

> COMPETITION IN THE REAL ESTATE SECTOR



Until recently, the property industry has not needed to concern itself too much with competition law. That has now changed. In January 2010 the Department of Business, Innovation and Skills announced the Government's intention to apply the full provisions of competition law to land agreements, with effect from 6 April 2011. They will do this by revoking the existing exclusion of land agreements from the ambit of the Competition Act 1998.

At the moment we have only draft legislation, but as the proposal is to implement a recommendation of the Competition Commission, it is likely to become law regardless of any change of Government. As the effects of the change will be retrospective, this is something which the industry needs to address from now onwards, not just after April 2011.

Currently, land agreements are excluded from the application of the Chapter I prohibition in the Competition Act 1998, which prohibits any provision in an agreement that may have an appreciable restricting or distorting effect on trade in the UK.

From 6 April 2011 the exclusion will be revoked, with retrospective effect, resulting in any such provision in a new or existing land agreement being void and unenforceable.

If the offending provision cannot be severed from the agreement, then the whole agreement may be at risk.

Also the parties to the agreement might be subject to sanctions under the Competition Act and to actions by third parties who consider that they have suffered loss by virtue of the existence of the provision.

In addition to changing practice for the future, organisations may (because of the retrospective effect of the revocation) wish to review their existing titles, leases and other land agreements to assess whether they may breach competition law.

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What is a “land agreement”?

It is an agreement which alters, transfers, or terminates an interest in land – which includes any estate, interest, easement, servitude or right in or over land (including a licence). In Scotland it also expressly includes an interest under a lease and other heritable rights in or over land, including a fixed charge over land. It also applies to restrictions placed on parties in their capacities as holders of any interest in land.

So it will include leases, documents conveying title to land and documents containing title covenants or real burdens.

Why is this change being made now?

In 2008 the Competition Commission published a report on their investigations into the supermarket sector. That report included a recommendation to revoke the exclusion for land agreements – either partially, with the revocation only applying to those agreements which relate to the grocery market, or a complete revocation. The Government perceived no benefit in a partial revocation (and indeed envisaged that it might simply lead to arguments about which land agreements were prohibited and which were not) and so they decided on a complete revocation.

Historically land agreements were excluded from the Chapter I prohibition for logistical reasons. In the past there was a special clearance procedure if parties were concerned that their agreement may breach the rules. It was thought that the number of notifications of land agreements seeking special clearance would be overwhelming. That hurdle has been overcome as the system has now changed to one of self assessment, coupled with random audits and the rights of third parties to report potential breaches to the Office of Fair Trading (OFT). This has therefore cleared the way for the Government to implement the Competition Commission recommendation.

Which restrictions might be prohibited?

Any restriction on use or trade could potentially be prohibited. For example:

- > a landlord undertaking to its anchor (or any other) tenant not to let any other unit in a shopping centre for a competing use – an exclusivity entitlement or, in Scotland, solus trading clause;
- > a supermarket selling surplus land subject to a title covenant or restriction that it cannot be used as a supermarket; or
- > use restriction in a lease.

“Any restriction on use or trade could potentially be prohibited.”



In most cases land agreement restrictions will not breach competition law, either because they do not contain offending provisions or because they fall within two of the main exceptions, being those:

- > not having an appreciable effect on trade; or
- > whose positive benefits outweigh any consumer disadvantage wrought by the restriction.

We have set out below more detail on these two exceptions with some suggested examples, however without more Government clarity on how the exceptions will be applied to real estate no one can yet be sure which situations will breach competition law and which will not. The OFT have said that they will issue new guidance, but this may not be available until much nearer April 2011. In the meantime there will be a significant degree of uncertainty, not least due to the proposed retrospective effect of the provisions. Such uncertainty is not helpful in the current economic climate where the real estate recovery remains fragile.

No “appreciable” effect on trade exclusion

Although the law refers to UK trade, in most cases it will be viewed at a local level.

If for example a large DIY store has a high market share in one local area, and there is a shortage of available land or buildings which are, or could be, used for a competing use, then any restriction which benefits the DIY operator may have an appreciable effect on trade within that area. Such restrictions may therefore breach competition law.

On the same example, if there were no shortage of land or buildings in the area which could be used for a competing use, and there were a number of competitors already in the locality, then the restriction might be considered not to have an appreciable effect on trade.

Another example might be a landlord granting an exclusive trading right to its anchor supermarket tenant in a retail development and imposing restrictive covenants on other units. If that development was a parade of shops, being the only retail development in the area then it might have an appreciable effect on trade. The same may not be the case if the development was a shopping centre in a city centre, which had numerous other supermarkets already operating in the vicinity.

It is expected that the OFT will also apply their usual minor agreement thresholds. Generally they take the view that a provision will not have an appreciable restriction on competition if the market share of those involved is not above a certain level. For agreements between competitors, the parties' aggregate market share must be below 10%. For those between non-competitors it means that the share of neither must exceed 15%.

Positive benefit outweighing consumer disadvantage exception

For this exception to apply, the person seeking to benefit must be able to show that the restriction has offsetting benefits and goes no further than is required to create those benefits.

Take for example the usual situation in a shopping centre where the leases contain use restrictions. These are imposed for good estate management reasons, to maintain a balanced mix of tenants and uses, in order to ensure a flourishing centre that is attractive to customers.

Another example would be a retailer which has invested considerable sums to develop a site, which provides some benefit to the local consumers. It may be considered unfair to prohibit that retailer from having some “exclusivity” period before rival traders can begin to operate in the area. The Competition Commission recognised this to a degree when it noted that local planning authorities should not allow exclusivity periods for more than 5 years for large grocery retailers. It is possible that this may feature in the OFT guidance, and if it does then perhaps they may extend the concession to other major traders or anchor tenants.

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Consequences of breaching competition law?

In addition to the restriction being void, the OFT can impose significant fines, of up to 10% of an organisation's turnover. The Enterprise Act 2002 makes it a criminal offence for individuals to enter certain agreements which are viewed as cartels, and directors who breach competition law could be disqualified.

Such significant fines and other penalties tend to be reserved by the OFT for the most severe cases of anti-competitive behaviour. This is partly due to limited resources in the OFT, but also because generally land agreements are unlikely to involve more than local competition issues.

Finally however, organisations should bear in mind that third parties, who claim to have suffered a loss as a result of the existence of a prohibited restriction, may raise an action for damages against the parties to the agreement.

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What to do next?

Clearly there will now require to be more focus on competition law in real estate transactions. The sooner the OFT issues its promised guidance the more certain the position will become.

Organisations may also wish to review their existing land agreements with a view to identifying any potential breaches of competition law. If a restriction does not benefit from one of the exemptions or exclusions, this might have significant commercial effects, for example an exclusive trading benefit given to an anchor tenant might become void but the lease would remain enforceable. The anchor tenant may suffer if the landlord is then free to let other units to competitors.

As regards such existing land agreements, it is expected that the OFT will not apply any of the available criminal sanctions in relation to a breach, and would restrict action to making the relevant restriction void. However this has not yet been confirmed by the OFT and we would therefore strongly recommend that anyone who could potentially be subject to such sanctions does check their existing agreements with a view to taking any available action to amend them (if possible) before April 2011.

Also if the person at risk of prejudice by the voiding of a restriction currently has (but may not, in April 2011, have) some negotiating position for another reason, then that could be used now to soften the adverse effect of future loss of the benefit of the restriction e.g. by a rent reduction or some other benefit to be provided by the Landlord.

KEY POINTS

- › From 6 April 2011, the Competition Act regime will apply to any land agreement which may have an appreciable restricting or distorting effect on UK trade e.g. exclusive trading entitlements or restrictions on use.
- › The regime will apply to all land agreements, existing and future, including leases and title covenants or real burdens.
- › If any land agreement breaches the rules, the offending provision will be void and unenforceable.
- › Also the parties to the agreement might be subject to sanctions under the Competition Act 1998.
- › Most land agreements will be unaffected, but when entering into a new agreement those involved will now have to consider whether the rules will apply. It will be particularly relevant when dealing with supermarkets or other entities who have more than a minor share of their market.
- › As the regime will be applied retrospectively (with the potential – albeit unlikely – application of sanctions in addition to the voiding of the relevant restriction) we would strongly recommend that organisations review their existing land agreements to check for potential breaches, with a view to taking action to remove the relevant provisions before 6 April 2011.
- › The Office of Fair Trading have said that they will issue new guidance, but this may not be available until a few months before the revocation takes effect.

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Competition law, and the impact of the Chapter 1 prohibition being applied to UK land agreements, will affect those involved in the property industry. Our industry expertise allows our lawyers to address the issues and to provide advice on the implications of the expected revocation of the land agreements exclusion on 6 April 2011.

We represent a number of clients who are likely to be affected by the new rules and will be working closely with them to assess the best ways to deal with future transactions and also to review any consequences for existing agreements and to consider whether any action might be taken before April 2011 to off set the adverse impact of the voiding of any current restrictions.

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