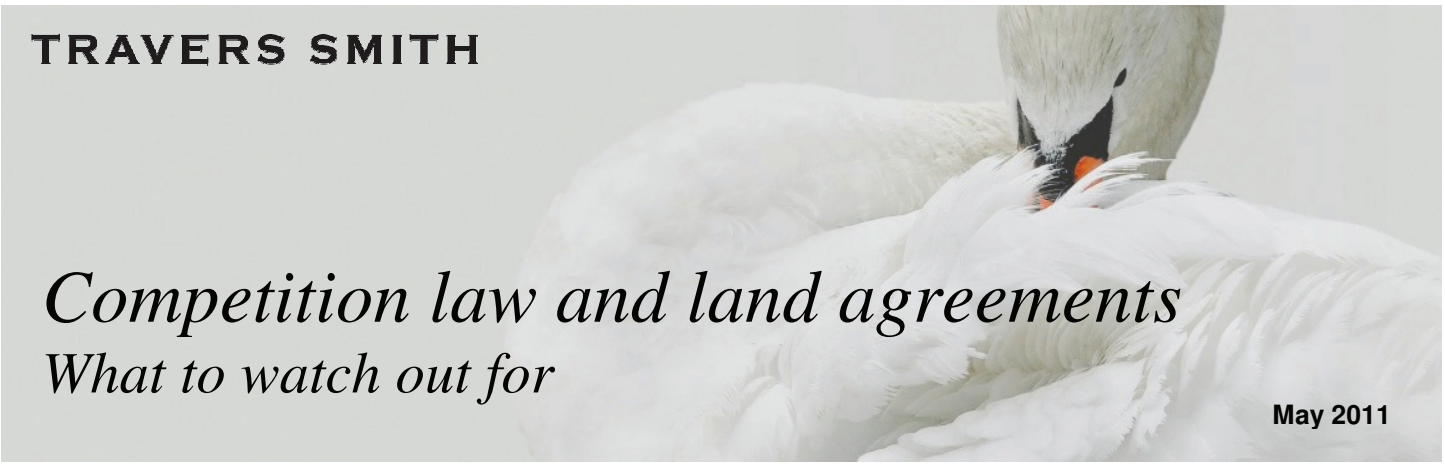
TRAVERS SMITH



Competition law and land agreements

What to watch out for

May 2011

Leases and contracts for the sale of land are no longer excluded from the Chapter I prohibition of the Competition Act 1998. What does this mean in practice and which types of provision may be in danger of falling foul of the Act?

Why worry about competition law?

The Chapter I prohibition of the Competition Act 1998 prohibits anti-competitive agreements. Breach of the prohibition can have serious consequences.

As from 6 April 2011, all **new and existing** agreements which create, alter, transfer or terminate an interest in land are no longer excluded from the scope of the Chapter I prohibition.

Such agreements include leases, development agreements and contracts for sale, and transfers, of land - but not planning agreements.

Most residential arrangements will also remain outside the scope of Chapter I.

Following a consultation (see our briefing dated October 2010), the Office of Fair Trading (OFT) has recently published final guidance to assist property sector participants in self-assessing land agreements for compatibility with competition law.

Potentially problematic provisions which are discussed in the final OFT guidance include:

- tenant exclusivity provisions
- permitted user and restricted user provisions
- post-sale restrictive covenants on use.

The final guidance contains more specific commentary on each of these common types of restriction in land agreements. It also includes guidance on the OFT's enforcement priorities.

However, as practical guidance for property sector participants it remains somewhat limited.

What are the risks?

The potential consequences of breaching the Chapter I prohibition include:

- unenforceability of the relevant provision and, potentially, the entire agreement;
- investigation by the OFT, with consequences including fines of up to 10% of worldwide turnover; and
- private actions for an injunction and/or damages by harmed third parties which have suffered loss.

In practice, the risk of unenforceability is likely to be the principal concern in relation to most land agreements. The OFT's guidance indicates that the OFT is more likely to investigate (and potentially subsequently impose fines) in cases where:

- the parties are competitors and the relevant provision is aimed at sharing markets between them; or
- the relevant provision shuts out competitors or dampens competition and where one of the parties has a high market share (30% or more) or the provision in question is widely used in the market.

As regards agreements entered into prior to 6 April 2011, where a party has used best endeavours to amend or remove an infringing provision from an agreement, and has not sought to enforce it, the OFT may consider this a mitigating factor in determining the appropriate amount of fines (if any).

What types of provision may be anti-competitive?

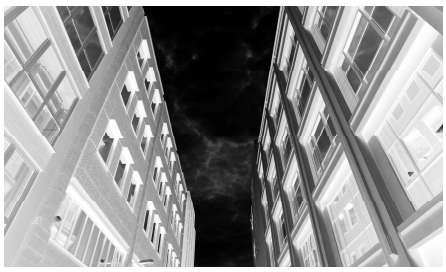
Land agreements often contain provisions which restrict the way in which land can be used or how rights over land may be exercised. However, the OFT expects that only a minority of such restrictions will infringe the competition rules.

This will be the case where the provision:

- has an appreciable effect on competition in the relevant market (which can be the case even in small or local markets); and
- is neither objectively necessary for the purposes of the overall agreement nor has sufficient countervailing economic/consumer benefits of the kind which can be taken into account to justify an exemption.

Anchor tenant exclusivity

Leases in developments such as shopping centres often contain a restriction on the landlord leasing other units to businesses which compete directly with the anchor tenant. Although such provisions are capable of infringing the Chapter I prohibition, this will very much depend on the specific circumstances.



Where the anchor tenant faces competition from other businesses in the relevant local area, the provision may not be regarded as having an appreciable effect on competition. For example, if the shopping centre is located in a town centre, an anchor tenant department store may face competition from other department stores near to the shopping centre.

Further, it may be that the development would never have been built unless the anchor tenant had been given exclusivity for the relevant period. In this case, the provision would be considered objectively necessary for the purposes of the overall agreement and would not be subject to the Chapter I prohibition.

Similarly, the exclusivity may also be able to be justified on the basis that its overall benefits (e.g. in helping to secure a high profile tenant whose presence will attract

large numbers of shoppers) may be expected to outweigh any anti-competitive effect.

However, to rely on either of these later two bases, the duration of the exclusivity will usually need to be limited to the "start-up" phase, i.e. the time needed for the anchor tenant's customer base and revenue to become sufficiently stable to secure a return on its investment. For example, a restriction that lasts for the full duration of a 25 year lease is unlikely to be justifiable.

Exclusivity for other tenants

Exclusivity in favour of other (non-anchor) tenants raises similar issues but, where there is an appreciable effect on competition, it will often be harder to justify such provisions. For example, a non-anchor tenant such as a coffee shop would be unlikely to be critical to the development of a shopping centre, nor would it be likely to act as a major "draw" for shoppers to the shopping centre as a whole.

Permitted user / tenant mix

The OFT guidance indicates that permitted user clauses (permitted uses for the land) and restricted user clauses (non-permitted uses for the land) will not generally be regarded as objectionable and that such provisions can legitimately be used to achieve an appropriate mix of tenants within a development.

That said, permitted/restricted user clauses can become problematic if:

- the landlord is also a competitor of the tenant and seeks to restrict the tenant from undertaking activities competing with the landlord; or
- in practice they grant a particular tenant exclusivity.

Ideally, the landlord should be in a position to demonstrate that any permitted user/restricted user clauses have been arrived at on the basis of objective criteria and not to limit competition to the landlord or to confer exclusivity upon a particular tenant.

Restrictive covenants

The final guidance indicates that the OFT has no objection to restrictive covenants designed to prevent activities that would interfere with the existing use of any retained land.

For example, where an owner of an office development sold adjacent land subject to a restriction on its use for industrial activities (with a view to minimising noise and other disturbance), this would be unlikely to infringe the Chapter I prohibition.

However, a restrictive covenant directed specifically at preventing the use of land by competitors would be at much greater risk of infringing Chapter I.

A problematic restrictive covenant

The OFT guidance gives the example of the owner of a petrol station which operates two sites in a small town, but wants to close one of them down. The owner faces no competition from other petrol retailers in the immediate local area. In order to maintain this position, the owner wishes to impose a restrictive covenant on any buyer of the site which is to be closed preventing the land from being used as a petrol station.

In the OFT's view, unless there are many other suitable sites for use as a petrol station in the same area, this provision would be likely to appreciably restrict competition in the local market. It is very unlikely to justify an exemption on economic/consumer benefit grounds.

Conclusion

As noted, the OFT expects that only a minority of restrictions in land agreements are likely to infringe the Chapter I prohibition. Nonetheless, a number of the provisions noted as potentially problematic in the OFT's guidance are not uncommon in land agreements. As such, it will be important for property sector participants to ensure that they take competition law into account when negotiating land agreements in the future and to consider whether it is necessary to review any of their existing agreements for compliance post 6 April.

It is also important not to lose sight of other ways in which competition law continues to apply to activities in the property sector and in respect of which the previous exclusion for land agreements never applied. For example:

- **Price-fixing:** agreements between two or more landlords to co-ordinate rent rises or to set minimum rental levels have never been excluded from the Chapter I prohibition – and would almost certainly be regarded as a serious infringement, potentially resulting in significant fines.
- **Abuse of dominance:** Operators of key facilities such as ports or airports may be at risk of a breach of the Chapter II prohibition, which outlaws abuse of a dominant position. For example, the High Court has recently found that Heathrow Airport breached the Chapter II prohibition by refusing to allow competing providers of airport parking to use Heathrow airport forecourts to offer "meet and greet" and "valet" parking services.
- **Merger control:** In certain cases property transactions can be scrutinised under the separate merger control rules. For example, in 2008, the OFT investigated and referred to the Competition Commission the proposed grant of a lease of a cinema in north London to a company that already operated a competing cinema nearby.

Lastly, following the Competition Commission's inquiry into supermarkets, special rules apply to restrictive covenants or exclusivity provisions in favour of large grocery retailers.

If you would like to discuss any of the issues covered in this briefing, please contact one of the partners named below or your usual contact at Travers Smith.

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