



Revocation of the land agreements exclusion

The revocation of the Order¹ excluding certain land agreements from the competition rules will affect a relatively small proportion of arrangements, mainly in concentrated retail markets.

Summary

News that land agreements will be subject to assessment under the competition rules from April 2011 has provoked a number of articles and briefings implying that many restrictions in leases will now fall foul of the competition rules. References to heavy fines and the widespread unenforceability of restrictive covenants make good headlines, but are alarmist and significantly overstate the impact of the changes. The intention underlying the revocation was primarily to remedy situations in which restrictive covenants in property agreements create barriers to entry to already concentrated local retail markets, such as the market for grocery retailing. Most existing and new restrictive covenants will remain entirely unaffected.

Background

Revocation of the Order must be seen in the context of the prohibition from which the Order originally granted an exclusion. The relevant law here is the Competition Act 1998. One of its two main substantive provisions (often referred to as the Chapter I prohibition) prohibits agreements between undertakings that have the object or effect of restricting competition within the UK. Just because an agreement prohibits a party from acting in a particular way does not necessarily mean that it restricts competition. The impact on competition can be assessed only in the context of a relevant market. This is defined by reference to product and geography. The product market is essentially that class of products or services that customers view as substitutes for each other.

Recent examples considered by the competition authorities include markets for grocery retailing, retailing sports footwear, the supply of nuts, seeds and dried fruit through specialist retailers and the supply of betting services through licensed betting offices. The geographic market for each of these types of product or service will vary according to the size of the area within which competition takes place. So competition in the market for the supply of betting services takes place within a radius of between 400m and 800m, that being the distance that a punter might walk to place a bet. In contrast, the market for large grocery retailers is assessed by reference to 10- to 15-minute drive times. It is highly unlikely that a relevant geographic market would be limited to the area of a single retail development.

An agreement that appreciably limits competition within a particular product and geographic market is prohibited, unless it meets the conditions for exemption (essentially where the restriction of competition is outweighed by its benefits to consumers).

Agreements that are prohibited are void and unenforceable, although a court will assess whether a particular offending restriction can be severed so as to leave the remainder of an agreement unaffected. If the Office of Fair Trading investigates and confirms the existence of a restriction of competition that has no justification, it may impose a penalty of up to 10% of group turnover, although in practice a penalty of this magnitude would be imposed only in the case of the most serious price-fixing cartel. This is probably a convenient point to include a reminder that no business should enter into any sort of price-fixing or

¹ The Competition Act 1998 (Land Agreements Exclusion and Revocation) Order 2004, 2004 SI No 1260.

marketsharing arrangement with a competitor, whether formal or not.

Competition restrictions in land agreements

Land agreements typically contain a range of restrictions. Many of these, such as covenants to repair and pay the rent, are incapable of restricting competition. Others, such as restrictions on the ability of a landlord to grant leases to competing retailers, and restrictions on landowners selling sites to competitors of a holder of an option over a development site, have the potential to do so. In order to provide certainty, to avoid large numbers of land agreements being unnecessarily notified to the Office of Fair Trading when the Competition Act 1998 came into force, and taking into account the perception that land agreements generally had little impact on competition, the government made an Order excluding from the Chapter I prohibition agreements that created, altered or transferred an interest in land.

Since then, a number of circumstances have changed. The option of notifying agreements to the OFT is no longer available, the onus now being on undertakings and their advisers to self-assess compliance. There is therefore no need to protect the OFT against a deluge of notifications. The particular catalyst, however, was the Competition Commission's report on grocery retailing, published in 2008. In that report, the CC identified a number of factors that contributed to a lack of competition in the grocery retailing sector, by preventing new entry in concentrated local markets. Amongst those factors was the widespread existence of exclusivity obligations (prohibiting the lease to competitors of other units in developments), and restrictive covenants (preventing the sale of sites to competitors). The CC therefore recommended the removal of the exclusion from these categories of agreement, or the revocation of the Order in its entirety. Following a consultation process, the government has decided on the latter approach.

Impact of the revocation

All that revocation of the Order does is to bring land agreements into line with all other types of agreement that may or may not restrict competition and therefore require individual assessment. It is only where an exclusivity arrangement or restrictive covenant creates or reinforces a barrier to entry to

an already concentrated relevant market, thereby appreciably restricting competition, that (subject to any other consumer benefits that may save it) it will be prohibited. Essentially, if in spite of the clause, other actual or potential competitors can continue to operate or can open outlets sufficiently close to the retailer that there is a reasonable choice within the catchment area applicable to that type of retailer, the clause will not be in breach of the competition rules. Even if a retail tenant is successful in excluding a small number of particularly close competitors from the same development, there is no restriction of competition in the relevant market if other competitors (albeit perhaps less close competitors) are permitted within the same development, or if there are other established competing retailers, or suitable sites for them to open in, within the catchment area, whether it is a 5- or 10-minute one within the same town centre, or a wider one embracing a number of towns.

The process can be reduced to the following checklist.

A competition checklist

1. What is the type of business that the restrictive covenant seeks to protect (ie. the business that is not permitted elsewhere within the development, or that is not permitted to buy the site)? How far do customers typically need to travel to visit outlets of that kind?
2. Does the restrictive covenant protect that business against all competitors, or only a limited number of particularly close competitors? For example, women's clothing retail is likely to consist of only one single product market, notwithstanding the various brand identities, so a clause prohibiting the landlord from letting only to certain named competitors, but permitting others, is unlikely to restrict competition from a substantial proportion of the market.
3. If the restriction does seek to exclude a substantial proportion of actual or potential competitors, by reference to the products or services affected, are there nevertheless a sufficient number of competing existing brands (perhaps 2 or 3 alternatives, depending on the products or services concerned), or suitable sites for competitors to open, within the same catchment area as the outlet seeking to impose

the restriction? If so, the restriction is unlikely to have an appreciably restrictive effect on competition in the relevant market as a whole.

If, having worked through this checklist, the restrictive covenant appears to be capable of appreciably restricting entry to a market in which a particular retailer already faces only limited competition, it should be reviewed more closely in the light of the competition rules. If not, it is unlikely that the revocation of the Order will result in the restriction being held to breach the competition rules.

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