

COMPETITION LAW AND COMMERCIAL PROPERTY: WHAT YOU NEED TO KNOW

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MICHAEL BOWSHER QC AND PHILIP WOOLFE
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The Coalition Government has pressed ahead with plans to extend the application of Chapter I of the Competition Act 1998 to land agreements, previously excluded from its scope. Agreements relating to land, particularly covenants which directly or indirectly restrict the use of land, may need to be assessed to see if they infringe the Chapter I prohibition. This represents both a threat and an opportunity for commercial parties.

INTRODUCTION

Since the coming into force of the Competition Act 1998 ("CA98"), certain agreements relating to land have been excluded from Chapter I CA98 which prohibits anti-competitive agreements. That exclusion is presently contained in the Competition Act 1998 (Land Agreements Exclusion and Revocation) Order 2004 ('LAEO').

However, in its April 2008 report into the supply of groceries ("the Groceries Report") the Competition Commission ("CC") concluded that 'land banking' and land agreements which restricted the possibilities of building new supermarkets were distorting competition in certain local retail markets for the supply of groceries.

In view of this, the CC concluded that land agreements relating to the groceries sector should no longer benefit from the exclusion from the Chapter I prohibition provided for by the LAEO. The CC therefore recommended that Government consider repealing the LAEO altogether as they deemed it an anomaly in the modern competition regime and believed there may be other sectors, not just groceries, in respect of which land agreements might be similarly capable of having adverse effects on competition.

In response to the Groceries Report and following a public consultation, the then Government announced in January 2010 that the LAEO would be revoked, with a one year transitional period. The revocation order did not make it through the 'wash up' at the end of the last Parliament, but the required Order was approved by Parliament in June 2010. The revocation will take effect from 6 April 2011, giving affected businesses a transitional period in which to implement any necessary changes. The OFT will be providing guidance on the application of competition law to land agreements in order to assist business in assessing

land agreements following the revocation of the LAEO. It has announced that it will publish draft guidance for consultation in October 2010. That will be the first opportunity for those concerned to see the OFT's thinking on this subject, and to seek to influence the content of the final guidance.

THE LAEO AND THE PRESENT APPLICATION OF COMPETITION LAW TO LAND AGREEMENTS

At present, the Chapter I prohibition does not apply to any agreement to the extent that it is a "land agreement". A land agreement is defined as an agreement between undertakings which creates, alters, transfers or terminates an interest in land, or an agreement to enter into such an agreement, together with certain obligations and restrictions as set out in Article 5 of the LAEO. Article 5 of the LAEO defines the scope of the obligations or restrictions which also fall within the scope of the exclusion and includes both many covenants restricting the user of land ("user covenants") and certain options over land.

However, it is important to note that agreements and transactions relating to land have never fallen entirely outside the scope of competition law. To the extent that any agreement is not a 'land agreement' as defined in the LAEO, for example where a lease includes covenants which do not benefit any relevant land or personal positive covenants, it has never benefited from the LAEO and has always fallen within the scope of the Chapter I prohibition. Examples of such obligations might include the obligation on the tenant of retail premises to purchase supplies from their landlord, such as in the classic tying of a pub or petrol station. Further, the LAEO does not exclude land agreements from the application of EU competition law and the exercise of property rights conferred by such agreements has always potentially fallen with the rules in Chapter II CA98 which prohibit the unilateral abuse of a dominant position.

THE EFFECT OF THE LAEO BEING WITHDRAWN

In principle, once the LAEO is revoked any term in any contract between two businesses which relates to land may potentially be prohibited under Chapter I CA 98 if it has the object or effect of preventing, restricting or distorting competition.

However, it is important to be aware of the limits to the scope of the prohibition. First, the Chapter I prohibition only applies to agreements and "concerted practices"; it does not apply to the unilateral exercise of property rights by the holder of such rights as such.

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However, one important issue which may need to be determined is the extent to which it will be possible to challenge the validity of, say, a restrictive covenant on the basis that the agreement which created that covenant is void under s 2(4) CA 98. Secondly, the Chapter I prohibition only applies to agreements "between undertakings". Agreements between a business and a private individual acting as such will continue to fall entirely outside the scope of the prohibition, although in the case of some individual land owners it may require some careful analysis to ascertain whether they are acting as a private individual or as an undertaking carrying on "economic activity". An ordinary homeowner selling off part of their garden for development would probably not be an undertaking; a wealthy individual carrying out serious investment in land might be.

In practice, particular attention is likely to focus on certain restrictions and obligations which used to fall within Article 5 of the LAEO, that is user covenants and options.

Perhaps the most important likely anti-competitive effect of user covenants is what is termed "foreclosure": that is, competing undertakings may be denied access to a market because they cannot obtain a suitable site. In considering foreclosure it is necessary to define the relevant markets and consider the effect of the term in the context of all the relevant features of that market. Restrictive terms will be more likely to infringe the Chapter I prohibition if identical or similar terms cover a large proportion of the other land which is in the same relevant market. It is also important to be aware that some terms other than user covenants may also have this effect, and so fall within the Chapter I prohibition, such as options or covenants restricting alterations to the property. The key question is whether such terms in fact enable incumbent undertakings to control a large proportion of sites suitable for a particular use within the relevant market and so prevent other undertakings from gaining access to that market.

Normally, the market is defined in two dimensions: first it is defined as regards the products or services which fall within it; secondly, it is defined geographically. Essentially, the process of market definition involves considering a core product and considering what other products are substitutable for it, first from the point of view of actual or potential purchasers (the demand side), and secondly from the point of view of actual or potential suppliers (the supply side). It may be necessary to consider not only markets for land but also markets for the supply of other products or services. For example, a restrictive covenant on certain premises preventing them from being used for, say, the disposal of waste may affect not only the local market for the supply of land, but also the local market in waste services. Even as regards the market for

land itself, it is important to realise that, in many cases, demand for land is what economists term a “derived demand”: whilst a homeowner wants land for its own sake, a business usually only wants premises for the purposes of carrying on its business. The purposes for which a business wants the land will determine both the type of land sought and the area within which it was sought. On the supply side, the ability of owners of other sites to make their land available for a particular use is likely to be limited in particular by the planning system, but also by matters such as easements over the land, other property rights over the land, public rights of way, common law nuisance and environmental factors.

Where terms of an agreement between undertakings do have the object or effect of restricting competition, they may nonetheless be exempted under section 9 CA 98 where four conditions are met, namely that (i) the agreement contributes to improving production or distribution, or promoting technical or economic progress, (ii) consumers will obtain a “fair share of the resulting benefit”, (iii) the restrictions are indispensable to achieving the benefits in question and (iv) the restrictions will not allow the parties to the agreement to eliminate competition in respect of a substantial part of the products in question.

The application of the law may be illustrated by considering a hypothetical large out of town retail development in which the developer is considering leasing one unit to a supermarket, and applying user covenants to all other units preventing them from being used for grocery retailing. Such a covenant is likely to increase the value of the retail site to the supermarket and the potential rent that the developer can obtain for that particular unit. It may also contribute to maintaining a diversity of retail sites within the development, making it more attractive to consumers and more profitable for the developer as a whole. Depending on the presence of other supermarkets in the local area and the extent to which other potential sites are affected by planning restrictions or similar user covenants, it is possible that the user covenant in question may fall within the prohibition in section 2 CA 98 as having an appreciable effect of foreclosing access to the market. Since (as the CC concluded) a large number of consumers are only willing to drive for 15 or 20 minutes to get to a supermarket, potential supermarket sites are only likely to be directly substitutable for one another within a quite limited geographic area. Within that area there may be a lack of sites capable of being developed in a comparable manner, due to the layout of transport links, planning restrictions or simple geography. A high street site may be suitable for a smaller convenience-type store but not for the larger type of store which also needs retail space for clothing and electrical items. However, such a covenant might nonetheless benefit from exemption under s 9 CA 98. The mere raising of the value of the supermarket unit

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is unlikely to be sufficient to obtain exemption, since that is simply the result of the restriction of competition itself and does not reflect a benefit to consumers. However, the developer's concern to maintain a variety of types of retailers within a single development may well be of benefit to consumers and fulfil the other requirements in s 9 CA 98.

PRACTICAL CONSEQUENCES

Competition law issues can be raised in regulatory proceedings or litigation.

Action by a public authority may involve an investigation by the OFT, or by a sectoral regulator such as Ofgem or Ofcom, under their Competition Act powers or it may be a market investigation reference by the OFT to the CC under the Enterprise Act 2002. That prospect may seem remote for many commercial parties, but should be borne in mind in particular by large commercial operators with a presence across substantial parts of the UK or those operating in strategically important industries, such as supermarkets, utility companies, mobile network operators, transport companies or port and airport operators. For such parties, the operation of physical sites (such as mobile base stations, bus depots, airports) is vital to their commercial operation, they require a presence in a particular local area and there may be physical or planning restrictions on the availability of competing sites. In such cases, the result is likely to be the definition of small markets in which restrictions on individual sites are much more likely to be considered by regulators to have an appreciable impact on competition. Further, although individual local markets may be small, the cumulative effect across the UK may be significant or, in the case of a facility like an airport, even a single local market may be of considerable financial and economic importance.

Secondly, there is the risk (or opportunity) of private litigation. One form this may take is an action for damages by a person, who may or may not be a party to the agreement, who claims to be affected by the restriction of competition contained in an agreement. More likely however, and perhaps the most significant source of risk or opportunity for most commercial parties, is the possibility of resisting enforcement of obligations contained in an agreement on the grounds that it is void under s 2(4) CA 98. Alternatively, a party to a lease may wish to preempt matters by seeking a declaration to the effect that the lease contains a restriction of competition and is therefore void, for example, where a lessee of land wants to redevelop it in a manner which is apparently prohibited by a user covenant or non-alteration covenant contained in the lease. Alternatively, where the lessor owns a large retail or industrial development, the lessor

may itself wish to escape from covenants which prevent it from leasing other sites within that development to undertakings which compete with one existing lessee. In such cases, one of the key risks to consider is the issue of severability: where an offending covenant is severable from the remainder of the agreement, the agreement can remain in force, but if it is not severable the agreement as a whole will be void. Depending on the commercial context, that could be either desirable or disastrous. Either way, it requires careful consideration.

NEXT STEPS

In the short term, the revocation of the LAEO will lead to legal uncertainty and both risks and opportunities for parties to agreements relating to commercial property. The long-term impact of the LAEO remains unclear: Much will depend on the content of the OFT guidelines, which are due to be released in draft later this month, and on how the courts take up the application of the Chapter I prohibition to land agreements. At each stage, it will be helpful for competition lawyers to work with property lawyers to establish good working relationships, to understand clients' commercial objectives and to develop practical and cost-effective solutions to meet those objectives as far as possible.

Property lawyers will need to be ready to help their clients deal with those risks and opportunities in a number of ways. First, it is vital to be aware of the application of the Chapter I prohibition both when drafting new agreements and when advising on existing agreements. Unfortunately, this is not simply a case of choosing an appropriate form of words and amending boilerplate clauses: competition law responds to substance rather than form, and restrictions may have the effect of restricting competition even where that is not their intended purpose. Secondly, property lawyers will need to help their clients manage the legacy of existing agreements which will likely not have been drafted with competition law in mind. The review of existing agreements is obviously an enormous, and potentially unmanageable task. In practice therefore, lawyers advising commercial parties will have to take a risk-based approach, initially identifying those clients and those agreements which are most at risk, and subsequently carrying out a more detailed analysis where potential problems are identified and or agreeing a bespoke solution to that particular problem.

As competition lawyers, we are already working with property lawyers to help clients with these issues and are continuing to work to understand how competition law may practically be applied to land agreements in the United Kingdom. Many of us have experience of applying

EU competition law to land agreements. Yet because EU competition law only applies where there is an effect on trade between Member States, these cases have often involved atypical circumstances, such as proximity to a national border or very large scale industry where there are few developed sites in the whole of the EU. By contrast, the routine application of competition law to land agreements in much smaller geographic markets may throw up very different issues. There are inevitably issues of law which will need to be settled by the courts in due course: for instance, the extent to which a restrictive covenant affecting freehold land is to be treated as an "agreement" falling within the scope of the prohibition rather than as a property right; or the kinds of public benefits which may objectively justify or exempt a restrictive agreement. We will therefore be watching early developments in this field very closely and will help our clients by providing further analysis. In particular we will provide a briefing on the draft OFT guidelines when become available.

GETTING IN TOUCH

For more information on Michael Bowsher QC and Philip Woolfe contact the Clerks on +44 207 405 7211 or consult the 'Find a Barrister' section at www.monckton.com.