LAND AGREEMENTS – KNOW YOUR COMPETITION

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Introduction

All 'land agreements' are soon to be the subject of competition law. A new competition law mindset therefore needs to be adopted by those involved in advising, negotiating or litigating on such agreements. Whilst there is a transitional period from 6 April 2010 to 5 April 2011, in which it is possible to apply to the Office of Fair Trading ("the OFT") to determine whether restrictions in land agreements are competition compliant, after that date all 'land agreements' will have to self assessed for compliance with competition law. It is anticipated that advice from counsel will often be sought in the course of this new self-assessment process. This paper is therefore intended as an introduction to the applicable principles.

The new law

A 'land agreement' is

> *'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 any obligation and restriction to which Article 5 applies'*
>
> (see Article 3 of the Land Agreements Exclusion Order 2004/1260 ("the Exclusion Order"))

Land agreements were previously generally exempt from Chapter 1 of the Competition Act 1998 by the Exclusion Order. However, the Competition Act (Land Agreements Exclusion Revocation) Order 2010 ("the Revocation Order") revokes the Exclusion Order as of 6 April 2011. From this date, all land agreements will be subject to Chapter 1 of the Competition Act 1998. This will apply to all existing land agreements as well as those made on or after that date.

Agreements most likely to be affected

The Chapter 1 prohibition only applies to agreements between undertakings[1] or businesses and does not apply to individuals. Therefore agreements concerning residential property made between or with an individual are outside Chapter 1.

The agreements most likely to be affected are:-

- Covenants imposed by tenants on landlords, especially those imposed by anchor tenants;
- Covenants restricting the type of commercial activity that a tenant may undertake;
- Restrictions placed upon vendors not to sell adjacent property to a competitor of the purchaser;
- 'Solus' agreements requiring purchases to be from a particular source;
- 'Lock out' agreements which are for more than a few months.

Key points

The key points to note are as follows:-

- Until 5 April 2011 applications may be made to the Office of Fair Trading ("the OFT") to determine whether restrictions are competition compliant;

[1] Guidance on the meaning of 'undertaking' is given in Chapter 3 of the OFT's Draft Guidance on 'the application of competition law following the revocation of the Land Agreements Exclusion Order' see especially sections 3.3 and 3.4

- From 6 April 2011 all land agreements, including those made before this date, will be subject to the full force of competition law;
- A provision will only be anti-competitive if it has an appreciable effect on competition and does not come within one of the exemptions;
- An anti-competitive provision is void and unenforceable;
- An offending undertaking may be subject to a fine of up to 10% of its worldwide turnover and damages or injunctions by third parties.

Practical effects of change and advice going forward

Landlords and tenants

Before the Exclusion Order is revoked on 6 April 2011 undertakings should undertake a full audit of any land agreements they are involved in, including standard clauses. There are still some five months until the end of the transitional period (5 April 2011) remaining. Within this period parties to a land agreement that might be considered anti-competitive may seek a ruling from the OFT as to the legality of such restrictions. This provides parties with certainty and may mean that lesser restrictions may be agreed instead. Staff negotiating agreements or transfers of property should also be given competition compliance training.

Investors

Investors should include checking for potentially unenforceable anti-competitive restrictions within due diligence and consider securing warranties against any such liabilities

Lenders

Lenders should consider whether the value of their security may be affected where the property has the benefit of restrictions which are potentially anti-competitive. Where customers have the benefit of such restrictions it should be considered whether their financial performance, and therefore their ability to repay loans, will be affected by the removal of protection for such restrictions.

Competitors

Retailers and other undertakings may wish to consider whether the protection they have from competition is in fact enforceable.

The OFT Draft Guidance on 'Land Agreements'

On 15 October 2010, the OFT helpfully published Draft Guidance on the new changes. The consultation on this guidance will run until 14 January 2011. The key points contained in the draft guidance are summarised below:-

- Chapter 2 summarises the key issues. In particular, it notes that there is no presumption that a restriction in a land agreement is anti-competitive.

- Chapter 3 deals with the main elements of the prohibition against anti-competitive agreements and makes the following points:-

    a) The prohibition is against agreements that prevent, restrict or distort competition to an appreciable extent;

    b) Competition law only applies to agreements between undertakings. The prohibition does not apply to agreements between or with individuals not acting as a business. Therefore residential property agreements will not be caught;

    c) An anti-competitive provision will be void and unenforceable unless it benefits from an exemption;

    d) An agreement will not fall within the prohibition unless its actual or potential effect on competition is appreciable;

    e) Enforcement action may be taken by the OFT, the European Commission or a sectorial regulator;

    f) Parties to a prohibited agreement may also be susceptible to private actions brought by third parties.

- Chapter 4 provides guidance on the definition of a market[2], in particular:

    a) Consideration must be had to the relevant market, that is, 'the market on which the land affected by the agreement is used to carry out an economic activity'. It may also be necessary to consider the market for land itself;

    b) There are usually two dimensions to any market: a product dimension and a geographical dimension;

    c) The product dimension is defined by establishing the closest substitutes to the product in question, usually by employing a hypothetical monopolist test[3];

    d) A similar approach is used to define the geographic scope of a market.

- Chapter 5 is probably the most useful of the Draft Guidance and provides guidance on assessing the impact on land agreements on competition. In particular:-

    a) The OFT expects that only a minimum of restrictions on the use of land will be anti-competitive;

    b) It can be helpful to consider the competitive situation in the absence of the agreement in question ('the counterfactual'). An agreement will only be anti-competitive if it has a negative effect on competition when compared with the counterfactual.

    c) The OFT will have regard to the European Commission's Notice on Agreements of Minor Importance[4] ("Notice") when determining appreciability.

    d) The first stage is to determine whether the restriction on competition is one listed as 'hardcore' in the Notice[5] (for example to fix prices or to allocate customers);

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[2] More detailed guidance on market definition is set out in OFT Guidance: Market Definition (OFT403)

[3] For more detail see 4.10- 4.11 of the OFT Draft Guidance. In summary the test involves making a hypothesis on the effects of having a single supplier of the product who implements a small but significant non-transitory increase in price where that increase is profitable.

[4] Official Journal of the European Union 22.12.2001

[5] Paragraph 11 of the Notice

e) If the agreement does not contain a 'hardcore' restriction then it will not appreciably restrict competition if:

i) Where the agreement is between competing undertakings the aggregate market share of the parties does not exceed 10% on any of the relevant markets affected by the agreement;

ii) Where the agreement is between non-competing undertakings the market share of each of the parties does not exceed 15% on any of the relevant markets affected by the agreement;

iii) In both a) and b) the threshold is reduced to 5% where competition in the relevant market is restricted by the cumulative foreclosure effect of parallel networks of agreements having similar effects on the markets[6]. That is where usually at least 30% of the relevant market is covered by parallel agreements.

f) Agreements which exceed the above thresholds are not automatically anti-competitive but may need to be assessed on an individual basis.

- Chapter 5 then sets out key factors for assessing whether a restriction in a land agreement restricts, prevents or distorts competition:

a) Nature of the restriction

A restriction which guarantees one party exclusivity or protection from competition is the restriction most likely to have an appreciable effect on competition. Potentially anti-competitive restrictions may apply to both freehold and leasehold land.

b) The relationship between the parties

Agreements between competitors that restrict the ability of the parties to behave independently in the market are most likely to be anti-competitive.

[6] See paragraph 8 of the Notice

Agreements which foreclose a competitor form the market or restrict the commercial freedom of a trading partner may well also be anti-competitive.

c) Market power[7]

The greater the parties' market power the more likely the restriction is to be anti-competitive.

d) Barriers to entry and availability of suitable land

e) Cumulative impact of multiple agreements.

- Chapter 6 provides guidance on the application of the exemption criteria[8]. For an agreement to be exempted four cumulative criteria must be satisfied[9]:-

  a) *The agreement must contribute to improving production or distribution, or to promoting technical or economic progress;*

  The benefits of the agreement must outweigh or at least match the negative impact on competition. The example provided by the Draft Guidance is in relation to exclusive rights for tenants of shopping centres that may have the benefit of encouraging investment in the centre and/or tenant mix.

  b) *It must allow consumers a fair share of the benefits*

  In other words, the net effect of the agreement must be at least neutral for those consumers affected by the agreement.

  c) *It must not impose restrictions beyond those indispensable to achieving those objectives*

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[7] Market power is defined at 5.21 of the Draft Guidance as *'the ability profitably to sustain prices above competitive levels or restrict output or quality below competitive levels'*

[8] Section 9(1) Competition Act 1998, Article 101(3)Treaty on the Functioning of the European Union

[9] Regard should also be had to the European Commission's Guidelines on the Application of Article 81(3) (Official Journal of the European Union C101, 27.4.2004)

The test is not whether without the restriction the agreement would not have been concluded but whether the benefits could have been achieved by a less restrictive agreement. A relevant factor may well be the duration of the restriction.

d) *It must not afford the parties the possibility of eliminating competition in respect of a substantial part of the product in question.*

The guidance states that the OFT would expect parties to restrictive land agreements seeking to rely on an exemption to identify the sources of potential competition and provide evidence that they constitute a real competitive constraint.

- Chapter 7 deals with abuse of a dominant position (Chapter II Competition Act 1998, Article 102 Treaty on the Functioning of the European Union). This involves a two stage process; firstly, consideration is given to whether a firm is dominant and secondly, whether it has abused its dominance[10]. It is worth noting that there are no exemptions from either Chapter II or Article 102.

- Chapter 8 provides useful analysed examples of potentially anti-competitive restrictions in land agreements and annex A is a self assessment flow chart. These analysed examples, the self assessment flowchart and a glossary of terms are annexed.

Possible relevance of Groceries Market Investigation (Controlled Land Order) 2010 ("the Controlled Land Order")

It should also be noted that certain land agreements which relate to grocery retail are also subject to the Controlled Land Order[11]. The Controlled Land Order operates in addition to competition law controls and entered into force on 10 August 2010. This Order contains certain remedies[12] against 'large grocery

[10] Further guidance may be found in OFT Guidance Abuse of a dominant position (OFT 402) and the European Commission's Guidance on its enforcement priorities in applying article 82 to abusive exclusionary conduct by dominant undertakings (OJ C45, 24.2.2009)

[11] See http://www.competition- commission.org.uk/inquiries/ref2006/grocery/pdf/controlled_land_order_100810.pdf

[12] The Competition Commission consulted on a range of possible remedies in a Remedies Notice published on 31 October 2007

retailers'[13]. Part 3 of the Order is concerned with restrictive covenants. Article 4 requires large grocery retailers to use their best endeavours[14] to enter into deeds of release and secure the removal from the Land Registry of the restrictive covenants listed in Schedule 2a and any other covenants which fail the test in section 4(4). Article 5 prohibits large grocery retailers from entering into restrictive covenants that may restrict grocery retailing unless they are permitted by article 6.

Part 4 is concerned with exclusivity agreements. Article 7(1) prohibits large grocery retailers from enforcing exclusivity agreements to which article 7 applies after the time period in article 7(4). Article 8 prohibits large grocery retailers from entering into exclusivity agreements which may restrict grocery retailing with a duration of more than five years from the date on which the store which benefits from the exclusivity began trading.

Some indication of the likely approach of the OFT and the courts to the Revocation Order may be found in the above provisions of the Controlled Land Order. In particular, there seems to have been an acceptance of exclusivity agreements which do not exceed 5 years.

Consequences of breaching Chapter 1 Competition Act 1998

If a provision is found to be anti-competitive the OFT may impose fines of up to 10% of the world turnover of the offending undertaking (s.36 Competition Act 1998[15]). There is however limited immunity for small agreements (s.39 Competition Act 1998) and for breaches of Chapter II which involve conduct of minor significance (s.40 Competition Act 1998).

Guidance as to the assessment of fines to which the OFT must have regard[16] is provided by the OFT's *'Guidance as to appropriate amount of a penalty'*[17].

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[13] Defined in the Order as a person designated as such under Part 2 or the persons listed in Schedule 1 : Asda Stores Limited, Co-Operative Group, Marks and Spencers plc, Wm Morrison Supermarkets plc, J Sainsbury plc, Tesco plc, Waitrose Limited.

[14] This must be carried out without any charge to the burden party and within the time period specified in Article 4(5) (article 4(2). The obligation to use best endeavours does not require payment to a party to secure release of the covenants (article 4(7).

[15] Fines may only be imposed under this section where the infringement was committed either negligently or intentionally.

[16] S.38(8) Competition Act 1998

A provision which is found to be anti-competitive is void and unenforceable. Under competition law it is only the offending provision that is void[18]. However, as a matter of contract law, the voidness may affect the whole agreement. The leading case on severance remains the Court of Appeal decision in *Chemidus Wavin v Société pour la Transformation* [1978] 3 CMLR 514 where Buckley LJ framed the relevant question to consider as follows:

> *'[whether] the contract could be said to fail for lack of consideration or on any other ground, or whether the contract would be so changed in its character as not to be the sort of contract that the parties intended to enter into at all.'* [19]

Although anti-competitive provisions are void the Court of Appeal in *Passmore v Morland* [1999] 1 CMLR 1129[20] held that the voidness may be transient. In other words, if market or economic conditions change such that a restriction is no longer anti-competitive, it may cease to be void. Although *Passmore* concerned what was Article 82 it is probably right that the somewhat perplexing concept of transitory voidness also applies to Chapter 1 of the Competition Act 1998.[21]

It is now clear that third parties to an agreement may seek damages from the parties for a restriction that is found to be anti-competitive. Competition law damages may now be sought either in the Competition Appeal Tribunal (s.47A Competition Act 1998)[22] or in the usual courts.

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[17] OFT 423

[18] Case 56/65 *Société Technique Miniere v Maschinenbau Ulm GmbH* [1966] ECR 235

[19] For more detail see *Courage Limited v Crehan* [1999] E.C.C. 455 paragraphs 157-179 and *James E McCabe Ltd v Scottish Courage Ltd* [2006] EWHC 538 at paragraphs 51-52.

[20] *Passmore* was applied by Park J in *Barrett v Inntrepeneur PUB Company* [2000] E.C.C 106

[21] S.60 Competition Act 1998 requires the Competition Act 1998 to be as consistent as possible with European competition law. The OFT Draft Guidance takes the view that the decision in *Passmore* also applies to Chapter I Competition Act 1998, page 15 footnote 16.

[22] The first competition damages case to come to trial in the CAT *was Enron Coal Services Ltd (in liquidation) v English Welsh & Scottish Railway Limited* [2009] CAT 36. The decision in Enron was issued on 21st December 2009 and permission to appeal to the Court of Appeal was refused on 9th February 2010. Enron is useful as an indication of the difficulties particularly relating to quantum and causation that face claimants claiming competition law damages.

It may also be possible for the weaker party to an unenforceable anti-competitive contract to claim restitution and/ or damages under the contract against the stronger party. This is however a complicated area and the position is far from settled. Detailed consideration of this issue is outside the scope of this article although the basic tension is between the domestic law principle of *in pari delicto* and the competition law principle of 'inequality of bargaining power'[23].

Reasons for the change

The driver behind the revocation of the Exclusion Order was an investigation by the Competition Commission[24] into anti-competitive and restrictive practices within the grocery retail sector. The Competition Commission found that certain land agreements between large grocery retailers had an appreciable effect on competition and should not benefit from the Exclusion Order. The Competition Commission produced their final report 'The Supply of Groceries in the UK Market Investigation' on 30 April 2008[25]. Of particular relevance are chapter 7 'barriers to entry and expansion' and chapter 10 'findings and features'. The culmination of this investigation was the Controlled Land Order discussed above. It was felt that the most straightforward option was to revoke the Exclusion Order in its entirety rather than risk encouraging litigation as to the meaning of grocery retail agreements.

A further practical reason behind the change was that since 2004 applications on individual agreements are no longer made to the OFT but there is instead a system of self assessment. There had previously been a concern that the OFT would be overwhelmed with requests relating to land agreements and this was one of the reasons that 'land agreements' were previously the subject of exemption from the full rigour of competition law. However, following the introduction of the system of self assessment, this practical reason for the Exemption Order was removed. Hence, it is as a result of the previous practices of the supermarket giants and the removal of procedural obstacles which has now made many covenants in the property sector subject to a whole new range of challenges.

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[23] For more information the reader is referred to *Gibbs Mew plc v Gemmell* [1999] E.C.C 97 and *Courage v Crehan* [2004] EWCA Civ 637 (overruled by House of Lords at [2006] UKHL 38 on different grounds)

[24] Following a referral by the OFT under s.131 Enterprise Act on 9 May 2006

[25] See http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm

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