was changed to provide that we could take representative actions to recover damages for business complainants other than under unconscionable conduct.

Just consider this, even if small businesses were to give us evidence that showed a clear breach of section 46 or any other provision of Part IV, all we could do is take an enforcement action in the court and possibly get penalties of up to $10 million per offence. But that money does not and cannot go to the

complainant. It goes to the Commonwealth and that small business person would then have to take their own action to gain damages. Under the statute we really are not in a position to help as much as many people assume we are.

CHAIR—Unless members of the committee have any questions, I will move onto the next topic.

Ms GAMBARO—I just need some more clarification on the BHP and Queensland Wire case. I have had representations made to me concerning independent cinema chains and their films being withheld by the major chains. I cannot see the distinguishing feature. You say to the committee that large enterprises are concerned about their profits and you need to look at situations where that occurs. But where you have an independent cinema operator who has constantly had their films withheld over a long period of time, that is a withholding of the particular product and they only deal in that product. In one particular case—and I will not bring it up at the moment—there is no other avenue for that company to take. What is the fine distinguishing feature from that and from BHP and Queensland Wire?

Mr Asher—The distinguishing feature here is, to use a colloquial term, would be a smoking gun. In the Queensland Wire case, there were certain documents discovered that showed a deliberate intent by a large corporation to rub out a competitor. That is the in the nature of evidence. The commission would always look when investigating these potential breaches of section 46 to discover if there is a legitimate alternative explanation for the commercial conduct of the party complained about. If there is, and in the absence of this evidence of intention, it becomes in our view an impossibility to establish in the courts that there had been a breach of that section of the act. I fear that that is the general position that we find ourselves in.

Mr RICHARD EVANS—If I understand what you are saying correctly, under the current law—and just following on what you said about the film distribution—you actually need really hard, smoking gun evidence. You say in your evidence that under the current law that maximising profits is a general business system. Therefore a person who dominates the market, their feeling is that they have to get rid of their opposition totally to have total dominance of the market. Under the current law you would consider that to be okay, is that right?

Mr Asher—It depends on the conduct in question. It can happen in a couple of ways. One is by acquiring a competitor and recently the commission obtained a $5 million penalty against Pioneer, which was fairly powerful in the besser blocks market in Brisbane. They acquired a vigorous competitor who was forcing their prices down. The commission believed that that was an unacceptable action and we were able to get a $5 million penalty against them for that conduct.

On other occasions, if it is by competing more vigorously and offering large discounts, that might raise the issue of predatory pricing. Predatory pricing would require that a company for a period would sell perhaps at lower than long run average cost or some other economic formulation. But even there you would need to show that in the long run what they were hoping to do was to drive out the competitor and then be in a position to increase their prices later to recoup all of those losses that they incurred meanwhile. The courts have looked at that fairly closely in a number of cases, including in relation to some suburban newspapers and the standard of evidence that they want happens to be a fairly high one.

Does profit maximisation constitute a breach of the act? Almost certainly not. You do need to show more. You say if they try and drive the firm out of business, it depends on how. If they drive them out of business by providing better products at better prices, the answer is that that is not unlawful. If they act unlawfully—and this is the test—by other means, then the commission can take action.

Mr RICHARD EVANS—So there has to be a clear intent, like a general manager writing to his sales manager saying, 'I want this opposition wiped off the face of this earth,' Although he may say that verbally, unless he puts it in writing there is no case to answer.

Mr Asher—There would be some other circumstances, for example, I mentioned predatory pricing. If we were able to prove that for a period the company was selling the product or service at something that was obviously below the cost of production, that also might be evidence of a breach. But that is more in the nature of a horizontal complaint where you have one large trader and a smaller one in the same business.

Most of the complaints that I take it that the committee was concerned about are more the vertical relationships; the large company buying from the smaller company, agribusiness buying from the farmer or the franchisee in a captive relationship with the shopping centre owner or an oil company site. Those relationships actually are far harder to show this purpose, because if you think about it, it cannot be in the interests of the large shopping centre owner to cause the bankruptcy of his or her tenants. So, even though they might be very hard bargains, you have to find some clear intention in that circumstance.

Mr RICHARD EVANS—Let us move to where a retailer or a franchisee is in a captive agreement. They are locked in for five years, 10 years or whatever it might be, whether it is a franchise agreement or a captive agreement. If the lessor or the franchisor decides to increase rent for instance on a lessor basis by eight per cent—which is about six per cent higher than the inflation rate—surely that is called maximising profits, but is it fair?

Mr Asher—It might not be fair but there is no provision in Australian law that commercial dealings need to be fair.

Mr RICHARD EVANS—Is that a weakness in commercial dealings?

Mr Asher—There are very few commercial bargains in a highly competitive market that you would say are based on fairness.

Mr RICHARD EVANS—That particular lessee cannot walk away from that agreement without facing severe financial penalty so they are forced then to increase their rental, based upon their lessor maximising profit. You are saying to me that that may not be fair but there is no action that that particular small lessee can take?

Mr Asher—That does not follow because any increase in rent or any call for capital contribution for refurbishment would need to be dealt with in the contract between the parties, the lease arrangement, the franchise arrangement or collateral contracts. If the lessor or the franchisor was applying those terms in a way that was harsh or oppressive or unconscionable that might lead, in some states, to remedies. There is specific

legislation in the oil industry and in a number of states in shopping centre tenancy arrangements that addresses some of those issues.

I point out again that it comes back to the terms of the signed agreement between the parties. If an owner asserts rights that he or she does not have against a weaker party, perhaps a unilateral change, or had suppressed certain information or acted in that way, that might be unlawful. Where there is an allegation of unconscionability, the commission is entitled to bring actions—and we have done so on several occasions—on behalf of small enterprises to recover damages. But, under these other provisions, as I have mentioned, we have no authority to seek compensation for parties who suffer loss.

Mr RICHARD EVANS—In relation to a franchisor and a franchisee, there is a set agreement, which is usually an inch or so thick. Let us say that a distribution process that used to be distributed at state distribution point is to now be a centralised distribution process—the franchisor suddenly said 'I don't want state distribution any more. I want it centralised'. It is not part of the franchise lease or agreement or whatever it is called but he can unilaterally make that change with a clause which says that the franchisor has absolute rights on these issues. Is there no course of action that the franchisee could take?

Mr Asher—In that circumstance, it is likely that a change of that character might well invoke section 51AA. If somebody has a fixed contract with no option to change that might qualify as a special disability under the High Court test for unconscionability. But you would need to find some use of power that overbears the ability of the smaller trader to make an independent decision in his or her interests.

Mr RICHARD EVANS—And, according to what you have said, you need to have that 'smoking gun' available to be able conclusively prove that there is an unconscionable act.

Mr Asher—No, the smoking gun relates to monopolisation, or section 46 conduct. In relation to unconscionable conduct, different tests would apply.

Mr RICHARD EVANS—You said that—and I think it was section 46—there are clear guidelines for people to operate under—

Mr Asher—That is under section 51AB.

Mr RICHARD EVANS—But you mentioned 46, about there being no absolute right of small business to be able to stay in business and things like that.

Mr Asher—Yes, that is right.

Mr RICHARD EVANS—When small business enters into business, they do so with good faith and all of that sort of stuff. What they are not prepared to do is go through a whole lot of educational processes—in fact, getting an understanding of the true realities of small business. Who makes sure these things are being done correctly and operating correctly? Who is supposed to police it? What sort of education is there available and who is responsible for that education?

Mr Asher—I believe you have hit on what I see as the most productive area for minimising the incidence of complaints. You rightly point out that many people investing in a small business enterprise are very enthusiastic, often very inexperienced, and aren't prepared to spend a lot of time undergoing education or, unfortunately, looking at the documents that they have before them. There can never be a way in which that can be made compulsory except that people will bear part of the consequence of their failure to do that.

Now that does have harsh consequences. But the point of intervention for policy makers and organisations such as ours is to see what we can do to ensure that, where larger enterprises do act in a predatory or unlawful way, we can intervene swiftly and firmly and limit that wrongful conduct. But the responsibility always has to be with the person entering a small business to take some minimum steps to protect their own economic interests.

Each state has a fairly active small business development centre. There are all sorts of resources available in colleges and things of that nature. As we said in our first submission, the emphasis in a remedy needs to be there plus—this is something that needs to be re-emphasised—provision for early intervention where relationships start to break down. In our experience, we need to get the parties together, and that is a large part of our role. When we receive a complaint, we will quickly take it up with the person complained about and often matters can be put right straightaway. Where things are not done straightaway, and the relationship breaks down completely, it is our experience that those are the ones where there is no remedy and it often leads to the failure of one or both businesses.

CHAIR—Time is moving on and I particularly want to get onto an issue which the ACCC is involved in—that is, the case in the court under 51AA at the moment against Shell Australia. Could you explain to the committee how the ACCC initiated this case for litigation.

Mr Asher—A year or so ago the commission issued instructions to all of its regional directors to make contact with the representatives of small to medium sized enterprises, the business associations, COSBOA and others, to ask them to bring to our attention circumstances where their members were subject to unconscionable conduct. In addition, in the report published last year by the ACCC on petrol pricing, we highlighted the issue of unfair market practices. We signalled in that that the commission would be actively investigating any complaints of abusive power by corporations. We received 11 or so complaints from franchisees, corporations and others. The matters that led to the filing of that case against Shell came to us in that way.

CHAIR—I draw your attention to some of the evidence that was presented to this inquiry, that section 51AA could be unconstitutional. Has that been raised in the court?

Mr Asher—I have seen those arguments. It has never been raised in court but there again there is not a lot of litigation on this issue. Typically, it is only when somebody, a large party, thinks that they are likely to lose that they would then raise that issue.

CHAIR—Have you got a view on that?

Mr Asher—My view is that it is not the best form of law but I doubt that the courts would strike it

down. It is not equivalent to that West Australian native title case. I think the body of law that constitutes unconscionable conduct is much clearer.

Mr ALLAN MORRIS—Can I refer you to the department's submission where they say:

The ACCC should be encouraged to publicly announce that it intends to pursue particular actions with the potential to clarify the scope of the existing law and where the ACCC believes a successful outcome would provide a public benefit. This rationale would provide some defence for the ACCC against claims it was 'anti-business' or wasting taxpayers and the defendants' money.

Have you read their submission?

Mr Asher—I am aware of that particular comment. The commission has always taken the view that the best way of sending signals to the marketplace is through the cases that we actually take. To say that we are going to file actions where we do not have the evidence before us we just do not think is sound public policy, and maybe that is not quite the intention.

Mr ALLAN MORRIS—I hear that. I will just follow on then. We have heard of many cases being referred to you.

Mr Asher—Yes.

Mr ALLAN MORRIS—I will cite some examples if you like such as the Shell dealer who pays more for his products from Shell than a non-Shell dealer. Wouldn't that be unconscionable conduct?

Mr Asher—No, it would not unless there were particular—

Mr ALLAN MORRIS—In other words, a Shell franchisee is compelled by Shell to pay more for a product than somebody else?

Mr Asher—In the petroleum industry, which is perhaps one of the most complex commercial dealings of any, what appears to be the price almost never is. If I could just draw your attention to all the ancillary contracts that will often go into a franchise arrangement: for a start, who owns the land on which the service station is built—

Mr ALLAN MORRIS—No, I am sorry, this happens all the time. A product is $14 to a dealer and $10 dollars to a non-dealer. It is very simple, with documents and transactions.

Mr Asher—I have never seen such a simple one and I would like to. If I could just point this out: often you have some, say, renovation loan or some head lease rebate, some supply arrangements—all of these things that complicate—

Mr ALLAN MORRIS—But there are actually some simple ones. What people are saying to us is that you do not really want to hear. The impression I got just then was that you did not want to hear, either.

Mr Asher—No.

Mr ALLAN MORRIS—You told me it was too complicated when I am saying in fact it is very simple.

Mr Asher—I am sorry, I did not mean to say that it was too complicated. I meant to say that I have yet to see—

Mr ALLAN MORRIS—If you were to say publicly, for example, that if companies do not make products available on equal terms to their own franchises as well as everybody else then you will take action, if you were to say that out loud, that would send a very clear signal.

Mr Asher—Except that, of itself, that is not unlawful.

Mr ALLAN MORRIS—I would have thought prohibitive and restrictive pricing practices are.

Mr Asher—The parliament removed section 49 from the Trade Practices Act three years ago. It was about price discrimination. That provision is no longer in the statute and, for that to be unlawful, it would need to be either unconscionable or a breach of section 46, which is the abuse of market power provision. There is no general requirement for a company to deal with another company.

Mr ALLAN MORRIS—I agree. I guess the nub of it is that the Shell dealer cannot sell somebody else's oil because he has a franchise. He must sell Shell oil and the price they charge him is more than they charge a non-Shell dealer. Are you saying that is not oppressive or not unconscionable, that that is quite fine?

Mr Asher—I believe that the circumstance you have described, and I would be really keen to look at more information—

Mr ALLAN MORRIS—We will be giving the *Hansard* to you and the gentleman produced the invoices from the other dealer showing the price.

Mr Asher—As well as any ancillary contracts between the parties that might mitigate that?

Mr ALLAN MORRIS—I am sure the man would be very happy to do that.

CHAIR—It might be a matter that your constituent can—

Mr ALLAN MORRIS—It is not my constituent; it is a South Australian. But it was presented to the committee. Mr Chairman, what I am concerned about is what Mr Asher says—that there are all these other issues—and with that particular approach people say well, we are not really interested. By the way, Mr Asher, I really thought your comments about a landlord not wanting the tenants to go broke was very naive. That must be the most naive thing I have ever heard.

Mr Asher—Right.

Mr ALLAN MORRIS—I mean if you talk to the shopping centre owners and so on, they want their

centres to be fresh, new, different and invigorating. If you always have the same tenants year in and year out, then what comes through very clearly is that it is very hard to refresh your centres unless you change your mix a bit, and changing your mix often means getting in new things. You cannot get in new things if the old ones are still there, so the idea that they do not like seeing them go bankrupt is incredibly naive. I think there is actually a campaign at times to do just that and, if you look at some of the centres, you would find that.

One of the things that comes forward clearly to me has been the practice of landlords saying to a tenant, 'If you do not pay the rent, I have someone else who will.' This supposed person is not visible because obviously they are in a bargain situation, so the tenants says, 'It is over priced but, if someone else is going to pay it, I really do not have any choice.' If that situation came up and the landlord could not produce the person who was seriously negotiating and who had offered the price, would that constitute a breach of section 52?

Mr Asher—It could easily constitute a breach of section 52.

Mr ALLAN MORRIS—Are you interested in those?

Mr Asher—It depends again on the circumstances, but the commission—

Mr ALLAN MORRIS—Yes, but are you interested in those?

Mr Asher—Of course, yes.

Mr ALLAN MORRIS—So if I can find you some tenants where that has happened, you would be interested?

Mr Asher—The commission would certainly be prepared to look at such matters.

Mr ALLAN MORRIS—And you could require the landlord to produce who that person was?

Mr Asher—Possibly. We do have certain evidence gathering powers. We have to find that there is a threshold reason to believe that there might have been a breach of the act but, once that is satisfied, the commission could investigate such a matter and potentially take action.

CHAIR—I would like to move on to another topic—that is, codes of conduct and get an opinion from you. For example, the franchising code and the oil code, if they were to be underpinned in the Trade Practices Act, what in fact would that mean?

Mr Asher—It could mean one of a number of things. In relation to the franchising code, it is in a sense underpinned by the Trade Practices Act because it is a code that is an agreement between competitors and thus is authorised. The commission had to look at that and give it authorisation before it could be put into effect.

CHAIR—Authorised by whom?

Mr Asher—By the Australian Competition and Consumer Competition.

CHAIR—But after any public consideration?

Mr Asher—Yes. The authorisation process is a public process where the commission must publicise and circulate copies of the draft to invite comments from parties and to hold a conference. Indeed we have done that twice now in relation to that code. We can impose conditions on that.

CHAIR—Which could be enforced?

Mr Asher—Yes.

CHAIR—How would the enforcement occur?

Mr Asher—If a party failed to live up to the conditions, the commission could remove the authorisation and that would subject them to action under part IV of the act. Unfortunately, that is not a remedy for a particular franchisee because that would just terminate the agreement.

I was getting on then to the second element in which a code might be underpinned. Many of the state laws have provisions that codes of conduct can be enforced as though they were regulations. There is no such provision under the Commonwealth and the commission has recommended several times that that might become the easiest way to give clout to industry codes. The parliament is often wary of extensive new laws, but this might be a way in which a code can be given some enforceability. It raises some constitutional issues, but I think they are ones that can be dealt with.

Mrs JOHNSTON—I want to go back to what you said earlier, Mr Dee, in regard to the possible formation of an Australian business disputes council. The evidence that we have heard obviously indicates that there is either not a lot of trust on the part of some of the smaller businesses in the ACCC or, indeed, that it may be far too difficult for them to even contemplate seeking your assistance; and there seems to be a time lag there too, which may not be of benefit to them. Could you outline a little more the proposal that you may have? I am particularly interested in how the disputes will be solved. Will they be solved faster? Will it be less costly? I do not mean only in payments but also in the amount of time that the business owner is away from his or her business. Most importantly, will it actually produce the result? At the moment, some of the things that we have been talking about and hearing about are certainly not bringing any result to the smaller business person. That was a lot of questions in one.

Mr Dee—This issue has yet to be tested, and it has got to be tested at the round table, which is representative of small and large business. I guess a lot of this is posited on notions in Oilcode, which I have been involved with. That has been very successful in resolving disputes quickly and effectively, and I cannot see any reason why that practice cannot be transposed onto a larger basis; but time will tell.

What happened in Oilcode was that you had some codes which acted as dispute avoidance

mechanisms, in the sense that they set out some rules for franchising codes, and certain action had to follow. Then there was a dispute-settling mechanism: essentially, what happened there was that parties had to try and resolve their dispute themselves. If not, it went to the association negotiator, who went straight to the oil company. A lot of disputes were settled on that informal, trouble-shooting level, before they went up to the industry conciliator.

Mrs JOHNSTON—May I interrupt? In some of the evidence that we have heard—and, certainly, in my own state of Western Australia—the oil code does not appear to be working to the benefit of perhaps the smaller person. It seems to be somehow skewed to the larger companies and it gives them an advantage that I would not consider to be fair to both parties. I do not think that Oilcode is really the success that perhaps it should be.

Mr Dee—I could give you a news clipping from Marcus Kollington, who is head of the SSA and was singing its praises. I am happy to get that and forward it to the secretariat. David Newton, who is the industry conciliator, has come out and said that in his opinion the thing has worked very well. I accept that there might be individuals who think that it has not.

Mr BEDDALL—There is a massive dispute between all oil companies and their franchisees.

Mr Asher—Of course, the arrangement has broken down lately, so Bill Dee is not speaking about the current operations. Perhaps I could take just one second to say that the ACCC, until four or five years ago, had been receiving many of the complaints from the small franchisees. There had been a number of legal cases where the franchisees got together to try and challenge the companies. Typically, they lost. We were brokers in establishing the oil code to try and provide some collective way of avoiding the court action in circumstances where the small traders almost always lost. In the first few years, there were half-a-dozen or so disputes where good settlements were reached early and preserved the commercial relationship, and things worked well. Undoubtedly, the industry has now moved into a far more turbulent phase, and there is real doubt about whether the code is in effect at the moment or not. As I understand it, there are no matters currently before the disputes tribunal. In my view, if that could be fixed, that could be one of the most important things to assist the transition of the industry.

Mr BEDDALL—I have listened without too much questioning. But I make the point that, seven years ago, almost to the day, this committee brought down a report; but, if anything, the problems seem worse rather than better. One of the things we have to grapple with as a committee is the fact that particularly with, say, the franchising code, we initially recommended as a committee that it be legislated. We were convinced—and I was convinced, as minister—to take the self-regulation code, and we have seen that fall over in the past few weeks. Without any real underpinning, as you said, I am interested in the concept that you have about them being equivalent to a state legislation, where they become regulation. That is a simple methodology, and it is something you could get through the ideology of ‘no regulation and more legislation’.

We have talked about this as a committee, and I think we have talked about it to you before. There is a group of people who are consumers here. There are a whole stack of people who have gone out with their superannuation packages and bought a job. If we keep saying they are business people on an equal par with Coles Myers or with Shell, then we are denying the fact that these people need consumer protection. This

committee is trying to find a way to protect those people, while at the same time always believing in the fact that the right to succeed is the right to fail and that bad business decisions will lead to failure. If you took that away, we could all become rich small-business people if the government underwrote us. But the government is not going to underwrite, and neither should it.

I would like to explore—and perhaps you can give some more information about this—how you could simply transfer those codes into regulations. All the vested interests will fight it. The franchisors association is jumping with joy that the franchising code has fallen over, because they can see a way in which they could take control. I saw interviews yesterday where they were saying, 'We can help the government; we could run it for them.'

Mr Asher—Yes. It is certainly a huge personal disappointment to me, for another reason: when the then Trade Practices Commission first was involved in negotiating with franchisors and franchisees about the first version of the code five years or so ago—and I think you may have been the minister at the time—it looked as though there would be some very substantial information disclosure provisions, dispute provisions and all of those things.

Unfortunately, when it came time for the code to be brought to us for authorisation, a lot of clauses had disappeared. A lot of franchisors said they would not participate, and a number of banks said they would not participate unless many of those clauses were removed. So, the document that was finally authorised was a fairly pale shadow of the goal and, needless to say, it failed. Unfortunately, the recent one was not vastly better. And then, of course, it ran into other problems that you probably know quite a bit about.

As for the way in which codes can be made to have effect, the best example I can give you is part 7 of the New South Wales Fair Trading Act, which is a market sensitive provision. The goal is that where an industry association is administering its own code, there is no need for anybody to intervene, and it lets the market work where the market does work. But, for people who are not covered by the code—or if somebody refuses to accept the rulings under the code—then it allows some limited public enforcement of that code. In my view, that is a light-handed, market based way, but one which picks up the biggest problem of industry codes of practice, which is that you cannot do anything if people refuse to obey them.

CHAIR—Can I open up another topic with relation to the retail sector and the allegation that large firms are able to dictate the level of rentals and that small business picks up an unfair proportion of rental bills in shopping centres, et cetera? When the then Trade Practices Commission considered the Coles Myer merger, did you take into account the impact that the merger would have on the retail property market? If you did, did you reach any conclusions as a result?

Mr Asher—At the time of the Coles Myer merger, the merger test in the Trade Practices Act was quite a different one from the one in the act now. At that time, it only entitled the commission to intervene if the acquisition would lead to dominance of the market—which the courts at that time had held to mean basically that there were no other competitors who could stand up against the enterprise.

The former government changed that act over three years ago now to one of substantial lessening of competition. You might be aware that two years ago when Coles Myer again attempted to acquire some

smaller operators in the Western Australia market, Foodland, the commission swiftly intervened and received an injunction to prevent it. So at the time we did not look in detail at the effects on shopping centre arrangements because the overwhelming body of opinion was that it was not at that time unlawful. Today it would be unlawful and the commission might be able to do it. But in any event that would be part of a merger analysis. Yes, it would.

Mr BEDDALL—Coles Myer at that stage swore to the government of the day that they would never use their market power and abuse it.

Mr Asher—Yes.

CHAIR—Another issue that has been brought before the inquiry has been a lot of complaints from small business concerning alleged unfair dealings by the major trading banks and other financial institutions. Some small businesses, including rural properties, do not have the financial resources to challenge a bank. I understand that ACCC has recommended to the Wallis inquiry that there be a one-stop shop for dispute resolution called the financial sector advisory tribunal. If that comes into being, would that in fact cover disputes covering small businesses, including the rural sector small businesses?

Mr Asher—Yes. I think the chances of that happening are vanishingly small. The opposition by the financial institutions to coverage of commercial transactions is likely to be overwhelming, just as it was when there were attempts to extend the self-regulatory code and the jurisdiction of the banking industry ombudsman to include commercial transactions. There was just absolute opposition from the banks. I think the government would need to intervene before there would be any likelihood of that happening.

CHAIR—What is your view on the Banking Ombudsman scheme being expanded to cover he small business transactions?

Mr Asher—Personally, I think in the long run it would be greatly to the interests of the financial sector and to commercial consumers in the banking industry to have a non-litigious basis for resolution of disputes.

CHAIR—And small business?

Mr Asher—And small business, yes. I think that would be self evidently a sensible thing to do, but there is overwhelming opposition.

Mr ALLAN MORRIS—I am going to ask you some questions that can be put on notice for response.The first one concerns the example I gave you before about a landlord saying they have an alternative tenant. This could in fact constitute a breach of more than one section, because they may not have a tenant. There is the question of access to information by the tenant. Nothing destroys a bargaining process more than someone saying, ‘I have got all the aces. I have got someone to replace you, so sign up or get out.’ I would like you to respond to that in writing.

Secondly, I draw your attention to today’s hearings and the witnesses coming from the Australian

Institute of Business Brokers. Their submission raises a question about the artificiality of centre rents, how they structure the value and eventually the share value of the management. The implications of that are really both far reaching and quite serious and could in fact constitute quite misleading and deceptive conduct. It may even constitute a fraud upon the shareholders in terms of the actual value that is being projected. I am sure others would appreciate a written response or comment from you on that submission, because as I said, it does really raise some very far reaching issues.

CHAIR—Would you be able to provide that?

Mr Asher—Certainly.

Mr ALLAN MORRIS—It is actually in the committee's interest and public interest that you do provide that, because the implications of that are really quite serious. The claim that rents were overstated by 50 per cent is really quite serious. The third thing is the perception and concern in the business community expressed in the submissions to us. It is raised by the department and I think their response to that was somewhat limp. In your submission you say that it is really up to the business person to sort themselves out. That is really their choice. If that is the case, then there is an argument that says, 'Well, why bother having you?' You have almost argued against your own existence.

The question is raised about what will trigger an issue from your point of view. The department has raised the question and others have said that your hurdles are too high. You have given other kinds of reasons. I cannot expect an answer now.

CHAIR—Mr Morris, I am loath to interrupt, but would you put a question to our witnesses and then get a response?

Mr ALLAN MORRIS—I am asking if you can response to my comments and observations. It is not a yes or no answer. I would therefore like you to pin down for us in writing where the hurdle is and how you define the hurdle. We have heard four or five different arguments as to how you do it. I do not think you have actually said so yourself how you do it. I think you have avoided the issue. I would like you to be quite precise. Is it only if you are sure to win, if it is going to interpret case law or if it is going to be a case where there is no other action available in the civil courts to the applicant? There is a whole range of reasons that people have told us as why you do not act or where you might act. I do not think you have actually given us a precise definition.

Mr Asher—Could I just briefly say that the commission has published its case selection criteria. I will certainly ensure we get a copy to the inquiry, if we have not done so already. I thought that was included in our first submission.

Mr ALLAN MORRIS—The point I am making is that if you read the submissions you will find that people have four or five different versions as to how they think you interpret that. In other words, your criteria must be sufficiently vague for people to draw entirely different conclusions from it.

Mr Asher—If I could put it another way. I can understand anybody whose business is threatened or

who is facing bankruptcy believing that their case is the most meritorious of all. I am sure I would in similar circumstances, but of itself that does not make the conduct complained of a breach of the law, nor can it guarantee that the commission, even if it did take it up, would be successful in court.

Mr ALLAN MORRIS—That is the very point though. What the department is saying is that you should take up cases that you might even lose, because it is only by doing that that you will define the law. That is the point that is being made that you are not responding to.

CHAIR—We have run out of time. I would like to thank Mr Asher and Mr Dee for attending the public hearing. However there are still some matters that the committee wish to pursue with the ACCC. If you are agreeable, the secretariat will put to you in writing the further issues that the committee wishes to take up with ACCC. Thank you very much for your attendance this morning.

[10.14 a.m.]

FANNING, Ms Margaret, Assistant Secretary, Business Environment Branch, Department of Industry, Science and Tourism, 20 Allara Street, Civic, Australian Capital Territory 2601

NEIL, Mr Gordon, Director, Business Law and Microeconomic Reform Section, Business Environment Branch, Department of Industry, Science and Tourism, 20 Allara Street, Civic, Australian Capital Territory 2601

NOONAN, Mr Philip, First Assistant Secretary, Office of Small Business and Federal Consumer Affairs Division, Department of Industry, Science and Tourism, 20 Allara Street, Civic, Australian Capital Territory 2601

CHAIR—Welcome. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or give an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament.

The committee prefers that all evidence be given in public, but should you at any stage wish to give evidence in private you may ask to do so and the committee will give consideration to your request. The committee has received a written submission from the Department of Industry, Science and Tourism, dated 5 February 1997.

Resolved (on motion by Mrs Bailey):

That the above submission be received as evidence and authorised for publication.

CHAIR—Would you like to make any additions or alternations to your submission?

Mr Noonan—No, Mr Chairman, but perhaps I might make some brief opening remarks to bring together some of the themes in the submission.

CHAIR—Thank you, and it would be helpful to the committee if the statement is brief.

Mr Noonan—The Department of Industry, Science and Tourism welcomes the opportunity to give evidence before this committee. The department is exposed to various aspects of the fair trading debate and, as such, is well placed to provide balanced comment on what are contentious issues. That small business feel that they are being exploited by larger firms is unquestionable; the correspondence that the department and our minister has received is testament to that. But what is needed is to review these small business problems with a critical eye to see the extent to which legislation is necessary, or even appropriate, to deal with them.

Many of the problems that have been brought to our—and, no doubt, the committee's—attention are actionable under existing law. That small businesses are unaware of or unable to fully utilise the existing law

is of concern to the department. A system of justice that can only be used by those with resources to fight is a system that is not working properly. DIST has proposed in its submission a range of options that may improve small business access to justice. These include greater use of alternative dispute resolution, industry ombudsmen and the consideration of establishing commercial tribunals with less formal rules of court. Such mechanisms have worked well for consumers who, like some small businesses, can be denied access to justice through a lack of resources.

DIST also recognises that any change to the law to better protect small businesses is undermined by a system of justice that cannot be readily accessed. On the other hand, DIST recognises that a system of law that is too easily accessed and does not deter the taking of frivolous and over speculative litigation is also unacceptable. In making the recommendations to improve small business access to justice, DIST is mindful of the impact that an overly litigious environment can have on business certainty and investment.

The conflicting tensions of fair and equitable access to justice are complex and difficult issues. While DIST recognises the need for action in this area, the department also recognises that considerably more work needs to be undertaken to ensure that any changes are to the betterment of the community as a whole. Improved access will reduce some of the pressure on the government to amend the law to better protect small business, but there are also steps that small businesses themselves can take to reduce their own risk, and they can be supported in that.

The level of optimism in small business is a key reason for the success of the sector and, in particular, its ability to outperform other sectors of the economy. This optimism can come at a high price, however, with some small businesses having unrealistic commercial expectations. It is not realistic to expect the average small business person to have the skills and expertise of a large company.

Improved business skills would better enable small businesses to protect themselves in a competitive commercial environment—skills such as a basic understanding of the law and the ability to critically assess a business plan. By making small and medium sized enterprises better able to protect themselves and fostering realistic expectations of their commercial prospects, the level of dissatisfaction and dispute between firms would be reduced.

Larger businesses can also take steps to ensure that a commercial relationship is on a sound footing. This can be shown to benefit both parties. The use of plain English contracts and cooling-off periods allow small businesses both the ability to comprehend and the time to assess a commercial arrangement. Expectations are therefore more likely to be met, with less disputation at the conclusion of an arrangement.

For a number of industry sectors, the problems experienced are not covered by existing law and cannot be adequately addressed through better business education. These problems are typically industry specific in nature and do not give rise to arguments for solutions of general application. Amending a general piece of legislation to prevent particular problems in the franchising industry, for example, is undesirable as it imposes a cost on all industry when the need for action might be narrow.

Legislative solutions, and industry specific ones in particular, can be clumsy and quickly outdated. This leads to economic distortions and industry inefficiencies. Industry codes of conduct are therefore a

valuable component of a deregulatory approach aimed at achieving minimal effective regulation and avoiding the pitfalls of industry specific legislation. Codes have many advantages over legislative solutions and they are outlined in the paper.

DIST does not deny that small businesses may suffer a range of disadvantages in their dealings with larger firms. Many of these disadvantages are born from the economies of scale or from other intrinsic advantages that larger firms possess. It would be inappropriate for action to be taken to prevent firms utilising the natural advantages brought by size. Notwithstanding this, by placing small businesses in a position where they can better look after themselves and where the institutional biases in the judicial system can be overcome, many of the problems brought to the attention of this committee can be addressed.

Small business deserves a fair go, but amending the law will not necessarily achieve this. In our opinion, better access to justice, better education and better industry practices governed by industry administered codes of conduct offer a better approach to what may seem intractable problems. Thank you, Mr Chairman.

CHAIR—Thank you. I will move to one issue that has been well to the fore in representations to this committee and also an action which occurred during the first round of public hearings. That was that the Franchising Code Council is now in the hands of an administrator following the withdrawal of government funding. Would you like to give the reasons for that and the timing of the withdrawal of funding for the council?

Mr Noonan—The previous government had entered into an agreement with the Franchising Code Council to provide funding over a number of years, starting in 1995-96. The out year fundings were all subject to appropriation, of course. After the March election, the government paid the 1995-96 amount, which I think was $325,000. Then, in the budget, it continued the 1996-97 grant—$648,000—but it terminated the out years, that is, 1997-98 onwards. That naturally left the Franchising Code Council in a position where they were not going to get as much money from government grants as they had anticipated, starting in 1997-98. Correspondence was exchanged with the government. The minister met with the Franchising Code Council and urged the council to revise their strategic plan so as to fit within the diminished future resources that they would have, and to use the full amount of the grant during 1996-97 to buy time to adjust to these new circumstances.

There seems to have been a disagreement within the council between those who thought that that was a practical course and those who wanted to persist with the original strategic plan which assumed the higher level of funding. Our understanding is that that disagreement has ultimately led to the failure of the code council. I would emphasise that there does not seem to be any problem with the code itself which was administered by the council, but rather with the financial circumstances governing the body which was administering the code. The code council, in its press release of late December, refers to threats of litigation as being a serious factor in their decision to wind up.

CHAIR—What is happening at the moment? Are there any transitional arrangements in place to handle any complaints or disputes? What is the current situation?

Mr Noonan—The minister made a statement during question time late last week in which he indicated that he was negotiating with industry to see whether an alternative code could be put in place.

Mr BEDDALL—This committee recommended in 1970 that there be legislation to protect franchisees in what was then perceived to be a growing industry, and subsequently was. As minister, I was convinced that we should have a period where we would have a voluntary code. The voluntary code has now been in place for about three or four years. We have the situation where there is actually nobody administering the code at the moment. There has always been opposition within the Franchising Council because of its sheer nature. It is adversary rather than complementary—it is franchisors versus franchisees.

My concern is that unless we get some legislative underpinning of that—and the Trade Practices Commission has made some suggestions as to how that could be done without too much difficulty, drawing on part VII of the New South Wales fair trading act—and unless you get some teeth into this legislation, we will never have a situation where franchisors even know that the franchise they are about to purchase is the subject of some litigation.

I understand that there is no mechanism for finding out if there is a dispute between franchisees and franchisor, and there is no mechanism for those franchisors who have breached the code to be named, either in parliament or publicly. I also understand that one of the fears of the Franchising Council was that, if they did remove someone from the Franchising Code, they would then be personally liable to litigation. Legislative underpinning, surely, would give some comfort for the code to take action.

This is an industry which has grown rapidly and has attracted good and bad franchisors, and there needs to be some sort of consumer protection. Voluntary codes are fine as long as people adhere to them. In my experience in looking at the Franchising Code, people only adhere to it when it suits their purpose.

Mr Noonan—There are a number of issues which you have raised there. Perhaps the first point that I would make about the need for legislation to underpin the code is to affirm that there is no problem with the code itself and, in fact, under the administration of the code by the FCC, the proportion of registrations by franchisors was rising quite rapidly.

Mr BEDDALL—Can I take that point. I have heard all these arguments. I heard them from the franchisor. It rises, then when someone is in dispute with the Franchising Council they drop out, and then when they get sorted out, they come back in. It is all semantics; you can do anything with statistics. Is that a circumstance you have come across?

Mr Noonan—No, it is not. But the objective with any voluntary code of practice must be to give the code of practice sufficient weight in the market so that franchisors cannot afford commercially to ignore their obligations if they are members of the code. That is partly a question of the extent of penetration into the market. By increasing the average coverage of the code, the FCC was approaching a situation where there was a greater and greater awareness of the code within the community, with the result that it was more likely that a franchisor who was not a member, or a franchisor who had dropped out, would be brought into commercial disadvantage by doing that because franchisees and potential new franchisees would be less willing to deal with them.

Mr BEDDALL—Is McDonald's part of the code yet?

Mr Noonan—Yes. I am pretty sure that McDonald's is a member of the Franchising Code.

Mr BEDDALL—Can you check that because there was a lot of resistance from McDonald's at the start, even in acknowledging that they were a franchise?

Mr Noonan—They have had a senior officer on the FCC for some time. The other point that you raised, which is related to the extent to which the community knows about whether a franchisor is complying or not, is the capacity to name a franchisor that is failing their obligations. I do not necessarily think that the whole code needs to be legislated in order to tackle that specific problem.

The problem is basically that the Franchising Code Council, in this case, has no protection from defamation proceedings being brought by the franchisor on the basis that the code council spreading information that the franchisor has misbehaved is defamatory. In fact, even the code council telling people that the franchisor has been struck off is defamatory because it carries certain implications with it.

There are ways in which you can tackle that without having to legislate the full conduct of the code, and one of them is to provide for some qualified privilege for whoever is administering the code. That is done in some areas of securities regulation—

Mr BEDDALL—Why has that not been done then?

Mr Noonan—At the Commonwealth level, there is a pretty significant constitutional problem that would have to be dealt with in relation to providing for defamation, which is basically a state-territory matter. It might be that the Commonwealth could get some coverage in the constitutional area but certainly it could not get comprehensive coverage over all areas.

Mr ZAMMIT—You mentioned something about qualified privilege being provided, in your words, for whoever is administering the code. Qualified privilege is very dangerous, absolute privilege is not. Do you draw a distinction between the two or did you mean absolute privilege?

Mr Noonan—No, I was referring to qualified privilege, which basically protects you in respect of statements made in good faith in the discharge of your duties, under the code in this case rather than any absolute protection. That takes me to some of the policy issues. On the pros and cons from a policy point of view of legislating to give defamation protection, they probably start with the observation that there are a number of very major schemes in the consumer area where there is not any qualified protection for the bodies administering the code. I think the general insurance body has recently named a company and done so without any legislative protection.

First of all, there is the notion of whether the government should be conferring protection from the general law on a private body, which is something that needs to be evaluated. There is the more general point of those who are making statements in the public domain being accountable for the statements that they make about others. That is something that is not lightly put aside and is not often put aside.

It also has a significant economic issue, and that is that, to the extent that you protect people from the consequences of their actions, you are creating distortions in the marketplace because they no longer have to take the degree of care with their pronouncements that they might otherwise take if the law were allowed to operate as it should. In that area, the distinction between qualified privilege and absolute privilege becomes particularly important because, for the parliament to tell a private body, 'You can make any statement that you like at all and you are absolutely protected,' would be a very major delegation of the rights of the parliament and a fairly serious point of view.

How is that dealt with in the other schemes that I referred to before that do not have legislative protection? I do not know the details, but presumably they rely on insurance protections. The advantage of insurance protection over a legislative protection is that it enables you to take into account the performance of the body, so if the body is often getting sued for the statements that it makes then their premiums go up and that forces them to correct their behaviour, whereas for a body that uses the power to criticise others in public judiciously and appropriately and is not successfully sued, their premiums stay low.

There are a number of issues in the defamation area but none of those necessarily go to legislating for the entire code. You can actually offer a meaningful protection, notwithstanding the point that you make about it not being an absolute protection, that would give some confidence to the administrators of these bodies so that they could speak out without the need to fear for their personal liability.

CHAIR—That has not been done, has it?

Mr Noonan—No, it has not.

Mrs BAILEY—Mr Noonan, I would like to ask you a general question firstly. You have made a number of recommendations and expressed opinions in your submission. Can you tell me on what body of knowledge you base those recommendations? For example, did you go out and talk to small business? Did you survey? If you did, how many micro small business people did you consult before reaching those recommendations?

Mr Noonan—We did not conduct any particular consultative process for this particular submission, but we have been involved in this area of discussion, fair trading and franchising, for a large number of years. We are really drawing on all the reports and discussions, plus analyses and surveys by the Bureau of Statistics that have been done over that time.

Mrs BAILEY—If I could just seek some further clarification: while you have not actually spoken to any small business people in making these current recommendations, going back over a number of years, have you actually spoken or consulted with small business people? Or is it just a matter of reading reports and looking at statistics?

Mr Noonan—No. We in the department administer a number of formal consultative mechanisms—the National Small Business Forum, for instance, where the question of fair trading was debated very extensively during the early part of the 1990s, as well as the newly formed micro business consultative group.

Mrs BAILEY—That has only been going a few months.

Mr Noonan—Yes. They have not yet reached this kind of—
Mrs BAILEY—And they have not made any recommendations yet.

Mr Noonan—No. They are scheduled to report at the end of 1997. That was the scheduled date when they were established and that is still thought a suitable time.

Mrs BAILEY—I think you have answered that question. Mr Chairman, could I just pursue that a little further? Sticking with the franchising code; you actually said a few moments ago—I actually wrote your comment down—that there is no problem with the code. I have to say to you that I have this mental image that there is nothing wrong with the health system either until you get sick. In your opening comments you actually compared small business operators to consumers. But I would put the point to you that small business—and especially micro small business—in fact do not have access to the same sorts of dispute resolution mechanisms that consumers have. In the light of those comments that you have made here today, could you explain why you have reached this position where you see you cannot make the recommendation for any legislative underpinning of a code? Also, I would remind you that you have not consulted with any small business people or, in particular, micro small business people. Could you explain to this committee how you have reached that recommendation?

Mr Noonan—You have referred to my comments distinguishing between a problem with the code and a problem with the administration of the code. What I am suggesting there is that the content of the code is reasonably widely supported but I am not suggesting that it is not a problem that—

Mrs BAILEY—But it has no real powers.

Mr Noonan—Certainly at the moment there is no administration of the code, which is an issue which needs to be addressed. As to the sanctions that are available, that goes to the essence of self regulation versus government regulation and the code is a self regulatory model sponsored by the previous government. The question of whether that needs to be changed needs to be addressed in a way that says, 'Well, what exactly is the problem?'

Mrs BAILEY—I understand that, but my specific question to you was that you yourself mentioned that small business people are like consumers. But I am saying to you—and I am sure that you would readily acknowledge—that consumers have far greater access to dispute resolution mechanisms than small business.

On the one hand, what I am really saying to you is that I do not think you can have it both ways. You cannot say that small business people are like consumers but then deny small business, especially the micro small business, the same rights as consumers have. In the light of your own comments, I am asking you to please explain why you do not support a recommendation for legislative underpinning of something like the code.

Mr Noonan—You asked about access to dispute resolution procedures. We do not try to have it both ways; in our submission we do discuss in some detail the possibility that something akin to a small claims

tribunal might be established for the benefit of business. I think we say in our submission there are a lot of issues that need to be addressed there but certainly accessibility to justice is a major theme within our submission. Certainly we see that that is an area where, if that can be addressed, then some small business concerns can be met and perhaps obviate the need for legislative underpinning.

CHAIR—Could I follow that up also? You have devoted a fair amount of time in your submission to us, on page 20, about the constitutional effect of legislative underpinning, but I wanted to come back to the Gardini report which recommended a system of mandatory self-regulation. If the franchise code was to be underpinned in legislation, do you think it could be done by amending the Corporations Law, as recommended per the Gardini report, or by adding a new provision to the Trade Practices Act, as recommended in evidence that we have received to this inquiry?

Mr Noonan—The proposal that the Corporations Law be amended was not accepted by the previous government. Some of the reasons that that was the case are as follows: first of all, some of the larger franchise arrangements, for instance, motor vehicle dealers, would be exempt because the Corporations Law prospectus provisions have an exemption for investments over $500,000. There is another exemption which deals with a number of offers that are made over a 12-month period which might see smaller franchise systems not be caught by the rules in the Corporations Law.

Furthermore, it is very difficult to define the concept of a prescribed interest. The definition in the Corporations Law is already pretty vague and to add the concept of franchising would make it more difficult. At the moment, in fact, the Corporations Law operates by exempting all franchised arrangements. The definition of a franchise arrangement runs on for 20 or so lines and has a number of quite vague concepts in it. That operates okay while it is operating as an exemption because there is scope for the ASC to take a fairly liberal view of the exemption and nobody has to worry about where the precise borderline is.

But if there is to be positive regulation imposed using that kind of vague definition which has lots of words within it, like ‘substantially dependent’, ‘significant degree of control’, ‘capable of being identified by the public’, these are all concepts that are potentially extremely difficult to define with any precision. But if at the end of the day there are real penalties for failing to comply with the law, then those who are subject to it will make every effort to structure their affairs to avoid the definition. What will tend to happen, in our view, would be the legislation would become ever more complex and it would fail to capture exactly the arrangements which it was directed at, because they would be structuring their way out of it.

Mr BEDDALL—There seem to be 25,000 reasons why nothing can be done, but we have a situation where a franchising code is in administration and there is no protection there, basically, for franchisees. How do you think we can get to a resolution?

You talked about previous governments. I was part of one. When I in that previous administration brought in the franchising council, it was to ensure that we had a trial period. We looked at it over a number of years—now five or six, I think—to see if a voluntary code would work. You have got the council in administration. Now that did not happen overnight. Surely there was some thought going into it through the departmental process through to the minister to find a resolution to this, rather than the minister now running around saying he is going to appoint someone.

Is there any thought about how you make this work? It is not working now. We have evidence from franchisee after franchisee, we see major franchisors going to the wall and taking small business with them, and people could actually invest in those franchises the day before they collapsed and not know.

Mr Noonan—You certainly cannot entirely exclude the possibility of problems arising in particular situations, but what our submission is basically saying is that the way forward is not to try to legislate to solve every individual's problem. On the latest statistical data one per cent of franchisees say that they are currently in litigation or the courts, and 89 per cent of franchisees say they have a good relationship with the franchisors. So while there is no doubt, just because of the size of the industry, that there are many franchisees that have very significant problems—

Mr BEDDALL—What is the basis of that data? Where did that come from?

Mr Noonan—That is the Australian Bureau of Statistics survey. I think I can give you a reference to that later if you wish. Now what we are saying is that many of these problems arise because the franchisee was poorly advised when they went into the transaction. They did not ask the question, 'What are relationships like between you and your other franchisees? Are you in court with any of them at the moment?' Now that is a question that they should ask if they are properly advised, and getting them properly advised consists of two steps: first of all, telling them how to approach entering into the commercial transaction which, for many of them, will be the most major commercial transaction they have ever made, and there the government probably has a role to play; and then, secondly, they need to seek advice and make sure that the proposal that is coming forward is properly evaluated.

So it is that sort of educational strategy, if I might call it that, which is designed to stop the problems arising as far as possible in the future and then, where there are problems, make sure that the path to remedies for the franchisees is clear. We have made a number of suggestions in our submission about that. At the moment section 51AA is untested in the courts. The ACCC continues to try to pursue matters to get some standards enunciated by the courts, and unfortunately they are settling at the moment, but it is too early to say that section 51AA has failed. On the contrary, the fact that these matters are settling might indicate how powerful a provision it is and how reluctant the franchisor was to try to defend their conduct in some of those cases.

So it is a question of stop the problems arising in the future, open up the path to remedies at the other end and allow industry to get on with good self-regulatory codes like the code of practice. Yes, we have got a problem at the moment with the franchising code of practice, but that is not due to the code, it is due to the budget decisions that the government had to make and the way that the council members felt that they had to go.

Mr BEDDALL—That is not 100 per cent correct. There has also been great concern for a long period of time about individual liabilities by directors if they did not have underpinning.

Mr Noonan—Yes.

Mr BEDDALL—It has been there for a long time. The budgetary thing is one thing, but there has

always been that underlying concern and a strong argument from some members of the franchising code for underpinning.

Mr Noonan—Yes, and that has been based on their potential exposure to defamation in respect of naming parties. I have discussed before the issues that arise there. That might well be an area where some changes could usefully be made to protect these people who are in the position of administering these bodies who are often doing it on a voluntary basis and—

Mr BEDDALL—But if the government has cut the funding, it is going to be hard for them to find additional money to pay for insurance premiums, isn't it?

Mr Noonan—The question of the budget is a separate one, but the government's view is that in the longer run self-regulatory schemes have to be funded by the industry. I think the minister has made that clear on a number of occasions.

In the case of franchising, there has been government funding extending over a number of years with almost $1 million made available to the council during 1996 and 1997. So there has been very substantial investment by the government, and the government has said in its budget decision that now is the time for the franchising area to become self-funding.

Mr BEDDALL—It got wound up on 31 December.

Mr Noonan—It had $648,000 available to it during 1996-97 to adjust its corporate plan, to reduce its expenses and to raise its revenue because it also raises revenue from the industry. The council was not able to agree on a way forward, and that is why the wind-up took place.

CHAIR—I will go back to the beginning again because what has emerged now is a very defensive situation from the department. When you set about putting a submission before this committee, was it the department's view and your own view that you should be putting up what could be solutions to the problems that are being experienced in the small business area, or was it one of defending the current situation with just a little bit of rounding off at the edges? I would like to get back to your thoughts then.

Mr Noonan—I hope that the submission is not seen as defensive or negative in any way. Another part of my division is responsible for the government's response to the small business deregulation task force which will report next month. All the people who made submissions to the deregulation task force said, 'We do not need more regulation; we need less. We need to get black-letter law off our shoulders.'

It is from that background that we have approached the drafting of the submission, which is to say, 'If there is a need to modify the law as in the area of defamation, then let's go ahead with that, but let's not race to add hugely to the law by mandating whole codes of practice'—codes of practice being a particular area of concern in submissions to the Charlie Bell inquiry—'Let's not race to do that before we have examined exactly what the problem is.' We feel that, on examining what the problems are, if you follow a pro-active policy of education to stop the problems arising and freeing up access to justice to get the problems resolved once they do, then in fact you have met a very large proportion of the problems.

CHAIR—Can I just move onto another topic? Time is getting away from us, but I wanted to raise the present status of any proposed changes to the petroleum retail marketing legislation and Oilcode following the ACCC report on the Petroleum Products Declaration last year. Could you give us an update on that, Mr Neil?

Mr Neil—What is it in particular that you would like to know? Minister McGauran is currently consulting with participants in Oilcode with a view to seeing whether or not the negotiations which have been going on for some time about finalising their sub-codes can indeed go through. The government said that it would prefer to see a new improved Oilcode within the next 12 months and then move to repeal the two acts, the sites act and the franchising act. Minister McGauran is in the middle of that process right now.

CHAIR—With a reporting date or not?

Mr Neil—He intends to report back to government. I do not know the precise date of that, but I would expect that would be certainly well before the end of the 12 months. I think he sees that as a much shorter-term exercise—at least reporting in a preliminary way to say where the participants stand and what the prospects of resolution are.

CHAIR—Thank you. The other issue that I would like to come to is in your introduction where you suggest that certainty of contract was a fundamental consideration. What exactly do you mean by 'certainty of contract', and for whom?

Mr Noonan—What is meant there is that if those who enter into contracts fear that they are liable to be overturned on fairly general or new grounds that will be reflected in the price that they are able to charge. Let us take a franchisor. Suppose that a vague test, say, harsh or oppressive, was to be introduced into the Trade Practices Act. A franchisor knows that not only are their contracts potentially able to be set aside on the basis of unconscionability or on the basis of misleading or deceptive conduct—that is, things that are fairly much within their control—but that the actual substantive outcomes might be judged to be harsh. The contract might then be knocked over.

A franchisor is going to react to that by charging a higher price for the franchise than they would otherwise have charged, in order to reflect the greater element of risk that they are facing, and that will be to the disadvantage of franchisees ultimately. So that was the importance of certainty of contract. No contract is absolutely set in stone in the sense that courts can set it aside for well-established reasons such as misleading or deceptive conduct or unconscionability. But if you significantly broaden those areas, especially if you move into areas such as harsh and unfair where there is no established jurisprudence to guide you through on what those terms mean, you are adding significantly to uncertainty and significantly to the cost.

CHAIR—I put it to you that small businesses have very little certainty in relation to the contracts that they may enter into. For example, a retail tenancy lease gives the lessor considerable discretion in relation to rent review. That has emerged as a major problem in this inquiry. At times, tenants have been relocated to other shops or the tenancy mix of the shopping centre has been changed. All of that affects the viability of that small business in that shopping centre.

Mr Noonan—I would not characterise that necessarily as a question of certainty of contract but as a

lack of negotiating power in those situations to get the contract that you actually want. They have very few rights at all in that contract. That has been tackled by legislation in various ways in a number of states. Of course, the Commonwealth has particularly little constitutional reach in the area of retail tenancies. But it may be that one of the things that the Commonwealth can usefully do is to try to get some benchmarks established for retail tenancy legislation so that the rules are known across the country and do not vary from state to state, as they do at the moment.

Mr ALLAN MORRIS—Let me address this question of deregulation or lessening business regulation. Small businesses tell me what they mean by that is filling in less forms to the government for nothing, acting as a tax collector for nothing. That is what comes through. You are saying that what it really means is taking away laws or not having laws that protect them. I have not yet had one small business person tell me that we should soften or weaken laws or not put in laws that would give them some protection. Have you heard COSBOA or any other business organisation say that there should not be laws underpinning these things, that there should not be strengthening of the TPC or the ACCC legislation?

Mr Noonan—No. Certainly, no small business organisation or individual small businesses want protections taken away that are important and appropriate. Nobody wants to repeal section 52 of the Trade Practices Act, which is a major provision of relevance in this area. In answering your question about government forms that is certainly a focus of interest but there are other areas of regulation which tend to lead, inevitably, to government involvement in the sector that eventually becomes a burden on business. For instance, the Corporations Law is basically a law that is about regulating the rights of people who deal with companies and yet, overwhelmingly, the business community says that that has become a burden because there has been too much legislation. Every time a problem came up the response of the government was to introduce a whole raft of new legislation and, in the end, it got in the way of everybody, including those whom it was trying to protect.

Mr ALLAN MORRIS—I have heard those arguments. It seems to me that you are saying that, when anybody says we should legislate, we should automatically say no we should not. You say that there should be equality and that small businesses are underresourced. The fact is that many small businesses are faced with consumers who are vastly more powerful than they are. People who buy a product from a small shop have more legislative backup to fight that shop than the shop owner has in their transactions.

I find it really difficult to understand why you are so one-sided, why you are so unbalanced, why it is okay to have consumer legislation, which I gather is now in your department, black letter law, to protect consumers. You argue strongly against black letter law to protect consumers, when that consumer happens to be a small business person.

Mr Noonan—I hope I am not arguing an unbalanced view. I am saying, both about regulation affecting the rights of small business and regulation affecting the rights of consumers, that you have to go through a process of finding out what the problem is, and how to solve the problem in a way that will have the least impact on the market. We should always go through that process. In fact, the Council of Australian Governments have agreed that that is the process that should always be gone through.

Now, what we need to do in this area is analyse the problems to see whether they are problems that

can be addressed through educational needs. If they are, we do not need the potential costs that would be involved in legislating generally for the sector. If the educational approach is not adequate, if access to justice is the problem, then you tackle those kinds of issues, and then voluntary codes of conduct. It is only if you find that the voluntary codes of conduct are not adequately addressing the problems that you start to think about how can we supplement those by regulation.

Mr ALLAN MORRIS—The point I make is that I thought we had been through all that over the last seven, eight, nine years. At the end of that time, you are still saying that we have not yet accepted that voluntary codes do not work. I find it unfair that customers of a small business person in a franchise are protected from him but that he is not protected from his supplier. I do not find overregulation or red tape or any of the things that you have tended to put forward as being reasons why one should not. I am definitely having difficulty understanding what appears to be a bias or a blind spot in your presentation.

CHAIR—Unfortunately, we have run out of time. Obviously, if there are issues on which the committee requires additional information, the secretariat will write to you. Thank you.

GRIFFITHS, Mr Garth Warren, President, Australian Institute of Business Brokers Inc. 59A Stewart Avenue, Hamilton South, New South Wales 2303

CHAIR—Welcome, Mr Griffiths. I know that you have travelled from Newcastle this morning to attend the hearing at the committee's request, and we very much appreciate your participation in today's hearing.

The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded a contempt of parliament.

The committee prefers that all evidence be given in public, but should you at any stage wish to give evidence in private you may ask to do so and the committee will give consideration to your request. The committee has received your written submission and authorised its publication. Would you like to make any additions or alterations to that?

Mr Griffiths—I do not think so, Mr Chairman. Our submission covers all the issues that we wish to raise, albeit that it probably does not address the solutions to the problems that it raises.

CHAIR—Would you care to make a brief opening statement before we commence the questions?

Mr Griffiths—No.

CHAIR—You are quite happy to let your submission stand?

Mr Griffiths—Yes.

CHAIR—Could you just give me an outline of what the Australian Institute of Business Brokers does in the retail property market.

Mr Griffiths—Our involvement in the retail sector is that of business brokers. A business broker sells businesses, both leasehold and freehold businesses. It has long been held by the courts that if there is no lease there is no business. Therefore, a secure term, or secure tenure, is of paramount importance when you come to sell a leasehold business, and we are very involved in leases.

CHAIR—Do you act only for the vendors, or do you act for the purchasers as well?

Mr Griffiths—In some transactions, when you get to the bigger end of the market, we do do acquisitions on behalf of purchasers wanting to buy, but that is normally at a higher level.

CHAIR—I don't quite grasp that.

Mr Griffiths—It is not uncommon for business brokers to go out and purchase other businesses on behalf of a national organisation or a national company. They may wish to absorb another business, another competitor, and business brokers are often engaged in those instances on behalf of a purchaser.

CHAIR—So in terms of this inquiry you could in fact be acting for a large enterprise or you could be acting on behalf of a small enterprise; is that fair to say?

Mr Griffiths—Yes.

CHAIR—What in your view then has been emerging that is creating problems for small business in this situation?

Mr Griffiths—Our issue that we have tried to raise before this committee has been the issue of shopping centre rents. There is an enormous gap between what some of the major tenants may pay as opposed to the smaller tenants in shopping centres. As I have said in my submission, it is up to 1,000 per cent greater on a square meterage basis.

CHAIR—Is that the only criteria upon which you can base rental, or are you talking purely about—

Mr Griffiths—No. My own personal belief is that the best way to monitor rents is through a pure percentage of turnover. Everybody here I am sure will acknowledge that if you are in, for example, a newsagency, a newsagent purchases his papers at a certain price. No other newsagent buys them at a cheaper price; they are all on the same level playing ground. They purchase the product at the same price. They are then compelled to sell it at the same retail price, therefore their margins are the same. With newsagencies, for example, it is 25 per cent on the sale of papers. That is 25c in every dollar is made.

The problem that we encounter is that the difference between rents in shopping centres and the rents outside shopping centres is probably double at the moment. What I am saying is that they are twice as high in shopping centres as they are outside shopping centres. Yet the profit that is made is the same, proportionately—and I am talking about margin. Does that answer you, or not?

CHAIR—Yes.

Mr BEDDALL—I think one of the problems with rents is that initially there was a view that an anchor tenant—as you call it, which is the term I always used—such as Woolworths would come in and it would attract a whole range of people. At that stage you used to have a butcher, a greengrocer and a baker all in the shopping centre, and everyone was doing alright. The big change has been, has it not, that Woolworths and Coles and Franklins now are the butcher and the baker. So what they have done is take—

Mr Griffiths—They have become department stores.

Mr BEDDALL—And become huge in the areas where the small business cannot compete. Do you think that is one of the changes? We have always had this problem, but it seems to have got worse in the last few years.

Mr Griffiths—It is one of the changes. There is no doubt that the range of merchandise sold by the majors has become far more diverse. There was a market for specialist delicatessens; that has gone now. Every major chain in the food industry has a specialist delicatessen shop.

CHAIR—Can I ask you about goodwill in some of these situations you are talking about? You gave the instance of the newsagents there. Do you think that other retail tenants are entitled to recoup goodwill at, say, the end of a five-year occupancy, or a five-year lease?

Mr Griffiths—I have heard the argument that goodwill does not exist. I do not know what business brokers sell around Australia, but every day they transact goodwill. It is fair to say that goodwill in shopping centres is a thing that is diminishing at a rapid rate, but it is not diminishing outside shopping centres.

If I can take the example of a newsagency, a newsagency would probably be invited to go into a shopping centre because they are traffic generators. A newsagent going into a shopping centre may have a lease that expires in 12 months and, if he is not given a long-term lease, he is then placed in a position where he has an awful predicament. But if he were outside a shopping centre he has an alternative, and that is that he can pick up—if he does not like the rent at the end of five years when they are negotiating new leases—and he can find alternate premises.

But in a shopping centre you do not have that alternative. There are only four, five, six, seven or eight owners, maybe, of shopping centres in Australia and, if you are in one of those shopping centres you have nowhere to go, and each of those centre managers is fully aware of that. So bad is that situation that the Newsagency Council of New South Wales, for example, will not allow a tenant to be bound by a lease that does not give him a territorial boundary that goes outside the shopping centre. He must be given an escape to get out of the shopping centre.

Mr BEDDALL—The ACCC is now chasing that, is it not?

Mr Griffiths—I don't know. I read the other day where the Prime Minister has made an announcement that not too much is going to happen. I believe that it is pretty quiet now.

Ms GAMBARO—You have advocated that a better system of outgoings than is currently operating—and many of us have heard the problems inherent in that—would be to charge gross rents. Could you outline in more detail as to how such a scheme would work?

Mr Griffiths—When you make comparisons from one business to another and you get back to yardstick averages, where you are looking for an industry average of what a reasonable rent would be to be paid by a particular facet of business, the thing that must be considered is the total rent that is paid. These days we have base rent, we have contributions to outgoings, cleaning, and all sorts of other things that are tacked on. Fifteen years ago, 20 years ago, I would put it to you that outgoings probably represented an additional 10 per cent on top of the base rent. These days it probably represents 30 per cent advance on the base rent.

Lots of tenants would be of the belief that those facilities that are provided as outgoings are far too

elaborate. There may even be the opportunity to rort those systems. In recent times legislation has been introduced where outgoings in a shopping centre, in New South Wales at least, have to be audited, but the cost of that audit is then passed on to the tenant anyway. It is a minefield, but the fairest way to do it is to take an all-encompassing rent so that it is, as you call it, a gross rent, and then, if a shopping centre manager is smart enough to be able to provide a similar service at a lesser cost, then it is to his advantage.

Ms GAMBARO—Mr Griffiths, is information provided to the retailer on a detailed basis of what those outgoings include? Again, we have had submissions that state otherwise.

Mr Griffiths—I understand if you were to ask a landlord or centre manager they would say yes; if you were to ask a tenant they would say no. The answer is that not enough detail is given. They are given some detail, but it is not enough. It should be itemised in total so that you can see, as a tenant, exactly where your money is being spent.

CHAIR—I would like to follow that up for a moment. Comparing the example that you gave before with a retailer away from the shopping centre paying a gross rental, paying the outgoings that might be associated with utility services, and someone in a fruit shop—a fruit shop out there and a fruit shop in a centre—he is paying a certain level of contributions to that centre, and you are saying that you do not believe they are fully disclosed?

Mr Griffiths—The contributions to the centre are not fully disclosed, no. They are disclosed, but not in sufficient detail. For example, you will have a heading of promotion, advertising, but it is not detailed.

CHAIR—The fruit shop out in the strip shopping is not paying anything towards, say, turnover tax. Why are you advocating a turnover component of the rental within a shopping centre?

Mr Griffiths—I just say it is a fairer method of assessing a rental. I am not suggesting that somebody pays a rent plus a turnover tax, as you call it. What I am suggesting is that somebody should pay a rental based on their turnover. That is, for example, a restaurant orientated business in a shopping centre may be able to pay 10 per cent of its turnover as rent. When I say rent I mean gross rent.

Outside a shopping centre it has widely been the view of everybody in our industry that a restaurant cannot afford to pay more than eight per cent of its turnover. If it does it will simply fail. I put it to you that what is happening in shopping centres is that we are experiencing tenants having to pay up to 30 per cent of their turnover as rent. They just simply cannot survive.

Mrs BAILEY—Mr Chairman, if I could just follow up on a couple of those points that you have made. Would you see a solution to the problem that you have just described being businesses having to pay 30 per cent of their turnover in rent? It is my understanding from other evidence before this inquiry that the rental agreement is a secret. Would you see that if the rental agreements were open and there was disclosure that this would be one method of alleviating that problem?

Mr Griffiths—It would certainly go a long way to solving it. It has long been a problem for business brokers Australia wide that we have not been able to research that sort of information, other than when we

come to list a business for sale. We are probably the only group of people in Australia that take the area of a shop, the rental that is paid, the turnover of the business and from that can conclude industry averages. To my knowledge it is not available anywhere else. A register of rentals that were paid in the shopping centres would be a marvellous thing, from our point of view and from every tenant's point of view.

Mrs BAILEY—Does the same system work, for example, in strip shopping centres? I can remember, for example, when I had a small business myself, that the rent was based on the square metre and the position of the premises. Obviously you paid more rent if it was on a prominent corner position rather than tucked down a laneway. There was, if you like, a flat rate of per square metre.

Mr Griffiths—There are two things to consider. The angle that we would come from is to say that a business can afford to pay only a certain percentage of its turnover based on the fact that it assumes normal gross profit margins. There are people in the property industry who form a different view and say that the cost of this development has been $10 million therefore we must get a 10 per cent return irrespective of whether a tenant can or cannot pay the return. We need to get $1 million dollars in rent—10 per cent.

Mrs BAILEY—Can I just clarify from you, in your experience, this proposition of a percentage of the turnover. We have certainly heard that that practice is prevalent in shopping centres. Is it your experience that it is also prevalent in, for example, strip shopping centres or in any business outside the larger shopping areas?

Mr Griffiths—Which practice are you referring to?

Mrs BAILEY—The rental is based on a percentage of the turnover.

Mr Griffiths—Unfortunately, it is not a practice that is widely held at all. It is our view, as an institute, that it is a practice that should be adopted—because it is fair. What does happen now in shopping centres is that there is commonly a base rent. There is a minimum rent that you must pay. If you perform better then you must pay an additional rental. That for us is very, very difficult. It has no escape should you not do as well or should a centre manager introduce another eight butcher shops, Mr Beddall's example, and reduce your trade. That happens constantly.

The simple scenario to this is that rents should be based on turnover. There is plenty of evidence around to suggest what those industry averages should be. I would suggest to you that our institute would be able to do that around Australia with an accuracy of probably five per cent. The alternative that we have now is the escalations that are going on in leases that are being renewed or reviewed. All these new terminologies that have been introduced in the last 10 or 15 years have thrown rents way out of whack.

Mrs BAILEY—In your experience, are the people coming to you wanting to buy businesses actually well informed people? All these problems have been outlined to us, especially about small businesses in shopping centres, but I notice there do not seem to be too many vacancies in the large shopping centres. So there are obviously people lining up.

Mr Griffiths—There are lots of vacancies in shopping centres; it is just that you cannot see them. I

do not mean to be rude but there are holes that have been plugged artificially with temporary tenants—and there are a lot of them. It is something that is not made available to the public; tenants are not told. Like so many other things that happen in shopping centres, it is a facade to make you believe that there is a waiting list of people to go into shopping centres, but I can tell you there is not. In the town that I come from, for the first time last week I saw a real estate agent sign in the window of a vacant shop in a shopping centre. For me, that is the start. They have not been able to, as managing agents, find a tenant.

Mrs JOHNSTON—If I could just very quickly touch on the suggestion that perhaps it is a fixed percentage of the turnover that should be paid as rental. Obviously, if that was to eventuate, that would be something that would have to go to each state and territory before it could become uniform. Is that what you are envisaging?

Mr Griffiths—I expect so.

Mrs JOHNSTON—You see no complications or difficulties in that?

Mr Griffiths—Yes. There will be lots. But any change warrants a lot of consideration. If I can just go back to Mrs Bailey's question that I did not answer—excuse me, Mrs Johnston—earlier, you started to ask about the tenants and who they are and who the people are who are going into shopping centres. The one thing that I have heard today is certainly not the case: it is not a list of people who have pocketfuls of money and who are retirees.

The industry that I work in, from what I have heard here today, it is terribly disregarded. These people are the backbone of small enterprise in Australia. We are not talking about people who would come out with $200,000 from a retirement village. These people are like you. You have been there. These people are talented but they have been held over. It is not that they are not talented people. When people come up for renewals of leases invariably there is a problem where the sales are not sufficient to justify the rent that the landlords are asking. Invariably, the landlord turns around and says, 'The tenant's not good enough to generate the sales,' but that is just not the case. It cannot be the case so often.

I put it to you that in the town that I come from we have, supposedly, the greatest number of shops in Australia per head of population. I am led to believe that Australia has the most number of shops per head of population in the western world. From that I conclude that the town where I live has the most shops per head of population in the western world. I think we are right in the middle of it in Newcastle.

Mrs JOHNSTON—I rather admire your concept because I do think that setting the rent at a particular percentage, albeit that it fluctuates from time to time, is a much fairer situation to the person who actually goes in and leases that shop. The comments that you have made about not being able to pay the rent when your business goes down is obviously a very real one and this is why a lot of small businesses go broke and obviously have to leave or just walk out.

I would like to ask two more questions if I could. Firstly, what is your view about enticing people to go to shopping centres by dangling a carrot in front of them and saying, 'You can have a six-months rent free lease of your premises'?

Mr Griffiths—Fortunately, my business is not involved in that.

Mrs JOHNSTON—What is the institution's view then?

Mr Griffiths—The difficulty that you have with this is that it is creating a false economy.

Mrs JOHNSTON—Precisely.

Mr Griffiths—And it applies to just about everything. As I have mentioned in my submission, it does not matter whether you are talking about rebates on purchases of stock or whether you have a retailer who goes out and buys Coca-Cola and gets 12 bottles to the dozen or somebody who gets 13 bottles to the dozen as a special deal or somebody who gets a rebate of 50 per cent on the invoice. I cannot understand why people in commerce do not face the reality of the situation. Sooner or later somebody is going to get really, really hurt.

If I can put it this way for you: at the moment we have centre managers who are probably the pivotal point on a set of scales. On one side of the scale you have tenants who pay rent, and on the other side you have shareholders in property trusts. If these people continue to pay their rent, they will go broke and beneath them there will be blood on the floor. These people will remain very happy. But the tenants are failing now—right now they are failing. The result of that is that, for the people over this side, their investment is going to diminish. Sooner or later, the rents are going to have to come back. If they do not, who knows?

Mrs JOHNSTON—I follow you quite well and it is refreshing to see that somebody acknowledges it. My very last question, and it is a little bit off the track from what we have been saying, is that I am rather concerned that in some instances the behaviour of the business brokers is very unethical. They sell businesses to potential owners in the full knowledge that the information they are providing is, to put it very mildly, incorrect. I think that practice should be looked at, and again it is a bit like the situation you just explained. The business broker too has to exist, so the more often that business broker sells that business—and there are some cases where a person who specialises in delicatessens or lunch bars may sell that same business 12 times in two years, knowing very well that he is selling a crook business.

Mr Griffiths—I agree.

Mrs JOHNSTON—As the spokesperson for your institute, what is the institute doing about that to ensure that business brokers too have a certain amount of accountability? Quite frankly, once the deal has been completed, it is my experience and it has been brought to my attention that the person to whom the business was sold really has no avenue. He or she may scream and say that they are going to take legal action but in actual fact they do not. They do not have the time. They do not have the money, and they certainly do not have the energy because they have already got a crook business.

Mr Griffiths—Yes, I understand what you are saying precisely. It is a dilemma. What are we doing about it? Perhaps two things. The first thing we are trying to do is to distance ourselves and fight against the recommendations that have been made by the Hilmer report affecting licensing in our industry. That is a decision that has been made without any consultation with our industry at all. We believe that, if licensing is

taken away from our industry, the situation will get worse.

What can be done to rectify it? In South Australia they have introduced what I think is very good legislation. Accountability has to be brought by the vendor in a contract at the point of sale, and the vendor actually warrants the trading performance of the business when they sell it. That has got a lot of merit. It is very different from what happens in New South Wales—very, very different—and very different from what happens in Western Australia. But I think the South Australian legislation is head and shoulders above what we have in every other state in Australia, and we should all try and move towards that.

Mrs JOHNSTON—Thank you.

Mr ZAMMIT—Mr Griffiths, I am very impressed with what you said about the small business people who go into these shopping centres—they are the backbone of Australia, they put their lives on the line, they mortgage their houses, they are determined to succeed and they work long hours to succeed, yet everything is stacked up against them. I am very interested in your conclusions on page 10, where you say that one of the alternatives would be for the tenants themselves to engage the centre manager.

Mr Griffiths—It is an interesting thought, isn't it?

Mr ZAMMIT—Yes; I have not heard that put forward before. That is something we would be interested in knowing more about. For instance, if that were to come about, would you envisage one vote per shop or would you envisage 1½ votes for a very large tenant, perhaps such as Coles or Woolworths?

Mr Griffiths—I have not thought it through. In terms of the submission, it is funny what comes to you and becomes a lot clearer when you start to put pen to paper and look at what has been around you for such a long time. It is strange that the tenants pay these shopping centre managers to give them such a terrible time. At the end of the day, if they pay for those services—if they pay for advertising, for promotion, for the cleanliness, the music, and all the rest of it—I cannot see why they could not get together and why the hell they do not employ them? However that is done—whether it be done on some strata basis, similar to what a strata management system would be, or so many votes per square foot or per dollar rental paid—it is possible.

Mrs BAILEY—Would it compare to something like the body corporate of strata title units?

Mr Griffiths—The outgoings could become something like that, yes.

Mr RICHARD EVANS—The only comment I would make on that is that the owner would have to protect his own property, therefore he would have to be part of that management process anyway, wouldn't he?

Mr Griffiths—What does not happen now is that a centre manager does not contribute to the promotion of his investment.

Mr RICHARD EVANS—You are talking about an owner rather than the centre manager?

Mr Griffiths—I am talking about an owner of a shopping centre making some monetary contribution towards the wellbeing of his investment. He does not do that. He relies on the tenants to contribute to a sinking fund that promotes his investment.

Mr RICHARD EVANS—Fine. Thanks for that comment. The question I wanted to ask was a follow-up to what Mrs Bailey was asking you concerning the education, if you like, of people coming into small business. It seems to me, from evidence that we have had, that there is a plethora of information available through state offices, small business development corporations and a whole range of different things, such as colleges et cetera. Yet there are still a lot of people coming into business who are investing funds and working hard, and still do not understand the concept of goodwill—that it does not exist beyond their lease period. We had evidence in Perth of a person who was an accountant and who looked through all these things, and who still would give advice that a person going into retail business within a shopping centre would be crazy.

We are trying to find out through this committee how best to address that education process and I wonder whether you have any thoughts on how to educate, who is responsible for it, and whether it is a business broker's duty of care to pass these people on to someone who is an expert. A lot of people use solicitors who are not expert in lease negotiations. They talk to other so-called experts who are not necessarily educated in these areas. Is there an answer to this problem?

Mr Griffiths—Yes, there is an answer to it. It is probably as simple as this: if you go to the graph that we have prepared on shopping centre rents, and if you take either one, you will see that there is an escalation of rents that has come about through three factors. The first is the compounding of rents on year past, rather than a fixed 10 per cent increase each year on the base rent. That is what used to happen 20 years ago, that you would have a 10 per cent increase on your $1,000 rent and you would pay and extra $100 for the next 20 years—if you were to be there for that long.

Then they realised that it was pretty smart to compound these rents, in other words to charge a rent based on the previous year's rent. If you look at that graph it makes a dramatic difference. Then they found at the end of a five-year period, without giving any options for renewal—and they never give options—that they would have this opportunity to increase the rent at the end of every five years. That was so successful that they have now introduced a new thing called review to market. There is no review to market. It does not exist. We do not get engaged and we have got the detail of it. Very rarely do we get involved in review to market and no valuer has the access to this information. They come in to us.

Mr RICHARD EVANS—It is manipulative between the owners of shopping centres anyway.

Mr Griffiths—Absolutely, and they have got these tenants by the throat. What I am saying to you is that I believe that the failures occur as a result of the increase in rents. If you went back five years ago and looked at shopping centres, it was pretty much a fifty-fifty basis. Whatever the rents were was about what the net profit was for a working owner in a shopping centre of a particular business.

That is no longer the case. The rents are greater than the profits that they make. That is fine, provided the profits are sufficient to justify the capital outlay of the business in the first place. What I am saying to

you is the problem is the lease document. That is the problem. These businesses did work a long time ago. They are still there today but they are not making any money. The reason they are not making money is they are paying too much rent.

Mr RICHARD EVANS—That addresses the problem but how do we address the education of those who are going into business?

Mr Griffiths—It is probably as simple as asking perhaps another question: why do you need to have a review to market when already you have got a method of increasing the rent annually? Why is there any need to have a review to market? It is an additional 20 or 30 per cent each time they do it and at the end of the lease they do it for another 10 or 20 per cent. It is not hard to find that you are 50 per cent above the market just within a space of two or three years and that is where we are. In my view there is no justification for a review to market clause in any lease. They exist outside shopping centres, but they are never used because the tenant has the alternative of picking up outside a shopping centre on a ribbon strip and going elsewhere.

Mr RICHARD EVANS—The implication of what you are saying is that there should be standard rental leases across Australia. Would that be helpful?

Mr Griffiths—There should be a standard form of lease across Australia in our view, yes.

Mr RICHARD EVANS—So you would have a head agreement with maybe some supplementary addendums to suit a particular property?

Mr Griffiths—Yes, that would be fine as long as there is a set of standard rules. But I really cannot understand why—other than greed—there is a need for review to market. When you set out in any investment and you know that you are going to get a 10 per cent return on your money and that you are able to increase that by 10 per cent, given that you are able to compound it, is not that enough?

Mr RICHARD EVANS—According to the ACCC that is maximising profits and according to the ACCC that is not called unfair practice.

Mr Griffiths—I think that there is a real problem there.

Mr ALLAN MORRIS—Before I get to the substance of what I wanted to say, what you are implying is that the shift in rent as a ratio of turnover would therefore lead implicitly to an increase in mark-ups.

Mr Griffiths—Effectively that must happen. People have nowhere else to go but to increase the price of their merchandise.

Mr ALLAN MORRIS—Which in turn would then mean that that product price increases above and beyond inflationary type pressure, but from a pressure created by a shifting of rent as a ratio of business costs?

Mr Griffiths—Yes.

Mr ALLAN MORRIS—What I wanted to really get to was a much more critical issue. I think your paper raises it, but it has not been raised with us anywhere else and that is something that appears to be a fraudulent practice. I say that advisedly. I am quite well aware of what I am saying. It is the use of artificial devices to project higher rents than what they might appear to be. It was half raised by Mrs Johnston. This in turn capitalises the value of the property and the return to shareholders. Can you just go through that for us because that is really quite complicated. It has not been raised previously in any substantial way. Can you just explain to us how, firstly, charging a higher rent shifts the share value or the share dividend and, secondly, how artificial devices like rent rebate, six months free rent or some other artificial device translates through to the share value or to the property trust values?

Mr Griffiths—These days it is reasonable to assume that an investment property ought show a return of 10 per cent or 12 per cent in the market place. That is to say that, if you spend $100,000 in the acquisition of some real estate, it is reasonable to assume that you are going to get a $10,000 rental return. Therefore it follows that if you get a rental return of $20,000 a year, you suddenly have a business or a piece of real estate that is worth $200,000.

What the graphs do that are included in our submission is highlight the growth that has taken place in shopping centres particularly and that is being done at a very, very modest rate. The indexing method that has been used has been for 10 per cent compounded each year, using a 10 per cent increase at the end of every five-year lease and using a 10 per cent increase at the end of every three-year term where the people have come up for review to rental market.

If you have not seen that graph, I draw your attention to it. It simply means that a rent that commenced at $1,000 a week 20 years ago under the present methods that are applied in shopping centres and leases, that rent is now approaching $14,000 a week. That is almost 14 times what it was originally. I think if you were to average that growth out, from memory it is something like about a 68 per cent increase per year that the property trusts which own these shopping centres have experienced in capital value.

Mr ALLAN MORRIS—How does that translate into value and dividends?

Mr Griffiths—It does not really matter where you begin.

Mr ALLAN MORRIS—How does it mechanically transfer into value?

Mr Griffiths—Property trusts generally own shopping centres in this country. Most of them—and it affects most average Australians—own these shopping centres, having shares in the companies or property trusts that own them. What has happened is that the values of these shopping centres have in my view been artificially inflated based on the capitalisation of rents, which are perhaps 50 per cent greater than they really should be or really are, and they have been traded on the share market. The net result of that is that Mrs Smith who owns shares in the property trust may think that she has got $200,000 worth of shares when in fact she has probably only got $100,000 worth of shares, given that this bubble does burst, and it is our belief that it is not far from happening.

Mr RICHARD EVANS—One of them went to gaol last week, I believe.

Mr Griffiths—Just to take you one step further from what you were saying. What has happened, and happened in my region, was that we had one developer who is in gaol now I believe, who offered tenants an increased rent on the basis that he would give them a cash back arrangement on the spot. In other words, if the rent was $1,000 a week, he agreed to charge them $2,000 a week and would give them back $50,000 cash for each year of lease that they agreed to sign.

Tenants came to these people and said they wanted a lease. They would pay them $150,000. They entered into a lease. Three years later we had those people then coming into our brokerages and saying, 'Look, we want to sell our business', and that is how we exposed what had happened. We looked at the rents and realised that this is just not reality. We told them to go back and negotiate a new lease. Fortunately, in this instance somebody from outside Australia had not bought the shopping centre because had he, he would have been down at Watsons Bay and jumped off the Gap. In my view it was simply fraud.

Mr ALLAN MORRIS—There was another part of my question that you have not yet responded to. If a person spends $100,000 on fit out every three four or five years, what is the effect of the investment by that business person on the value of the asset and eventually on the property trust shares?

Mr Griffiths—I do not know the answer to that because I have not seen a valuation done, but it would not surprise me if the assets of that shop were added to the assets of the centre. There is plenty at law, and it is always a contentious argument, where, at the expiration of a lease, fixtures and fittings pass automatically to the landlord. It is not a view that is very widely known, and it is something that is always argued when it happens. It would not surprise me if those fixtures and fittings were included in the assets of the property that are valued, that are then traded on the share market, but I do not know that to be a fact.

Mr BEDDALL—Someone recently said to me that if he had put the money into Westfield shares that he had put into running a business, he would have been a lot richer person.

Mr Griffiths—You are probably right.

Mr BEDDALL—He reckons that was the only way to make money out of retail.

Mr Griffiths—And you did not take the advice.

Mr BEDDALL—No. A number of these shopping centres are now announcing significant, what they call, upgrades. I think Westfield has announced $2 billion worth of expenditure on its shopping centres. Does that money wholly and solely come from the increased rents? Is it paid for by the tenants, rather than from an investment from the Westfield property group? Do you know?

Mr Griffiths—No, I do not think anybody would be able to give you the answer to that, except that, if you were to take the share market and look at the dividends that had been paid over 20 years in any one of these property trusts, and then had a look at the growth predictions that we had given you, and suggest they are as high as 68 per cent each year when they pay a return of 14 per cent, one must ask the question, where has the money gone?

CHAIR—One of the strongest claims you have made in your submission is that retail property is overvalued. I want to come back to some of the history of that. The late 1980s fallout in the Australian commercial scene demonstrated, I think quite clearly, that properties were grossly overvalued at that time. Since that period, has there been a readjustment of the value of those properties, in your view, or has there been a flow-on effect which is still taking effect now with some of the markets and some of the retail rents?

Mr Griffiths—I do not think it has stopped it. There has never been a correction in the marketplace in shopping centres rents. There has certainly been a correction in ribbon strip rentals, but not in shopping centres.

CHAIR—Even with some of the shopping centres which existed at that time—at about say the late 1980s fallout—was there a readjustment at that time?

Mr Griffiths—Not to my knowledge, no. I never experienced it.

CHAIR—You commented that they are artificially inflated in some of these centres by about 50 per cent. You have given us some figures there and there are some figures in your submission, but do you have any further evidence, or any basis for that estimate of the 50 per cent overinflated value?

Mr Griffiths—The Australian Institute of Business Brokers went through a consultative process in Bondi just before Christmas on this subject. It is widely held by every broker that shopping centre rents are about 50 per cent above market.

Mr ALLAN MORRIS—That would be affected by the rent to turnover ratio, would it not?

Mr Griffiths—Yes, precisely. On one side we have shopping centres saying that the rent is the correct market value because somebody is paying it. We say that is rubbish. Because somebody pays a rent under duress, does not mean that that is the market value.

CHAIR—What about if someone sells the centre?

Mr Griffiths—If somebody sells the centre?

CHAIR—The total centre.

Mr Griffiths—And then they find that the rents are 50 per cent over market value.

CHAIR—What if they achieve on the market, a value on the sale of that total centre which reflects that the price for the rentals is somewhere near corresponding?

Mr Griffiths—I do not know that it has got any real basis in the commercial world when you get down to landlord and tenant. That is a transaction that has taken place devoid of what should be paid by a tenant.

CHAIR—But you raised earlier the proposition that the rentals were based on about a 10 per cent capitalisation of the value of the centre.

Mr Griffiths—Yes.

CHAIR—If the centre is sold for that amount that then leads to a continuation of that high rental or the 50 per cent inflated figure.

Mr Griffiths—It certainly leaves the new owner wanting the same rent, yes. Certainly it leaves him wanting the same rent but it does not necessarily follow that the rent that he is expecting to get is the correct rent. That is what you are saying has in fact happened, so then should the new owner take a bath as the new rents come up? Should he take a decline?

CHAIR—The sale of the centre to some other company, irrespective of who owns that company, might in fact keep on further inflating the value of the centre and keep inflating the value of the rentals. Have you seen any evidence of that?

Mr Griffiths—Yes.

CHAIR—Where companies have on-sold to maybe the same entity in another shape?

Mr Griffiths—There have been some articles written about that recently.

CHAIR—Perhaps you might draw the secretariat's attention to them later.

Mr ALLAN MORRIS—If a landlord gives a rent over, say, a five-year lease or a 10-year lease with one or two years rent-free, then the rent is not averaged across the total period. When they sell the centre or the building in three years time it is based on the then rental—

Mr Griffiths—That is right.

Mr ALLAN MORRIS—But the actual tenant has actually paid—

Mr Griffiths—Two-thirds.

Mr ALLAN MORRIS—It is actually less than that so to my mind that is basically fraudulent. Your implication is that your organisation believes that the bubble is about to burst. Isn't that what you have basically been saying?

Mr Griffiths—That is right. It just cannot go on any longer. Our institute is not involved at the end of selling or valuing the shopping centres. I note that you have got the valuers here later today; it would be very interesting if you were to ask them the question of how they capitalise rents and whether they do investigate the lease itself and whether any rent-free holiday period has been given. That is the essence of the question.

CHAIR—What recommendations would you suggest to this committee that we could put to parliament to address the malfunctioning, as you put it, in the retail property market? What do you suggest we do?

Mr Griffiths—There have been some things that have been talked about here today. A tenancy register I think would be a very good thing. A national lease would be a great thing. The abolition of review to market rentals—I think that review is not necessary. If a landlord goes into a short-term tenancy of only five years, surely there is no need to have a review within that five-year period. To me, that is greed. I cannot see any reason to have them.

CHAIR—You might recall my earlier question that I put to you about whether you advised retail tenants or not. Do you advise them about their upcoming rent reviews?

Mr Griffiths—If we are aware of them certainly we do, yes.

CHAIR—In other words if a small business operator approached a business broker, you would provide them with information which would equip them better to negotiate the rental reviews?

Mr Griffiths—We certainly try to do that.

CHAIR—Is that part of your role in the Institute of Business Brokers?

Mr Griffiths—Yes.

CHAIR—That has exhausted the questions. Thank you very much, Mr Griffiths, and I particularly want to thank you for making the journey down from Newcastle and being so helpful and of assistance to the committee.

Mr ALLAN MORRIS—Mr Chairman, just before you wrap up those comments, Mr Griffiths has been here earlier I noticed and he is interested in the questions to the valuers. If he wished to make any further written comments to us on what he hears today, or with hindsight, I am sure we would appreciate it.

CHAIR—I am sure if you wished to address further comments to the secretariat, the committee would be interested in hearing them. If you would be available to the committee for further contact we would appreciate that also.

Mr Griffiths—We would be.

CHAIR—Thank you. The New South Wales Retail Tenancy Disputes Unit's Mr Ken Carlsund has regrettably been held up and will not be in attendance, so we will be moving on to the Australian Institute of Valuers and Land Economists.

[12.04 p.m.]

GARMSTON, Mr Stephen, Associate (Valuer), Retail Leasing Specialist, Australian Institute of Valuers and Land Economists, 6 Campion Street, Deakin, Australian Capital Territory 2600

LOVELL, Mr Denis Patrick, Member, National Valuation Board and Fellow (Valuer and Land Economists), Australian Institute of Valuers and Land Economists, 6 Campion Street, Deakin, Australian Capital Territory 2600

NYE, Mr Bryan Geoffrey John, Chief Executive Officer, Australian Institute of Valuers and Land Economists, 6 Campion Street, Deakin, Australian Capital Territory 2600

CHAIR—I now call the representatives of the Australian Institute of Valuers and Land Economists. The committee understands that the delegation from the institute includes members who can advise on market valuation of commercial property, and the committee very much appreciates your willingness to provide expert advice to assist the fair trading inquiry. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect as proceedings in the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament.

The committee has received your written submission and has authorised its publication. Would you like to make any additions or alterations to that submission?

Mr Nye—No, we do not wish to.

CHAIR—Would you like to make a brief opening statement before we commence our questioning?

Mr Nye—The issues that we raised in the summary and in our report continue. They include the responsibility we have to undertake in valuation reports and the amount of remuneration we are receiving. Valuers are not receiving what we believe is sufficient remuneration from the banks. As an example, I would say that most average households when they go for a mortgage today pay an application fee of around $400. For that application fee it says that you will have an evaluation. In the majority of cases, a valuation is not undertaken. There is no onus on the bank to undertake it and the person who is paying that application fee never gets to see that valuation or even knows about it. The banks at the moment pay about $175 to a valuer to do that, when it is done.

At the other end of the scale, the banks or the financial institutions are asking valuers who do major valuations of business enterprises to provide incredible amounts of complete detail. A recent one asked the valuer to look at the macro- or micro-economic forecast of the wine industry in Australia before he went through the loan. The purpose of that was so that the valuer and not the financial institution would take all responsibility for the loan because the valuer has to have professional indemnity insurance.

CHAIR—Thank you. In your executive summary, you made reference to the crash of the 1980s which highlighted some deficiencies in professional practice in respect of valuation of land. You probably

heard my earlier comments about the late 1980s and whether there had, in fact, been an adjustment in the marketplace to the valuation of land and property, following that major shake-out in the Australian economy. Did your organisation have a very serious look at that? Did you in fact make some adjustments to your evaluation procedures for the value of land and property, following that shake-out?

Mr Nye—What the institute did, on behalf of all of its members, was lay down quite clearly a code of ethics which is compulsory on all members. It set up a whole regime of practice standards which are compulsory for members to follow through to make sure that we were never seen to be the profession that was taking the risks involved.

CHAIR—Apart from that, though, what did the organisation do about property and land valuations at that time? Did you mark them down or did you continue on at the same level?

Mr Nye—If you go back in history, the first marked down value which actually caused concern was done by a valuer at Grosvenor Place in Sydney, and that was done by redoing a valuation reflecting the market value at the time.

CHAIR—There is more than one instance. It was widespread throughout the whole Australian economy where valuations appeared to have been set year after year in the lead-up to the 1980s crash at rather high and inflated figures.

Mr Nye—What the institute did was to insist, and it continues to insist but it does not always get its way, that the financial institution instructs the valuer, not the person wishing to have the loan. What was happening during the 1980s was the person who wanted the money would instruct the valuer to do a valuation, and in that way made some assumptions in instructing the valuer. That was one of the concerns that caused that rethinking.

CHAIR—Did your organisation have concerns at the time? In fact, would your organisation have recorded proceedings of concerns from members about the way valuations were going in the lead-up to the 1980s?

Mr Lovell—Perhaps I could make a comment here that the concept is whether a valuation leads the market or follows the market. In 1987, I attended a conference here where Laurie Willett, who is a boss of Commonwealth Funds Management now, stood up in front of a group of valuers and said that valuers should be more contemporaneous, that valuers were lagging behind the market, that the market was moving fast and valuers were not moving fast enough with it. That was a line that he did not repeat after 1988 when the market went the other way. But it is a concept of what the valuer does, and the valuer fundamentally tests a hypothesis. A valuation is not an absolute thing. A valuation is a test of a hypothesis that says, 'If I put this product, this thing, this piece of real estate into the market today, what can I achieve for it?' To that end, it is a mirror to the market. It does not set the market; it reacts to the market as it is.

So, to answer your question, post-1988 into the 1990s the market was still booming in 1988-89 as a result of the 1987 stock market crash. A lot of money washed into the property sector, property was seen as a safe investment and it escalated values. Rents were not a function of that necessarily. What happened was

that things that were selling on 10 per cent yields started selling on five per cent yields. So the rents did not go but the market's perception of property as a safe investment went.

We had a situation come 1990 where the bubble burst and values did follow that. The trick was knowing when the fall started. It is like being on a train where the guy says to you, 'Just watch me and get off one station before I do.' You do not really know when it has happened until you can look with hindsight to see what the transactions are.

CHAIR—I think you have clarified something for me, and that is that the valuers, as an organisation, follow the market.

Mr Lovell—Correct.

CHAIR—That is helpful because in your submission you make lots of references to the role that financial institutes take, and it is fairly important that we clear up exactly where valuers do sit in the equation. I thank you for that.

Mr ZAMMIT—I might be an apologist for the banks but, in all fairness, what they say in regard to the valuation is that they invariably send either the manager, the lending manager or the branch manager, or someone like that, to go and have a look at the place in the bank's time. As a result of that, they would say, 'We lend only 75 or 80 per cent of the value. We have a bit of fat in case something does not work out so we do not need to have a written valuation.' I do not want to be an apologist for the banks: banks could be doing a lot more to help Australian small business but I think that is the answer they would give.

I want to go to the issue of valuing, say, shopping centres. If someone wants to buy a shopping centre, is it enough for them to go to the current owner and say, 'You receive X amount of rent so therefore the property must be valued as a percentage of the rent you receive'? Expecting a 10 per cent return, it is a very straightforward and easy formula to adopt. Is that what is generally done or do they come to you for a confirmation of the valuation? If they do that, do you then go and talk to any of the tenants and try to obtain an idea as to what their real rental is?

Mr Garmston—Could I just start by defining market value. The doctrine of market value was set out by Justice Isaacs in Spencer v. the Commonwealth which is a case that has been ratified many times by the courts. If you will bear with me I would like to read what Justice Isaacs had to say about market value. His words were:

To arrive at the value of the land at that date, we have, as I conceive, to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser, willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land, and cognizant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then-present demand for land, and the likelihood, as then appearing to persons best capable of forming an opinion, of a rise or fall for whatever reason in the amount which one would otherwise be willing to fix as the value of the property.

Now the institute has condensed those words, when looking at market rental value, into the following statement.

Market Rental Value is the estimated amount for which premises should rent, as at the relevant date, between a willing lessor and a willing lessee in an arm's length transaction, wherein the parties had each acted knowledgeably, prudently and without compulsion, and having regard to the usual market terms and conditions for leases of similar premises.

In undertaking an evaluation of a shopping centre, the first issue for the valuer to consider is the market rental value. The market rental value may not necessarily be the rental being paid under the lease document. In some instances, the rental paid under the lease document can be in excess of market rental and likewise it can be less than market rental.

The starting point for the value is determined by what the market rental for the premises are, be it a shopping centre or one shop. He then has to make adjustments looking at the provisions of the leases, where leases in the opinion of the valuer are above market, and he has to make a recognition of the fact that they are above market and he may look at the term of the lease before those rents come back to market value. Likewise, if the rents are below market value, he has to make a similar adjustment for the term of the lease until those rentals can be revalued back to the market.

Mr ZAMMIT—There were two questions that you have not replied to. The first question is: is it normal when someone wants to buy a shopping centre for them to get a valuation, or do they just accept the fact from the current owner, 'Here are the copies of the leases, this is the rent they're paying, so therefore you will have 10 per cent return, or whatever it is, nine per cent return, therefore the place must be worth that much'?

Mr Garmston—It would be normal in a transaction for a shopping centre of that size for the purchaser to obtain a valuation.

Mr ZAMMIT—All right. After you have investigated, checked, you value a property at let us say $10 million, on average. Is that in keeping more or less with the rent at the 10 per cent formula that is currently in place now? In other words, what I am trying to get from you is what happens when the valuations are done. We have had allegations that what does happen is the owners of the major shopping centres, by inflating the rent and by other means, are able to show a property that may have been worth—I think we read in one of the submissions—only $30 million in fact to be worth $60 million. When you do your own evaluations, based on those terms of reference that you have from that judgment, would you agree, in most instances, with the valuations shown on the books or do you show it to be far less?

Mr Garmston—I do not think that that is appropriate. The valuer is not asked to comment on what the value is on the books. The valuer is asked or instructed to do a valuation regardless of what the owner may think the property is worth.

Mr ZAMMIT—But you would have an idea of what the owner claims the property is worth because that is what that owner offers it for sale to someone else. You would have that knowledge?

Mr Garmston—Not necessarily. As Denis Lovell said, valuers are a mirror of the market. Valuers are

aware of sales that have recently been completed and what the market is prepared to pay for shopping centres. The duty of the valuer is to analyse those sales and determine what the market will pay, whether that is 10 per cent, 12 per cent or eight per cent, the market will determine that value and not the owner.

Mr Lovell—I would like to add a bit of focus to that. In terms of doing a valuation for a lender for a prospective purchaser, it would not be sufficient to provide them with a valuation that says, 'It is generating a million dollars so we cap it at 10 per cent, and it is worth $10 million.' That is just what he is asking for it and that is not sufficient. The requirements that we have from lenders today are for a much more stringent analysis of what the centre is doing. Normally, a minimum requirement would be a discounted cash flow analysis over a 10-year period.

That means we would plug in the individual market rents for each individual tenancy within the development and plot where they are going over the next 10-years. That would incorporate the concept of when they are due for rent reviews. With balloons, which the previous representatives here alluded to, where somebody gets two years rent free and you cram five years of rent into the last three, they would appear and would be discounted accordingly.

The valuer would only ever use the market rent. He would never use the actual rent. He would say, 'What is the market rent for this thing?' If we are achieving more than market rent, it has a premium and that premium has a finite lifespan, and it may be for the remainder of the lease. At the end of the lease, the best that can happen is that it goes to market. It cannot stay at the premium level. It may be a short-term loss. Maybe those first two years at rent free are in the first couple of years of the cash flow so it is a negative impact. All of those things get measured into a discounted cash flow. The valuer applies that same regimen to analysing sales of shopping centres.

These are quite complex matters and people tend to specialise in them. They get yields that are not just simple initial yields—that is, how much rent was being paid at the date it is sold—but rather they are analysed long-term investment yields that take account of the nuances of each of the individual leases that are applied. The only problem we have with that is the secrecy provisions that occur in a lot of leases. That makes life really difficult. But, in the main, the valuer deals with the market as much as the market can be known to him and so we differ with the view that there cannot be a market rent. We say that there must be a market rent and that it must be determined in this hypothetical arms-length negotiation. I hope that emphasises it.

Mr ZAMMIT—I am glad you raised it.

Mrs BAILEY—How, in doing your valuation, do you get at the facts when we have heard previously about the secrecy of lease agreements and contracts? Would you be supportive of some of the recommendations that have been put forward to us about more open disclosure of lease agreements or, alternatively, the other suggestion which has been put forward that there should be a standard percentage of turnover as one way of calculating a rent? What is your view on those two points that have been put before us?

Mr Garmston—I think the institute would like to see more disclosure of the details behind—

Mrs BAILEY—How could that be achieved in practical terms?

Mr Garmston—Currently, under legislation, shopping centre landlords have to provide a disclosure statement to the tenant which details the rent paid, the contribution to outgoings, percentages, rent-free periods, fit out allowance and all of those issues. I do not believe that that is then embodied in the actual lease document. Within time that document is in the hands of the tenant and also in the hands of the landlord. The lease document becomes a public document once it is registered, but the disclosure statement is, I suppose, at the discretion of the landlord or the tenant as to whether he makes that available.

Mrs BAILEY—Following the same line, I am trying to ascertain the true market value. Are you aware of valuations that are made on a shopping centre that include the assets of individual traders being included in the market value of the shopping centre.

Mr Garmston—Generally, in most shopping centres, the leases provide that when the rent is determined, if it is determined as a market rent, regard shall not be had to the tenants goodwill or the tenants fixtures—

Mrs BAILEY—I know what should and should not happen, but my question is whether you aware that that practice occurs?

Mr Garmston—No, I am not aware of that.

Mr Lovell—The answer is that they should not. The fact is that a tenant removing fixtures and fittings has a duty to make good. For instance, a Williams the Shoeman store has a very specialised Williams the Shoeman fit-out. The cost of removing it and making it goodwill exceed what it is worth. It has been depreciated off to nothing in terms of their books. They do not want it. They would rather walk away from it, which leads to a lot of the stuff being left behind. Its adaptability to the next user is the real trick and often it is and often it is not. If it is included, I would not see it being deliberately included. If it exists, after a tenant leaves, it is more because it is economic.

CHAIR—Is it reasonable to say that on most occasions you act for financial institutions or the owners of the properties in obtaining a valuation?

Mr Lovell—Yes.

CHAIR—They are mainly your clients; they ask you for a valuation. If, say, a retailer in a shopping centre asks you to act and obtain a valuation for them, how much disclosure of information can you obtain from the owners or the managers of the shopping centre for that client?

Mr Lovell—For the most part, as much as they are prepared to give, which is a difficulty. Valuers, in the main, quite regularly act on both sides of the fence. They build up a storage bank, if you like, of information. We have an advantage in so far as we act for a landlord in one matter and then we act for a tenant in a separate matter. We may well have some of that information. The question of disclosure is a critical issue to us.

CHAIR—Could you give us an example of where you have run into problems in that area, where you have been acting for a client who is a retailer and you have been refused information which would enable you to set a proper valuation for that client.

Mr Garmston—I am not a practising valuer. I am a member of the institute and I have not undertaken valuations for quite some time.

CHAIR—Mr Lovell, are you a practising valuer?

Mr Lovell—I am. I have not struck a situation where relevant information has been deliberately withheld. It would suit us better if it were more readily available. What tends to happen is that there is an informal network that enables valuers to get hold of most information.

CHAIR—Is it fair to say that the retailer is at a disadvantage in those negotiations because he does not have an assessment of the proper value of his site in the shopping centre?

Mr ZAMMIT—If this is agreed upon, would you want to see the inclusion of a clause that states something along these lines, and I am paraphrasing, that by arrangement the lessee and lessor—if they are happy about the rent increases between themselves that is fine; they can do that if they wish—in the event of a dispute or in the event that a tenant wishes to have the shop rent valued, that that valuation be accepted by the owner of the shopping centre? How else can someone protect themselves when someone comes in and says, 'Look, your rent's going up and that's it'? How else can they protect themselves?

Mr Lovell—Most dispute resolutions already exist in most leases. Most leases now provide, when there is a dispute between the landlord and tenant, that a valuer will be appointed, or two valuers will be appointed—one for the landlord and one for the tenant. They will come together and try and nut out what the rent really is. That is where a lot of information actually starts to come out; you get two alternate views put together. In the event that they cannot agree, then a third valuer is appointed just to basically determine it.

Mr ZAMMIT—What I do not understand is that we have got people here telling us that the rental that they are paying—that is, the people renting—is in excess of the profits. Now how can that happen when you are saying that there is this dispute resolution? You are obviously implying that it is working. How can it work if the profit is not more than the rent they are paying?

Mr Lovell—I appeared in the Supreme Court about a year ago when a restaurant was paying 40 per cent of its turnover in rent when it should have been paying eight per cent.

Mr ZAMMIT—Eight?

Mr Lovell—Eight. It was paying 40. The performance of the business never matched the original profit promises of the vendor; the guy went broke. He was being sued for back rent. At the end of the day he signed a lease that had a ratchet clause in it that did not allow the rent to go down. So the first thing we could do is eliminate ratchet clauses—that is, that the rent goes up automatically every year 10 per cent. They have been eliminated in the ACT. Whether it be capitalised or otherwise is irrelevant; they should be

eliminated.

The concept of market rent works while ever you have a market economy. You have a closed market in a shopping centre. There is the potential there for what they call the domino effect where you get one rent and you just get all the other rents off the first rent. So the concept of capacity to pay comes into play. If you can get the newsagent up nice and high first, you just rattle everybody off him.

So I do not know how you solve that, other than to say, 'Let the valuers do what they currently do'—which is to determine the rents having a regard for rentals for similar types of premises, not for newsagents. The valuers do not walk in blindly and say, 'Well, we got $800 for the newsagents, so therefore this frock shop is $800 as well.' It is a different business, so we look to what the comparable rents are for frock shops, both in that centre and in other centres.

Mr RICHARD EVANS—The trouble is that most shopping centres are owned by the one body who negotiate the rents, aren't they?

Mr Lovell—They are.

Mr RICHARD EVANS—And it is not just newsagents, it is also chemists and a whole lot of other people associated with shopping centres.

Mr Lovell—Of course.

Mr RICHARD EVANS—Of course when people are negotiating rents it is usually the shopping centre manager, and he may in fact be managing more than one property, so therefore he is pulling rentals from all different properties and taking the names out and saying it is a standard cost per metre and increasing the rents that way. When you guys are called in, shopping centre A, shopping centre B, shopping centre C could all be owned by the one property, but you have got to do the evaluation off that. So it has been actively manipulated up, and you guys have really no fall-back because you have got to do the market rentals, I guess, what the markets gain, and you have got no ratchet clause so therefore you cannot value down.

Mr Lovell—The rents can go down.

Mr RICHARD EVANS—But if there are ratchet clauses and you have got all of these valuations on shopping centres all over the town, how do you look as a valuer if you are valuing down and everything is up?

Mr Lovell—We do value down if that is what the market dictates. Indeed, locally the Tuggeranong shopping centre when it first opened achieved quite high rents, in the order of $1,000 a metre, and my recollection is that the rents are down 40 per cent on that now. So the rents do fall. Rents do not just have this linear plane that projects up through the ceiling. So rents do fall. It is a function of what happens to yields when rents fall as to whether the value falls.

Mrs BAILEY—You have obviously seen many instances where the small trader finds it very difficult to negotiate with the very large landlord. What suggestions could you make to this committee on ways of ensuring that the small trader does have some rights?

Mr Garmston—Clearly the small trader generally has his lease and the provisions of his lease to rely on. Generally speaking, most retail leases now have a dispute resolution clause within that lease. If the small retailer believes—

Mrs BAILEY—With the greatest of respect, we have heard numerous submissions from those small traders where that dispute resolution simply is unworkable, it just does not operate. What is the lease worth? It is worth nothing if it is not adhered to. It is the small trader who then does not have the means to take on the very big landlord.

Mr Garmston—If it is a matter of rental determination, I would have thought that it was quite a simple step for the lessee to take to invoke that provision of market review.

Mr ZAMMIT—How? Do they go to court? And they cannot afford it.

Mr Garmston—Within New South Wales they have the Retail Tenancies Act and the dispute unit as a mediation type of forum initially. I guess a lot of small retailers probably need more education in that area so that they are aware of what is available to them without having to go to court. Certainly if there is a lease provision that provides for, in the event of a—

Mrs BAILEY—How would they settle the dispute without going to court?

Mr Garmston—If there was a provision in the lease for,, as I said before, determination of current market value by a valuer or by a valuer appointed by the institute, then clearly the mediator in the retail tenancies unit would invoke that clause on behalf of the tenant.

Mr Lovell—Just for clarification, I recently had to go to Albury where in a strip shopping centre the tenant was in dispute with the landlord. They had both attempted to resolve it. They had got to a situation where the landlord wanted $55,000 a year; the tenant wanted to pay $40,000 a year. They could not agree, so the New South Wales division of the Institute of Valuers appointed me to determine it, so I went and determined it. I was able to establish market evidence, which is a bit of a difficulty within centres but it can be done—and this was a strip shopping centre so we had some evidence—and applied the rental. That rental bound both the landlord and the tenant—end of story, no going to court, it has been determined. That is what it is now for the next three years.

Mrs BAILEY—How many times would that situation arise with the dispute with a small trader in one of the large shopping centres?

Mr Lovell—We do them regularly in the larger centres. Usually for—if you will pardon me—the mum and dad type shops within centres as opposed to the major corporates like Country Road, Stock Jeans or whatever. But for the mum and dad-type things we do a lot of that.

CHAIR—Can I take that a little bit further? That is an important issue for us. The committee has been informed by property managers that they do establish market rent by negotiating with what we term captive tenants in a shopping centre. They cannot walk away from their business without forfeiting their investment in it; they have put a lot of dollars into it in fit-out and what they term as goodwill. The level of rental negotiated with that captive tenant then becomes the base market rent for negotiations with other tenants. You have obviously been involved in advising some of these tenants or giving them evaluations. Is that how it works in practice?

Mr Lovell—That is how it appears to work. That is the domino effect, effectively; you get the rent and everything flows off that.

CHAIR—A captive tenant sets the market for everyone else.

Mr Lovell—But captive tenants in shopping centres are only marginally captive anyway. We have this vision that they are captive of their fit-out, that because their fit-out is there and they have such an investment in that particular spot in the centre that they are captive to it.

CHAIR—They are economically captive, aren't they?

Mr Lovell—They are to a degree, but many tenants get moved at the end of their lease anyway or they have to undertake an upgrading program for their fit-out just by virtue of the centre saying, 'We want you to dress up your fit-out. It's not good enough. It's five years old and it's too old now.' There are powers within the agreements to actually force you to upgrade your fit-out. So the fit-out is as it is, but it is not the all dominating thing that you think it to be—a person will not move because they have spent $100,000 on a fit-out. That is the first issue.

CHAIR—What is the dominant factor?

Mr Lovell—The dominant factor is the position in the centre for the trade that they do. If a person is heavily reliant on foot traffic, they want to be in one of the busiest sections of the centre. A Granny May's will always want to be near the food, because that is where you find the maximum number of small feet wandering around who have $2 to spend. They do not want to be over near the banks which are in the dead part of the centre. You will find that they cluster things around the centre to suit the traders to trade off each other. We would look for rents in similar locations in the centre for similar type uses. That would be our aim. It would not be sufficient to take a rent from a high traffic area and apply it to a low traffic area. That would be to misrepresent it.

CHAIR—Can I just ask you one other question about the claim that some of the big shop holders in the major shopping centres are some of the larger companies which are paying lower rental per square metre than what some of the small retailers in that centre are paying. How do you establish the level and the valuation of a rental in a major shopping complex with a major tenant? Do you have various levels of rent which is determined on their frontage to the shopping centre, and does it diminish as it goes back into the rear of the shopping centre? How do you value the major tenant in that centre in terms of rental?

Mr Lovell—A centre opens usually to get a major person in there. There is going to be some form of inducement and whatever, so the initial rent that a major might pay in a centre is usually complicated with lots of other things. They come to first rent review, and the major player—a Big W or somebody like that—and Westfield will almost negotiate on even ground. They have an even amount of power. They are not the frock shop. They are Big W and they believe they bring a major amount of foot traffic to the centre, so the centre provides the infrastructure.

So they negotiate. Those rents get negotiated across Australia in different centres and they form the basis of us establishing what a rental might be. You cannot just measure the frontage and say, 'There is a 10 metre frontage at $10,000 a metre or whatever.' It can be square metres, but more often than not the shapes and the locations of these sites differ quite dramatically. Some are very economic users of space and some are not. It really comes out of a melting pot of a whole lot of data. That gets tested against what the rent actually is, and we determine it then from that.

CHAIR—In other words, the small retailer, even if they could be given that information, cannot have any impact on establishing their market rent?

Mr Lovell—No. It is not going to help them to know that Woolworths takes 10,000 square metres and pays $500 a metre gross. The guy down the corner who has got 30 square metres in a record store cannot relate it to the $500 a square metre for 10,000 square metres. He is going to be paying more like $1,500 to $2,000 a metre. The only true linkage is to go to the company turnover and say, 'What level of turnover does he do? What is his mark-up? What are his profit margins?' and then come down to an economic level that he can pay.

CHAIR—Thank you.

Mrs BAILEY—Mr Nye, do members of your institute operate under a code of conduct?

Mr Nye—Yes, they do.

Mrs BAILEY—How is that upheld?

Mr Nye—If somebody from the public or elsewhere reports that there has been something untoward, we will look at that. We have a whole range of different procedures, including a suspension or even a fine of up to $10,000 against a member. As well, we do it internally if we find somebody has not complied with our standards.

Mr RICHARD EVANS—We have heard a lot of evidence about people paying too much for rents. We have heard increasing evidence about shopping centres having more tenancies vacant. We have heard evidence that perhaps shopping centre properties are overvalued. If that evidence is correct, will there be an Armageddon in regards to property valuations of shopping centres? If that is going to happen, is it two years away, five years away, or 10 years away?

Mr Lovell—Mark Twain said forecasting is difficult, particularly about the future—and he was right.

There will be an Armageddon. It is a question of how landlords deal with their rent negotiations with their existing tenants as to how and when it comes and whether we have a soft landing or a hard landing.

Mr RICHARD EVANS—Thank you for that.

CHAIR—Thank you very much for your attendance at the public hearing today. We have run out of time. Members have got commitments in the House. However, there may well be some matters that the committee would like to raise further with you. If you would be available to the committee, perhaps we could correspond in writing between the secretariat and yourselves. I would appreciate any assistance you may be able to give us. Thank you very much for your attendance and for your frank answers to a multitude of questions.

Resolved (on motion by Mr Richard Evans):

That this committee authorises the publication of evidence given before it at public hearings on this day, including publication on the electronic parliamentary database of the proof transcript.

Committee adjourned at 12.47 p.m.