



THE CITY OF LONDON LAW SOCIETY

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Response to the OFT's consultation paper “Guidance on the application of competition law following the revocation of the Land Agreements Exclusion Order”

Introduction

The Competition Law Committee ("the Committee") of the City of London Law Society ("CLLS") welcomes the provision by the OFT of guidance on the application of competition law to land agreements following the revocation of the Land Agreements Exclusion Order¹ and is pleased to have the opportunity to comment on the draft guidance.

The Committee is made up of solicitors specialising in UK and EU competition law in a number of law firms based in the City of London, who advise and act for UK and international businesses, financial institutions and regulatory and governmental bodies on competition law matters.

In view of the importance of the guidance to the property, and related finance, sectors², the Committee formed a Joint Working Party to consider and comment on the draft guidance which includes three real estate practitioners³ (two of whom sit on the CLLS Land Law Committee) whose input and assistance has been extremely valuable.

Our principal comments are set out in the response to question 1 of the Questions for Consultation posed in the consultation paper. We then respond more specifically to questions 2 and 3.

Question 1

Is this guidance sufficiently clear to assist you in understanding how the law on anticompetitive agreements applies to land agreements in the UK? Is the format easy to follow? If not, what improvements do you suggest we make?

General Comments

¹ The Competition Act 1998 (Land Agreements Exclusion and Revocation) Order 2004.

² For the purposes of this submission we include the related property finance sector within the definition of "property sector".

³ Mark Heighton (CMS Cameron McKenna), Anthony Judge (Travers Smith) and Mark Rees-Jones (Clifford Chance).

Practical guidance

- 1.1. Our view is that, as drawn, the draft guidance is not sufficiently clear or practical for its intended target audience (namely real estate practitioners, property companies, investors in real estate and occupiers), and it would benefit from quite radical re-ordering - in particular, to give increased prominence to some of the helpful comments and examples which are currently somewhat buried in the text. By way of example: -
- (i) the guidance states⁴ that the OFT expects that only a minority of restrictions will be anticompetitive. By extension, this recognises that a small minority of land agreements will be anticompetitive. The Committee is of the view that the guidance should clearly state, at the outset, that the OFT expects the vast majority of land agreements to be non-problematic and explain the key factors that will indicate to real estate lawyers and their clients when there may be a need to seek expert competition advice;
 - (ii) the Committee welcomes the examples on pages 42 *et seq.* of the draft guidance, which are helpful practical illustrations of how Chapter I of the Competition Act 1998 ("Chapter I") will apply to land agreements. We would suggest, however, that these (and additional examples) appear early on in the main body of the guidance and are also used to illustrate more clearly how to approach individual aspects of the analysis, such as market definition⁵.

Impact of the revocation

- 1.2. We are concerned that the full impact of the revocation of the Land Agreements Exclusion Order (in particular on existing agreements which may contain problematic provisions), and the fact that the revocation takes effect in under 4 months' time, have not yet been appreciated by the property sector. The Committee is aware that there are substantial concerns that:
- (i) the revocation will lead to significant uncertainty regarding the enforceability (or otherwise) of land agreements (pending the actual practical impact of the revocation), and this could have a chilling effect on new transactions in the property sector; and
 - (ii) it is simply not practicable for the property sector to review all existing land agreements - in some cases, these may have been entered into decades ago.
- 1.3. The Committee appreciates that the OFT has been given a tight time frame within which to publish its guidance. However, given the limited time available before the revocation takes effect, we would urge the OFT to prioritise issuing finalised guidance as soon as possible following expiry of the consultation period.
- 1.4. Whilst the Committee recognises that this is not the OFT's responsibility, the Committee notes that there is inconsistency between the transitional arrangements for the revocation of the Land Agreement Exclusion Order and those in the Groceries Market Investigation (Controlled Land) Order 2010 ("the Controlled Land Order"); with the latter, for example,

⁴ On pages 13 and 24.

⁵ See further the responses to questions 2 and 3.

allowing "exclusivity arrangements" entered into by large grocery retailers to be enforceable for a period of five years. The short transitional period before the revocation of the Land Agreements Exclusion Order has therefore placed land agreements that are outside the scope of the Controlled Land Order in a worse position than those covered by it.

- 1.5. The Committee would suggest that the OFT considers discussing with BIS whether, in light of the potential impact of the revocation on property transactions and the related finance sector, BIS would be prepared to consider introducing a UK block exemption regulation for land agreements – for example, to extend the transitional period before the revocation takes effect and/or identify "safe harbours" for certain restrictions in existing and future agreements (such as a "safe harbour" duration for exclusivity arrangements where specified market share thresholds are satisfied). The Committee has also approached BIS with a view to discussing this.

Additional Guidance

- 1.6. The Committee would also welcome further guidance in the following areas:

Geographic Market Definition

- 1.7. §4.12 dealing with the techniques used to determine the geographic scope of a market does not provide sufficient detail on how to delineate local catchment areas. It would be helpful to have clear guidance on the radius (e.g. isochrone, postal areas, or Local Authority Licensing Areas) to be used in different circumstances - if necessary, divided into broad categories such as urban indoor shopping malls, urban outdoor shopping areas, out-of-town indoor shopping malls, out-of-town outdoor shopping areas, factory outlet villages and slightly more unusual developments/locations where there may be significant retail and leisure uses, such as railway stations, airports, and events venues.
- 1.8. The Committee would also welcome more detailed guidance on the practical application of the relevant methodologies, in particular, in relation to identifying competing businesses within a specified catchment area. For example, presumably a catchment area for a retail store in an urban indoor shopping mall would be likely to include competing shops that are located inside the shopping mall, as well as those located outside the shopping mall, provided they are within the relevant isochrone?

Tenant Mix/Use Clauses

- 1.9. §6.8 states that the attractiveness of a shopping centre to consumers on an ongoing basis may depend on its containing a mix of different types of retailer and that such a mix could be achieved through lease covenants imposed by the landlord restricting the way each retail unit may be used by the tenant. However the guidance does not give sufficient explanation⁶ of the circumstances in which, and why, the OFT considers this kind of restriction is likely to amount to an appreciable restriction of competition in the first place (in particular where it is not coupled with an exclusivity arrangement) - for example, where a landlord is under an obligation to maintain the entirety, or part, of a retail development as a high quality shopping mall. The Committee considers that this kind of

⁶ Neither in section 5 on *Appreciability* nor in section 6 on *Applying the Exemption Criteria*.

restriction would not generally restrict competition (absent clear evidence of an anticompetitive object being pursued by the landlord).

- 1.10. The Committee is also of the view that the guidance should explain whether and, if so, in what circumstances, the OFT considers a lease restriction imposed on a tenant regarding the use of land (it being very rare for such a restriction not to be included) can amount to a restriction of competition in breach of the Chapter I prohibition⁷.

Indispensability of Exclusivity Arrangements / Restrictive Covenants

- 1.11. The Committee would welcome further guidance on what would normally be permissible by way of the scope, and duration, of certain restrictions. What follows relates to exclusivity arrangements, by way of illustration, as the Committee regards this as a key area, but similar guidance would be appreciated in relation to other restrictions.

Exclusivity Arrangements

- 1.12. The guidance does not illustrate how, having concluded that an exclusivity arrangement appreciably restricts competition in breach of the Chapter I prohibition, the question of indispensability is to be assessed in the context of the scope of the restriction, both in terms of the activities covered and its geographic range. For example,
- (i) in what circumstances would it be more (or less) indispensable for an exclusivity arrangement to identify an exhaustive list of retailers to whom a shopping mall landlord is restricted from leasing rather than a general, but possibly wider, description of the excluded activities?
 - (ii) when could an exclusivity arrangement relating to a certain proportion of the relevant geographic market (rather than the entire market) be indispensable? For example, where an exclusivity arrangement applies to two thirds of a retail store's catchment area in an urban indoor shopping mall.
 - (iii) how would these factors interrelate with an assessment of the indispensability of the duration of the restriction?
- 1.13. §§6.13 to 6.15 refer to the duration of a restriction being "no longer than necessary to achieve the benefits identified"; explain that shorter periods are more likely to be considered indispensable; and give the example of a period of exclusivity possibly being indispensable where the viability of a proposed new shopping centre depends on securing the commitment of a large, high profile, retailer to act as an 'anchor tenant', where the period is limited to the period "necessary to give investors sufficient certainty that the shopping centre and department store will be commercially viable".
- 1.14. As outlined in §1.5 of this submission, the Committee would welcome the introduction of a "safe harbour" duration for exclusivity arrangements. However, if that is considered impractical, the Committee would welcome an explanation of the circumstances when it may (or may not) be appropriate for an exclusivity arrangement to be imposed for a period of up to five years, or in certain cases for a longer period (where objectively justifiable)(see also §2.3 of this submission). For example, the guidance could refer to

⁷ The Chapter I prohibition is set out in section 2 of the Competition Act 1998.

the following considerations when considering the permissible duration of an exclusivity arrangement⁸:

- (i) The European Commission's Vertical Agreements Block Exemption Regulation⁹ and Guidelines on Vertical Restraints¹⁰, which permit periods of exclusivity of up to five years in vertical agreements between undertakings where the relevant market share thresholds are not exceeded;
- (ii) The Controlled Land Order which, as explained above, allows exclusivity arrangements between large grocery retailers to be enforced for a period of up to five years. Whilst the Committee appreciates that the Controlled Land Order applies specifically to the "large grocery retailers" in the UK, it would be helpful to explain, in this guidance, why the five year period was selected (namely the average time needed for a large grocery store to reach maturity / the required return on investment) and whether this would be a reasonable starting point for assessing a permissible period of exclusivity in other situations;
- (iii) The position in the Netherlands, where a national equivalent of the Chapter I prohibition has applied to land agreements for many years and the competition authorities take the view that exclusivity clauses in relation to shopping centres are exempt provided they are no longer in duration than six years from the start of the first tenancy in the shopping centre, but likely to be prohibited if longer.

Existing Agreements

- 1.15. Whilst the unenforceability of restrictions in existing agreements which will now fall within Chapter I (and the impact of this on the agreements as a whole) will be problematic for contracting parties, businesses will be particularly concerned about the potential for substantial fines being imposed by the OFT. Clear guidance on the OFT's enforcement priorities would be particularly helpful to enable businesses to assess the magnitude of this risk with regard to existing agreements.
- 1.16. The Committee is of the view that the guidance should clarify the position and provide that, when applying its prioritisation principles and/or fining guidelines, the OFT will take the following into account:
 - (i) existing land agreements that were valid at the time they were entered into,
 - (ii) the long term nature of such agreements,
 - (iii) that such agreements may be difficult in practice to vary (since the counterparty and potentially third parties such as funding banks, tenants and sub-tenants would need to agree to any change), and
 - (iv) whether the party benefiting from the restriction has sought to enforce the relevant restriction subsequent to the revocation taking effect.

⁸ In particular, in the specific context of indispensability.

⁹ Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

¹⁰ 2010/C 130/01.

Severability

- 1.17. One of the principal reasons for introducing the Land Agreements Exclusion Order in the first place was to address concerns from the property sector about the uncertainty which would arise (if land agreements were not excluded from Chapter I) as to whether, and when, a land agreement might be valid and enforceable. These key concerns are justifiably resurfacing in anticipation of the revocation. Of particular concern is the concept of transient voidness.
- 1.18. We are, therefore, of the view that the OFT guidance should contain more detail on the principles of voidness and unenforceability, and of severability, that have been established under applicable EU and UK jurisprudence. For example, as a minimum, the guidance should clarify that, in practice, the OFT would expect most restrictions in land agreements that infringe Chapter I to be severable (depending, of course, on the precise wording of the contract).
- 1.19. The Committee appreciates that the practical consequences of a land agreement being void and unenforceable are a matter of contract law which the OFT's draft guidance does not seek to cover. However, given the significance of this potential issue to the property sector, more detailed guidance regarding the practical effect of an agreement becoming transiently void would be helpful, in particular regarding existing land agreements of the kind outlined above (see §1.16 of this submission). Whilst the relevant restriction (and the agreement itself) might be void and unenforceable for the period during which it infringes Chapter I, what would be the effect of this, for example, in relation to a restrictive covenant which was registered at HM Land Registry?

Question 2

Are the worked examples in chapter 8 useful in helping you understand the application of the law on anticompetitive agreements? How might they be improved?

The worked examples are very helpful. We think that they might be improved as follows: -

- 2.1 **Example 2.** The typical duration of a lease for a department store is 25/99 years rather than ten years.
- 2.2 It would be helpful if the example identified the Shop Here Centre as being a small indoor shopping mall, on the basis that exclusivity is more practicable and commercially justifiable at these kinds of development. In contrast, exclusivity is less practicable or commercially justifiable for larger indoor shopping malls, and is therefore less common in practice.
- 2.3 The Committee is also of the view that this example should provide an indication of a permissible duration for the exclusivity arrangement - for example, linking it to the time that is expected to be needed for the store to reach maturity (i.e. the point when its sales per week are projected to grow at a rate at or around inflation).
- 2.4 **Example 4.** It would be helpful if the example identified whether, and when, this type of restriction might be acceptable for a limited period of time, for example, when the restriction is necessary to protect the value of a neighbouring site or to allow the seller to

benefit from an uplift in the value of the land if sold on for a different use¹¹. In this latter case, a covenant is typically imposed restricting the use of the property and/or providing for a price adjustment if there is a change of use (or planning is granted for a change of use). For example, the value of land which can only be used for industrial purposes would be significantly less than that of land which could be used for residential purposes.

- 2.5 We are of the view that the example should also explain the practical effect of the restriction becoming transiently void and unenforceable, in particular, regarding the consequences for its registration at HM Land Registry.

Question 3

Are there any specific areas in the scope of this document where you consider further guidance or examples would be useful? Please explain which areas.

- 3.1 The Committee is of the view that the examples of the practical application of the guidance are one of the most helpful aspects. The guidance should include additional examples which, together with the existing examples, should be introduced throughout the main body of the document to illustrate how the various stages of the analysis are to be applied in practice.
- 3.2 Attached as an Annex are suggested additional examples of (i) a development agreement between house builders, (ii) an agreement to construct university accommodation, and (iii) factory outlet leases.
- 3.3 The Committee is of the view that additional examples should be included, such as examples of the types of restrictions that may be imposed regarding facilities where, for a period / certain periods of time, there is a "captive audience". For example, airports, theme parks, railway stations where there are a variety of retail and leisure operators. In relation to these facilities a land owner may well grant a period of exclusivity in leases of individual units to retailers and/or leisure operators.
- 3.4 The Committee would welcome guidance regarding the practical peculiarities of the competition assessment associated with such "captive audience" facilities. For example, in some cases (such as airports) consumers are generally infrequent visitors and have access to a facility for a limited period of time, but do not have the ability to leave the facility once they have passed beyond a certain point (eg having satisfied certain security checks). These facilities are also generally located out-of-town where limited alternative facilities may be available for all consumers visiting the facility. It would be helpful to contrast this with examples of a more limited "captive audience", such as a railway station, where there may be competing alternative retail and/or leisure outlets located nearby, and where we would generally expect restrictions would need to be less onerous in order to justify exemption from the Chapter I prohibition.
- 3.5 The Committee is also of the view that additional examples should be included demonstrating where the Chapter I prohibition has not been breached (for example,

¹¹ This clause is sometimes called an "anti-embarrassment" clause. However, more frequently the term refers to clauses that are typically (but not exclusively) used in the context of sales of land by local authorities and insolvency practitioners to allow for a potential price adjustment upon a subsequent transfer by the purchaser within a specified period, at a profit.

regarding restrictions on a landowner to preserve the retail/tenant mix in a shopping mall); and an example of a network of local agreements that has an impact on competition in a national market

Competition Committee of the City of London Law Society
22 December 2010

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ANNEX

Example 1 – Development Agreement Between House Builders

Homebuilder has a large development site in its land bank.

Homebuilder only wants to develop part of the site, and that over a period. This may be because Homebuilder does not have sufficient funding to develop the whole site, or sufficient capacity, or because the market at present does not warrant such a large scheme (i.e. limited demand).

Rather than keep the part of the site that Homebuilder is not able, or does not want, to develop Homebuilder divides the site into three parcels: Homebuilder keeps one parcel for itself to develop; and invites offers for the other two parcels from other house builders.

It imposes a number of restrictions on the two parcels of land that it proposes to sell (which also apply reciprocally to the parcel retained by Homebuilder). These include:

- a maximum density of development per parcel – i.e. no more than [x] houses per acre;
- a maximum number of houses per parcel;
- minimum size of plot per house;
- restrictions on the use of the parcels - e.g. only residential;
- covenants relating to establishing and maintaining estate roads and services.

Note for the OFT: The commercial reason for these covenants is to protect the remaining part that Homebuilder wants to develop itself - for example the planning permission for the whole site may limit the number of houses and Homebuilder wants to protect its share. Some covenants are to preserve the value of the houses that will be built by maintaining the character of the scheme etc. Without these sorts of covenants the scheme may not be developed but left in Homebuilder's land bank.

Example 2 – Agreement To Develop University Accommodation

Eastshire University owns a long leasehold interest in a large area of land located in the fringes of the city of East that it wants to develop into modern university accommodation to house students.

Eastshire University lacks the necessary capital to develop the area itself, so grants a long lease of the entire area for a term of 99 years to Developer, a specialist designer, manufacturer and installer of university accommodation. Under the terms of the lease Developer agrees to pay an up-front sum and nominal rent to Eastshire University.

Developer also agrees to construct student accommodation on the area provided that, following construction, Developer will grant a lease-back to Eastshire University for the same term as the long lease (less a nominal reversion of three days) at a rent calculated by reference to the rent that is expected to be received by Eastshire University from students occupying the student accommodation. As part of the agreement Eastshire University undertakes not to construct (either itself or in a venture with another company) student accommodation (or more than a specified number of units of student accommodation) within an agreed radius of the accommodation constructed by Developer unless a demand test for the accommodation on Eastshire University campus is satisfied.

Note for the OFT: In practice, agreements relating to university accommodation can be for a term of between 35-99 years. The restriction ensures that there will remain, for the term of the lease-back,

adequate demand for the accommodation constructed by Developer. Since the profitability of the contract is dependent on a sufficient supply of students, it would not be economic for Developer to effect the project without the restriction.

Example 3 – Factory Outlet Leases

Outlet Holdco, a specialist landlord, owns a factory outlet mall located in Designer Village in the UK. Outlet Holdco wants to grant retail property leases for a number of plots located at the mall in Designer Village, and wants to ensure that the mall operates as a branded factory outlet scheme selling premium goods at discounted prices that are cheaper than high street or other out-of-town shopping centre prices.

Outlet Holdco enters into a suite of retail property leases pertaining to retail plots located at the mall with various retailers of designer brands, including Marlborough Shoes (a well-known premium shoes retailer), Imagine (a high-end accessories retailer), and Wow (an exclusive brand of ladies fashion). The leases have a duration of 10 years and contain the following restrictions:

- a restriction (entitled "exclusivity covenant") on Outlet Holdco in favour of the luxury brand retailer not to lease other retail plots at the Designer Village outlet mall to a competing retailer;
- a covenant by the retailer not to price its goods at the Designer Village outlet above a specified proportion of its average high street retail prices (eg 80%);
- a covenant by the retailer not to operate a retail store at a competing factory outlet scheme within a specific radius of the Designer Village outlet mall (eg 50 miles). (Note: although retailers are prevented from operating a retail store at competing factory outlet schemes within the specified radius, the retailer is free to operate a retail store at nearby shopping centres, retail parks, high streets, or other retail locations.)

Note for the OFT: the restrictions are all necessary in order to ensure that the scheme operates as a branded factory outlet scheme. Without the benefit of the restrictions on pricing and on occupation at competing schemes, the viability of the factory outlet scheme would be in doubt and the scheme may well never be built in the first place. The exclusivity covenant imposed on Outlet Holdco is necessary in order to attract suitable retail brands to the outlet scheme. Unlike a shopping centre there is no one anchor tenant / a limited number of anchor tenants necessary to achieve viability. It is the combination of branded goods operators that is essential for the success of the factory outlet scheme.

**THE CITY OF LONDON LAW SOCIETY
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