Land agreements and competition law from April 2011

Introduction

Agreements that affect trade and have an appreciable effect on competition within the UK (or part of it) are generally prohibited by Chapter I of the Competition Act 1998 (the "Competition Act"), unless they produce countervailing public benefits that would enable them to be regarded as meriting exemption. The implications of breaching the Chapter I prohibition can be severe.

For convenience, at the time the Competition Act came into force, an exception to this general prohibition was created for common restrictions intended to protect interests in land (rather than trading interests). Agreements that created, altered, transferred or terminated interests in land (referred to for the purposes of this briefing simply as "Land Agreements") were therefore excluded from the scope of the Chapter I prohibition, provided the restrictions within them fell within certain bounds.

From 6 April 2011, however, that exclusion has come to an end. Land Agreements that have the necessary effect on competition will now be subject to normal competition law rules. This includes not only new agreements entered into on or after 6 April 2011, but also continuing agreements that were entered into prior to that date, even if they were lawful at the time.

Guidance issued by the Office of Fair Trading ("OFT") suggests that the OFT expects only a minority of Land Agreements to be caught by the Chapter I prohibition. Despite this, businesses and their advisers will have to assess, in the light of the guidance, whether specific agreements will be caught by the Chapter I prohibition, and what the likely consequences of this could be. The OFT guidance is broadly helpful, and contains some useful worked examples to illustrate how the OFT believes the Chapter I prohibition will apply in a property context. It can be accessed from the following link:


This briefing note outlines the key competition law issues raised in the context of Land Agreements, and the typical restrictions arising in those agreements. It does not address the issues raised in other types of restrictive agreements or concerted practices, such as price fixing, market sharing and bid rigging among competitors, which are likely to be classified as hard core cartel type activity, nor does it address issues of abuse of dominance.
Background

The Competition Act came into force in the UK in March 2000. The Chapter I prohibition outlaws agreements between businesses that could affect trade and bring about an appreciable restriction of competition in the UK (or part of it).

The consequences of a breach of the Chapter I prohibition can include:

- invalidity of the agreement or (if they are severable) any unlawful restrictions within the agreement;
- investigation by the OFT and a potential fine of up to 10% of group worldwide turnover;
- applications by the OFT for disqualification of individuals from acting as company directors; and
- actions for injunctions and/or damages from anyone who has suffered loss as a result of the breach.

An agreement will generally merit exemption if it produces efficiencies that outweigh the restrictions of competition that the agreement entails, provided that there is no less restrictive means available of achieving those efficiencies. However, if an agreement appreciably restricts competition, the burden of proving that it merits exemption will lie, in practice, on the party seeking to rely on the restrictive provisions it contains.

Against this backdrop it is important that businesses that are party to Land Agreements that could affect competition are able to recognise where there may be a problem and (to the extent possible) take steps to mitigate any risks to which they may be subject. It is equally important to recognise that, in many cases, a Land Agreement will simply not give rise to the effects on competition that are required to trigger the application of the Chapter I prohibition.

The OFT guidance goes some way to assisting in this recognition process, and the OFT helpfully indicates that in terms of enforcement priorities it will focus on just two types of Land Agreement:

- Land Agreements involving competitors, where restrictions are aimed at sharing markets (and which the OFT will consider as very serious breaches of the Chapter I prohibition); and
- Land Agreements where restrictions on the use of land serve to limit competition on a market that is defined by reference to economic activity that could be undertaken on the land in question (an example could be a local market for the retailing of DIY goods, where a restriction on the use of the land for these purposes actually limits competition in DIY retailing).

The OFT guidance

Restrictions accepted between competitors

The OFT guidance makes clear that where the parties to a Land Agreement are competitors, and the object of a restriction regarding the use of land is for the parties to share markets by territory, or by type or size of customer, the agreement will almost invariably be regarded as infringing the Chapter I prohibition and will stand virtually no chance of being regarded as meriting exemption.

Other types of restriction

Other types of restriction could impede competition, depending on the circumstances, where they raise barriers to entry or expansion in markets. The OFT identifies three broad types of restriction (exclusivity arrangements; leasehold use restrictions; and freehold restrictive covenants) where, if one of the parties to the agreement has market power, the imposition of such a restriction could lead to appreciable effects on competition.
**Exclusivity arrangements:** Exclusivity arrangements by their nature protect a tenant against competition from others operating from premises owned by the landlord. The effect on competition of such arrangements may vary dramatically, however, depending on the location of the premises (out of town versus High Street), the extent of the landlord’s estate, the availability of other suitable premises to let and the duration of the commitment. Where there is plenty of existing competition for the tenant in the market, or where there is ample opportunity for the tenant’s competitors to find other suitable premises in the vicinity from which to compete effectively with the tenant, a grant of exclusivity is unlikely adversely to affect competition. However, in some circumstances the grant of exclusivity (particularly for prolonged periods) may be regarded as bringing undue limitation to the ability of rivals to secure suitable premises in the vicinity from which to operate, and so causing an unacceptable restriction of competition.

**Normal restrictions as to use in leases:** Normal leasehold use restrictions will not usually pose problems, unless the use limitation is accepted by the tenant in return for a grant of exclusivity from the landlord, or is imposed by the landlord at the request of another tenant (in which case the market power of the relevant parties and the appreciability of any effects on competition will need to be assessed). For example, an owner of a shopping centre or retail park is entitled to restrict the types of business that may be carried out by the lessee in order to ensure an appropriate “retail mix” and the ultimate attractiveness of the centre or retail park to shoppers. Caution needs to be exercised, however, in the context of limitations on use accepted between competitors, as these could be construed as aiming to share markets. Restrictions that are required to be observed under planning obligations (for example those made under section 106 Town and Country Planning Act 1990) are separately excluded from the Chapter I prohibition.

**Restrictive covenants:** Freehold restrictive covenants can limit the availability of land to competitors of a transferor. If suitable available land in the vicinity is in short supply, and the transferor already has a significant market share in its downstream economic activities, then a covenant of this nature may increase barriers to market entry or expansion by competitors.

**Market power**

Market power arises when a business does not face effective competitive constraints on its activity. These constraints could come from existing competitors, or from the (credible) threat of market entry / expansion from other organisations that could become competitors (for example where other land suitable for the economic activity concerned is readily available).

We consider that, in many cases, common restrictions in Land Agreements will have no appreciable effect on competition and so will escape prohibition. For example if a landlord agrees to a restriction in a lease that prevents it from letting adjoining premises to an organisation carrying out the same trade as the tenant (a bookshop say), the impact of that restriction may be negligible if there are already other bookshops in the vicinity, or if there is plenty of other suitable property in the vicinity that competitors could use in order to compete with the tenant. In today’s complex retail environment, competitive constraints can also arise from online sales, and even a “bricks and mortar” bookshop with a limited number of competitors physically present in the vicinity, and where there is limited suitable property available for a would-be competitor to take on, may still not have market power.

The OFT guidance helpfully sets out examples of the types of provisions in commercial property arrangements that are unlikely to have any appreciable effect on competition. These include restrictions imposed on a lessee regarding alterations, repairs, obstructions to the premises, applications for planning permission, advertisements and hours of use.
Exemption

Where an agreement appreciably restricts competition, it may nevertheless escape prohibition if it merits exemption. An agreement will generally merit exemption if it produces efficiencies that outweigh the restrictions of competition that the agreement entails, provided that there is no less restrictive means available of achieving those efficiencies. However, the burden of proving that an agreement merits exemption will lie, in practice, on the party seeking to rely on the restrictive provisions it contains, and this can require detailed economic analysis and assessment. Although the OFT guidance indicates a number of possible efficiency gains that might result from a restriction (such as the creation of one or more new retail outlets, more efficient distribution of products, or a greater range of products being available to consumers), specialist advice as to the availability of exemption will be required.

Enforcement priorities

The OFT has indicated in its guidance that it is unlikely to take action in relation to a Land Agreement if none of the parties to the agreement has (or, as a result of the agreement, obtains) a share of a relevant market exceeding 30%. A relevant market for these purposes is a downstream related market such as the local DIY retailing market referred to above. If the beneficiary of an exclusivity arrangement had a share of, say, 25% of the local DIY retailing market, then the OFT would not be inclined to take any enforcement action in relation to it.

Whilst this “safe harbour” provision is helpful in principle, it will require businesses and their advisers to identify and define the boundaries of the relevant affected market(s) (for example by reference to product or service type and also by reference to geography).

Defining markets can be far from straightforward at the best of times, but in retail markets in particular the exercise can be particularly challenging. As a result, the OFT has stated that it is likely to take a pragmatic approach and consider a proxy for market share, so that if, in the case of a retail market, there remain four or more independent retail fascias operating in a given market (including the party benefiting from the restriction in question), the 30% market share threshold will be assumed not to be exceeded.

One caveat to this is that, just because the OFT may choose not to take enforcement action in this kind of case, this does not prevent others affected by an arrangement to raise competition law arguments if they can show that, in spite of market shares or market structure, competition on the relevant market is in reality restricted to an appreciable extent.

Fines

As stated above, if the OFT takes enforcement action, it can impose fines of up to 10% of group worldwide turnover. However, the OFT guidance makes it clear that:

- a finding of infringement of the Chapter I prohibition cannot be made, and penalties cannot be imposed, for any Land Agreement in respect of the period prior to 6 April 2011; and

- where a business has been found by the OFT to be party to an unlawful, anti-competitive agreement, in setting the level of any fine, the OFT will take into account the attempts that party has made to neutralise the effect of the offending restriction. For example, if a party has used its “best endeavours” to remove the clause from the relevant land register and has not sought to enforce it, the OFT may consider this a mitigating factor and reduce the level of any fine that it might be minded to impose. Best endeavours is traditionally a very high standard to meet, although according to the guidance, a party would not be expected necessarily to
Eversheds’ approach to the change in the law

We are keen to ensure that clients are presented with a balanced assessment of risks and opportunities presented by this change in the law. Our approach is, therefore, to try to help clients identify those agreements that are genuinely likely to raise competition law concerns, and (as appropriate) give them confidence in relation to the validity and lawfulness of other agreements. Our view is that many Land Agreements will simply not give rise to the effects on competition that are required to trigger the application of the Chapter I prohibition. However, there will undoubtedly be exceptions.

It is worthwhile also focusing on the types of risk that businesses will be exposed to if a Land Agreement does infringe the Chapter I prohibition. Whilst there will undoubtedly be situations where there is a genuine risk of fines or third party actions for damages (such as in relation to agreements between competitors containing “hardcore” restrictions), in the main the principal risk that will arise will be that of unenforceability of the restrictions. This may well be a risk that businesses are prepared to accept, so long as they can be confident that the remaining parts of their agreements will be unaffected (ie that under English contract law the parties are comfortable that the offending provisions can be severed) and that the financial consequences of unenforceability can be mitigated.

This change to competition law may not be seen as entirely troublesome. For some organisations, it may provide an opportunity to obtain commercial advantage from the invalidity or unenforceability of particular restrictions or agreements, or to free themselves from constraints that have previously prevented them from operating as they would wish to operate. It may even be possible to call into question the validity of competitors’ agreements with third parties, such as exclusivity arrangements with landlords. But clients going down this path should be prepared for competitors to act in a similar fashion.