Quickguides

UK competition law and land agreements
Quickguide overview

This Quickguide considers the application of UK competition law to land agreements, including leases. In particular, it considers:

- An overview of the key UK competition law provisions
- How the competitive impact of a restriction in a land agreement is assessed for competition law purposes
- The issue of abuse of dominance in relation to land agreements
- Specific legislation concerning the grocery retailing sector
- The Competition and Markets Authority’s administrative priorities in terms of enforcement

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UK competition law and land agreements

1. Introduction

Since 6 April 2011, restrictions in land agreements\(^1\), which had previously been excluded from the UK prohibition on anti-competitive agreements, must comply in full with competition law.

Restrictions in both new and existing land agreements which infringe competition law are automatically void and unenforceable, and if the restrictions cannot be severed, the whole agreement may be compromised. An infringement of competition law may also expose the parties to a range of potential sanctions, including fines of up to 10 per cent of the parties' worldwide turnover, and the possible disqualification of directors who knew or should have known about the infringement.

In March 2011, the Office of Fair Trading (OFT) published guidance which sets out the way in which competition law applies to land agreements (the "Guidance") and which has been formally adopted by the Competition and Markets Authority (CMA) (which took over from the OFT as the primary UK competition authority on 1 April 2014). The Guidance considers several common forms of land agreement, explains the application of the law but also, importantly, clarifies the circumstances in which the CMA is less likely to investigate.

This Quickguide provides an overview of the application of UK competition law to the types of land agreements covered by the Guidance. It will commence with an overview of relevant competition law, before considering how the CMA is likely to assess whether a land agreement is restrictive of competition.

2. Overview of UK competition law

**The Chapter I prohibition – anti-competitive agreements**

Under UK competition law, the Chapter I prohibition of the Competition Act 1998 (the Act) prohibits:

- agreements between undertakings;\(^2\)
- which may affect trade in the UK; and
- which have the object or effect of preventing, restricting or distorting competition within the UK or a part of the UK.

An exemption to the Chapter I prohibition is available where an agreement, although restrictive of competition, offers countervailing benefits (such as improving production or distribution or promoting technical or economic progress) that outweigh any distortion of competition, provided that certain cumulative conditions are met. The Chapter I prohibition is analogous to the prohibition under Article 101 of the Treaty on the Functioning of the European Union, but without the requirement of there being an effect on trade between Member States (which is less likely to arise in relation to land agreements which tend to be local in impact).

Infringements of the Chapter I prohibition fall into two broad categories: infringements by object and infringements by effect. In respect of infringements by object, the very purpose of the agreement is to achieve an anti-competitive restriction (for example, price-fixing or market-sharing). Infringements by object are typically the most serious forms of competition law infringement and it is very unlikely that an exemption will apply. Infringements by effect concern restrictions whose purpose is not to restrict,

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\(^1\) Land agreements include those which create, alter, transfer or terminate an interest in land, such as transfers of freehold interests, leases, assignments of leasehold interests and agreements relating to easements, licences and in Scotland, interests under a lease and other heritable rights in or over land.

\(^2\) An undertaking is an entity engaged in economic activity. Two companies within a corporate group (e.g. a parent and a subsidiary) will form part of the same undertaking, and agreements between them will not be subject to EU or UK competition law.
prevent or distort competition but where it operates in such a way in practice that it has an actual or potential restrictive effect, intended or not. Such restrictions are more likely to qualify for an exemption if they yield offsetting benefits, although adjustments may be necessary to ensure the exemption criteria are met.

**The Chapter II prohibition – abuse of a dominant position**

The Chapter II prohibition of the Act prohibits conduct by one or more undertakings which amounts to the abuse of a dominant position in a particular market where such conduct may affect trade within the UK (or any part of it). There is no exemption to this prohibition, but objective justifications may be accepted to show that the conduct was not in fact abusive.

A business can be said to be in a dominant position where it possesses substantial "market power" and can therefore behave, to an appreciable extent, independently of its competitors, its customers and, ultimately, consumers. Whether a business is dominant is a complex question of law and economics but, broadly speaking, concerns will only potentially begin to arise where a business has a share of 35 to 40 per cent or more of supplies or purchases of goods or services in a properly defined product and geographical market. However, the level of market share is a guide only and the key issue is whether the business in question has market power. Enjoying a dominant position is not, of itself, illegal. However, an undertaking which occupies a dominant position is under a special responsibility not to distort competition further and will therefore face certain limitations on its conduct which a non-dominant firm would not.

**Sanctions for infringing competition law**

An infringement of UK competition law can have serious consequences. In particular:

- contractual restrictions which infringe competition law will be void and unenforceable, so that they cannot be enforced through court action. Depending on the scope to sever these restrictions from the agreement, this may compromise the validity of the whole agreement;

- the CMA has powers to impose very significant fines on businesses found to be in breach of the competition rules (up to 10 per cent of worldwide group turnover);

- third parties may be able (and are increasingly deciding) to sue for damages where they have suffered loss as a result of any prohibited anti-competitive agreements or conduct under UK competition law;

- directors of UK companies that have infringed UK competition law may be disqualified from acting as a director for up to 15 years;

- under the Enterprise Act 2002, it may be a criminal offence to rig bids, fix prices, divide up markets or customers, or limit production or supply (the "cartel offence"). Conviction for the cartel offence is subject to a maximum penalty of five years' imprisonment and/or an unlimited fine; and

- the adverse reputational impact of being found to be in breach of competition rules can be very significant.

**Investigations**

The CMA is the primary enforcement body for the UK competition rules. The CMA is vested with powers to request or require information and documents to be provided and can also conduct investigations at business premises and take copies of documentation, electronic files, e-mails, and, in certain cases, seize original documents. These powers can also be used to inspect the premises of a business which is not under suspicion but which may have evidence which is relevant to an investigation into another business, such as a customer, competitor or supplier. These "dawn raids" can occur with no notice.

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3 In the regulated sectors, various regulatory bodies including ORR, Ofcom, Ofwat, Ofgem, CAA, PSR and the FCA also have powers to enforce competition law.
3. Assessing the impact of a restriction in a land agreement

Restrictions in land agreements regarding the way in which land may be used, or how a right over land may be exercised, do not necessarily infringe competition law. Parties that own or have an interest in land are generally free to determine how that land should be used or whether the land is suitable for use for a particular purpose.

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 fix prices or share markets by territory, type or size of customer, the agreement will almost invariably infringe the Chapter I prohibition. For example, a retail firm leasing land to a competitor on terms which require the competitor not to undercut the landlord's retail prices is akin to a price-fixing cartel between the competing retailers and very likely to restrict competition.

Other types of restrictions may have the effect of restricting competition, if they prevent competitors of a party to the agreement from competing effectively, for example, by increasing the cost of entry or expansion. When assessing whether this type of restriction has the effect of restricting competition, it is necessary to compare the situation on the relevant market with the land agreement (and the restrictions that it contains) in place, with the situation that would prevail in the absence of the agreement (the "counterfactual").

The assessment of a restriction in a land agreement will involve consideration of the following issues:

**The relevant markets affected by the land agreement**

The Guidance states that the assessment of a land agreement will generally involve the consideration of two relevant markets:

- the market involving the economic activity where the land affected by the agreement is used (the "related market"). For example, when considering a restriction in a lease that prevents the tenant from opening a coffee shop on the premises, it will be necessary to consider the impact of that restriction on the market in which a coffee shop would compete. This will depend on both the product and geographic scope of the market; and

- the upstream market for land that is suitable for use in the related market. In the coffee shop example, the product scope for the land will include all the land that is suitable for use by a coffee shop and similar premises selling beverages, within the relevant geographic scope of the relevant retailing market.

**The position of the parties on the relevant markets**

Land agreements are generally unlikely to restrict competition appreciably unless one or more of the parties possesses market power (i.e. it does not face effective commercial pressure) in the related market or the upstream market. A firm is more likely to possess market power where:

- it has a high market share or there are few competitors in the related market; and/or

- there are barriers to entry on the related market, in particular a shortage of suitable land. Such barriers may be significant where a single land owner owns all (or substantially all) of the available land suitable for use in a related market. This will depend on the nature of the related market. For example, a restriction which prevents land from being used for a particular type of large superstore is more likely to have an impact on competition than a restriction which prevents an individual high street unit from being used as a particular type of retail business, as there are likely to be fewer alternative sites suitable for a superstore development, and more alternative sites suitable for a high street store.
The nature of the restriction

The Guidance identifies a number of restrictions that are unlikely to restrict competition appreciably:

- covenants relating to payment of service charges or financial criteria;
- restrictions imposed on a lessee regarding alterations, repairs, hours of use; and
- restrictions on use which are designed to obtain an appropriate retail mix, or to facilitate the use of an adjacent site (the Guidance gives the example of restrictions against certain industrial uses in respect of land adjacent to a theatre).

The Guidance identifies two types of provision that might restrict competition and where companies should consider the effect of their arrangements:

- reciprocal freehold restrictive covenants or leasehold use restrictions: as noted above, restrictions on use will generally be acceptable (especially where their intention is to ensure an appropriate tenant mix), but if they are entered into by tenants on a reciprocal basis (i.e. on the understanding that other tenants will not be permitted to compete with them) such restrictions can operate as market-sharing or customer-sharing arrangements; and

- exclusivity provisions: such provisions may restrict competition, where they protect the recipient from other competitors. The CMA recognises, however, that exclusivity provisions may be necessary to provide an “anchor tenant” on a new retail site with the opportunity to recoup its investment and will therefore not be regarded as anti-competitive provided they are suitably time-limited. The time period to recoup this initial investment will vary, but will often be less than the duration of the lease.

In assessing these two types of agreement, the CMA will consider the extent of the relevant restriction. The longer the duration of a restriction and the wider its scope, the more significant its likely impact on competition.

Since publication of the Guidance, a European court has held that a non-compete clause benefitting an anchor tenant of a shopping centre by granting the tenant the right to prevent competing retailers from taking other tenancies in the shopping centre, may have the effect of restricting competition. Whether the clause was found to breach competition law required a full assessment of the legal and economic context of the agreement and an assessment of the actual and potential effect of the clause on competition.

The availability of an exemption

A land agreement which appreciably restricts competition may nevertheless be exempt from the Chapter I prohibition if the parties can show that it satisfies all four of the following exemption criteria:

- it contributes to improving production or distribution, or to promoting technical or economic progress (efficiency gains). These efficiency gains must, on balance, outweigh the negative impact on competition. The Guidance gives the example of a department store being given the exclusive right to operate as a department store in a shopping centre. This agreement may give rise to efficiency gains because the owner of the centre considers that the department store will attract considerable footfall to the centre. Other retailers may benefit from the footfall generated by the department store, which contributes to the attractiveness to customers of the shopping centre overall;

- it does not impose restrictions beyond those indispensable to achieving those objectives (i.e. the benefits of the land agreement could not have been achieved by a less restrictive agreement). The Guidance considers that an exclusivity provision in favour of a department store may be indispensable in order to incentivise it to set up its store in a shopping centre as an anchor tenant. However, an exclusivity provision of unlimited duration is unlikely to be indispensable, as a limited duration may be sufficient to attract the department store;

- it allows consumers a fair share of the resulting benefits. In the department store example, it would be necessary to consider the negative impact of having only one department store in the shopping centre;
centre (in terms of reduced competition on price), compared with the positive impact of having the department store within the shopping centre (e.g. increasing footfall, which attracts other retailers to the centre); and

- it does not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question. This will depend on the degree of competition existing prior to the agreement and on the extent of the reduction of competition brought about by the agreement.

4. Abuse of dominance

Where one of the parties to a land agreement is in a dominant position, care is required that the restrictions in a new or existing land agreement are not abusive and in breach of the Chapter II prohibition. Examples of abuses of a dominant position that relate to land agreements might include:

- a landlord exploiting tenants by charging excessive rents above the competitive level;
- a landlord of key infrastructure who is also active on a related market preventing a competitor on the related market accessing that facility (e.g. a port owner and ferry operator refusing to allow a competing ferry operator to use the port); or
- a landlord discriminating on price (i.e. rent) between tenants without justification.

The Guidance emphasises that firms are generally free to decide to whom they sell or lease land, and the price at which they do so. Conduct regarding land will only be prohibited by the Chapter II prohibition in limited circumstances which will depend on the facts.

5. Land agreements relating to grocery retailing

Since 2010, land agreements in connection with grocery retailing activities have been subject to additional control under The Groceries Market Investigation (Controlled Land) Order (the Controlled Land Order).

The Controlled Land Order is primarily aimed at preventing the use of exclusivity arrangements and restrictive covenants to restrict entry by competing grocery retailers into local areas where one retailer has a very high proportion of existing groceries sales floorspace (highly concentrated local markets). The Competition Commission has identified that such arrangements have an adverse effect on competition in the groceries market.

The Controlled Land Order applies to designated large grocery retailers\(^4\), who are required:

- to release certain existing restrictive covenants which had been found to prevent, restrict or distort competition by the Competition Commission;
- not to enter into any restrictive covenant or agreement, other than a planning agreement, that may restrict grocery retailing or have equivalent effect (i.e. which prevents land from being used for grocery retailing);
- not to enforce, after five years from the date of the Controlled Land Order, certain existing exclusivity agreements which had been found to prevent, restrict or distort competition by the Competition Commission; and
- not to enter into any exclusivity arrangement that may restrict grocery retailing or have equivalent effect with a duration of more than five years from the date on which the grocery store which benefits from it first began trading.

The provisions of the Controlled Land Order apply separately from general UK competition law. However, land restrictions in the grocery sector that are not caught by the provisions of the Controlled Land Order remain subject to general UK competition law.

\(^4\) In particular, Asda, Co-operative Group, Marks and Spencer, WM Morrisons, J Sainsbury’s, Tesco and Waitrose.
6. The CMA's administrative priorities

The CMA is not obliged to investigate every suspected infringement of competition law, and applies so-called "prioritisation principles" when deciding whether to take action in an individual case.

The Guidance recognises that only a minority of restrictions in land agreements will infringe the Chapter I prohibition and states, moreover, that the CMA is unlikely to investigate where none of the parties to the land agreement has a share of over 30 per cent on the relevant "related" market (or, if market shares are difficult to calculate, where there are four or more independent fascias in the relevant retail market).

However, where the parties to a land agreement are competitors and the restriction is aimed at sharing related markets (i.e. a cartel), the agreement is likely to constitute a serious object infringement of the Chapter I prohibition, and the CMA may investigate irrespective of the parties' market shares. The CMA is likely to impose substantial fines for such infringements.

7. Concluding remarks

Most restrictions in land agreements are unlikely to infringe competition law, although caution is required when negotiating land agreements, as infringing restrictions will be void and unenforceable, and other sanctions may apply. It is also important to assess the compliance of restrictions in existing land agreements with competition law.

The Guidance is helpful in clarifying how the CMA will enforce the Act in relation to land agreements. However, specialist legal advice will generally be required as the assessment of restrictions is based on their effect (which may depend on market conditions and so on) rather than their wording, so that an identically worded restriction may be valid in one land agreement but void in another.
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