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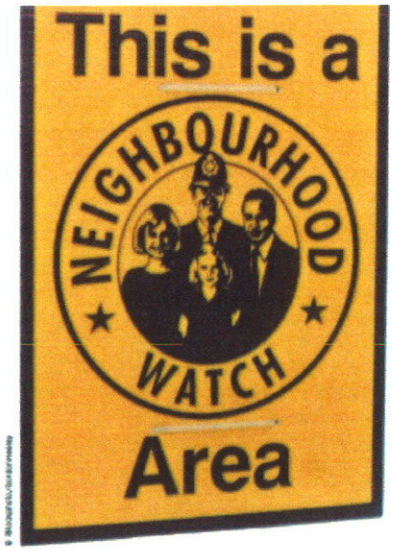

Vigilance matters

Restrictive covenants & freehold land: is now the time to wake up to the challenges to validity, asks Andrew Francis

IN BRIEF

- There is a continuing need to assess the validity of restrictive covenants which may fall foul of competition law rules.

It is over three and half years since the removal of the exemption of land agreements from Chapters I and II of the Competition Act 1998 (CA 1998) on 6 April 2011. Given the publicity surrounding the decision in December 2013 in *Martin Retail Group Ltd v Crawley Borough Council* [2014] L&TR 17, [2014] 1 EGLR 42 and the decision of Mr Justice Henderson in July 2014 in *Carewatch Care Services Ltd v Focus Caring Services Ltd & Ors* [2014] EWHC 2313 (Ch), [2014] All ER (D) 163 (Jul) property lawyers with an eye on competition issues are probably thinking that enough has been said on the subject. This article attempts to show by reference to an even more recent decision that the price of security is eternal vigilance and that even after the passage of time since April 2011, there is a continuing need to assess the validity of restrictive covenants which may fall foul of competition law rules.

Background

By way of background it is worth remembering the following key points:

- First, "land agreements" are widely defined by s 50(1)(b) and s 50(5) of CA 1998 and this includes covenants affecting freehold land and covenants in leases. Note that planning (s 106) agreements/obligations are excluded from CA 1998 under Sch 3, para 1. Agreements which fall within Ch 1 (s 2) can be oral, or in writing. Thus "anti-competitive terms" in transfers of freeholds grants of leases and options, covenants, and licences are all potentially caught by Ch 1.
- Second, this law applies to "undertakings" in respect of which EU law indicates that this area of law is not applicable to individuals who are not businesses, but will apply to public bodies as well as private ones.
- Third, and crucially, agreements will be caught and declared void if they contain a prohibited restriction. By s 2(2) of CA 1998 this means something in an agreement between undertakings which by object or effect appreciably restricts, distorts, or prevents competition in the UK and which does not fall within the exemption in Art 101(3) (s 9 of CA 1998). This may be defined as a "Chapter 1 Prohibition". The vital question to ask is does the existing agreement, or will the new agreement, by object, or effect, appreciably restrict, distort or prevent competition in the UK? This will be a question of evidence, usually based on the answers to well-established questions namely what is the relevant market, does the agreement (eg the trading covenant) in fact prevent restrict or distort competition in that market and is such prevention, restriction, or distortion of competition appreciable within that relevant market. As to the last question the answer is highly fact-specific. For example, there may be a relevant market by the application of the SSNIP test (see the Office of Fair Trading Guidance Note 1280a (adopted by the Competition and Markets Authority (CMA)) paras 3.4 to 3.16 (the Guidance Note) and the isochrones by which that market could be defined. The terms of the offending covenant may prevent, restrict, or distort competition within that relevant market. Whether that restriction etc is appreciable will depend on evidence as to what situation will prevail in the absence of the offending covenant; "the counter factual test". The question is "does the restriction contained in the offending covenant have a negative impact on actual, or potential competition compared with the position if there was no restriction?" (See the Guidance Note, para 4.4). Finally does the restriction satisfy the exemption criteria? (Note—this article does not consider issues arising under the Groceries Market Investigation (Controlled Land) Order 2010 published by the CMA).

Key question

The key question is the third one above; namely is there something in an agreement between undertakings which by object or effect appreciably restricts, distorts, or prevents competition in the UK and which does not fall within the exemption in Art 101(3) (s 9 of CA 1998)?

The importance of the third point above is demonstrated by the recent decision of the European Union Court of Justice (EUCJ) which in September 2014 gave judgment in the appeal from the General Court in the dispute between the Groupement des cartes bancaires and the European Commission (*Groupement des cartes bancaires v European Commission C-67/13 P* (*CB*)). The significance of that judgment for property lawyers in particular is explained below. In summary, when construing land agreements (eg trading covenants in a lease or on a freehold) the *CB* decision means that when carrying out that task, not all agreements potentially within Art 101(1) (or s 2 of CA 1998 which mirrors Art 101(1)) can be presumed to have the effect of restricting etc competition "by object" under Art 101(1). Save in cases where the agreement is by its very nature harmful to competition, eg a price-fixing agreement—not usually encountered in land agreements—the EUCJ stated that "by object" should be interpreted restrictively. Thus, save in plain cases there is an obligation on the party to it seeking to challenge the agreement (or the CMA or the Commission) to prove by an effects-based analysis that the agreement infringes Art 101(1) "by object". The alternative is to prove restriction "by effect". So there is no shortcut in the analysis. The practical effect when advising on land agreements potentially within Art 101(1) is set out below. In *CB* the EUCJ had to rule on the meaning of the words "by object or effect" in Art 101 TFEU. This states:

Article 101
(ex Article 81 TEC)
1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Interpretation

The court held that the words "by object" in Art 101(1) were to be interpreted restrictively. This means that unless the agreement under examination reveals a sufficient degree of harm on its face, so that there is no need to examine its effect (eg a price fixing cartel) the agreement must be examined to see whether its effect on competition is such as to prevent, restrict, or distort it to an appreciable extent; judgment para 58. This decision will force the Commission (and the CMA when concerned) to alter its policy of treating agreements as violating Art 101 by virtue of the fact that they contain restrictions which "by object" prevent etc. competition, without having to show their effect in such terms. (The record of the Commission's findings between January 2004 and July 2014 indicates that in non-cartel infringement decisions the majority (10/12) were based on a "by object" decision which saved the need for the Commission to spend time and resources in examining detailed evidence on the effect of the agreements under scrutiny). Thus, save as to "hardcore" agreements which "by object" will infringe Art 101(1), the task of the regulators and the courts will be to examine the effect of potentially void agreements within Art 101(1) more closely. That is not to say that even in the case of "by object" restrictions the economic and legal context in which the agreement was concluded by the parties can be ignored; quite the reverse, as the context is significant and market share will be one relevant factor for example even in "by object" cases. The question to be asked is does the object reveal "a sufficient degree of harm" to competition. Note that the subjective intention of the parties is not relevant and even if the agreement pursues other legitimate objectives it may still be held as having a restrictive object within Art 101(1).

Infringement

In the light of the *CB* decision the task set when examining whether agreements will potentially infringe Art 101(1) will require greater effort in obtaining the necessary economic data (for example) to judge their effect. The *CB* decision is an example of a case where, as the EUCJ recognised, there was a balance to be struck between the interests of the main and new members, where the latter could be required to make a financial contribution to the former whose efforts had developed the CB system. The *CB* decision is significant because it restores the distinction between the concept of restrictions "by object" or restrictions "by effect". Previous case law had led to a blurring of this distinction; eg *Allianz Hungária Biztosító Zrt and Others v Gazdasági Versenyhivatal C-32/11*. The Advocate General's Opinion to the court (27 March 2014) made clear the need to restore this distinction at para 52. That distinction is stated at para 58 of the judgment of the court, thus adopting the Advocate General's Opinion.

Lessons from this decision?

First, as it is unlikely that land transactions will involve a "hardcore" breach of Art 101(1) (but that might be possible for example in the sale of off-plan leases as between competing developers) the key question is whether the land agreement is "by object" anti-competitive based on the evidence of its effect (the treatment of "hardcore" infringing agreements as ones classified "by object" is reflected in the Commission's own Guidelines; 2004/C 101/08; para 21, and see the Guidance Note para 2.1 and footnote 13). This means that:

a. the mere existence of a covenant protecting trade does not of itself allow the covenant to be treated as infringing Art 101(1) (see the "sufficient degree of harm" point above);
b. that unless the agreement is so clear cut in its effect, the mere fact that the agreement is capable of restricting competition does not mean that it infringes Art 101(1) by object; and
c. the effect of the agreement must be considered. While this may require complex analysis (eg isochrones) no firm conclusion as to invalidity can be made until that is done.

Practical effects

First, the burden of proof is firmly on the challenging party, who must show at least a prima facie case for infringement of Art 101(1) whether "by object" or "by effect". Thus, in the case of a trading covenant for example, prohibiting the sale of certain goods in a retail park, the fact that such a covenant may restrict competition is not enough to bring it within Art 101(1). For example the position which would apply if the covenant was not in place must be examined; "the counter factual". The *CB* decision is good news for those with the benefit of these covenants.

Second, the importance of the exemption under Art 101(3) is now far greater given the need in most cases to examine the effect of the agreement. The burden is firmly on the party seeking to rely on any exemption, which is usually hard to prove. This was the point which seems not to have been properly explored by Crawley Borough Council in the claim against it by Martin Retail Group referred to at the start of this article. Thus, in the case of covenants protecting an "anchor tenant" in a shopping centre, while there may a strong case for establishing a breach of Art 101(1) "by effect" (if not "by object") the benefits that may be shown from those covenants and the economic effect of the anchor tenant within Art 101(3) must be demonstrated by the parties seeking to assert the validity of the agreement.

The *CB* case points the way to a thorough examination of the effect of land agreements from either side, with expert advice, before jumping to conclusions under Art 101. NLJ

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