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Briefing note April 2014

Leasehold use restriction found to breach UK competition law

A County Court has held that a user clause proposed for inclusion in a renewed lease of retail premises was in breach of the Competition Act 1998. Consequently, the landlord was unable to restrict the tenant from selling alcohol and groceries in competition with another of the landlord's tenants. While the judgment is likely to have implications for a relatively limited set of retail leases, those implications are potentially serious.

Rivalry and real estate

The judgment in *Martin Retail Group v. Crawley Borough Council* is the first time that a UK court has considered the compliance of a leasehold use restriction with the prohibition on anticompetitive agreements in the Competition Act 1998 (the "Competition Act").

Land agreements became subject to the Competition Act on 6 April 2011, following the repeal of the Land Agreements Exclusion Order. Despite detailed guidance that was issued in 2011 by the UK's competition authority (then the Office of Fair Trading, now the Competition and Markets Authority), competition law arguments have featured in only one previous judgment on a real estate dispute (*Humber Oil Terminals Trustee Ltd v Associated British Ports,* in which they were rejected).

Background

The claimant – Martin Retail Group ("MRG") – operated a newsagents in a parade of 11 shops in a housing estate in Crawley, East Sussex. It leased the premises from Crawley Borough Council ("Crawley"), as did all the other shops in the parade. When its lease came up for renewal under the Landlord and Tenant Act 1954, Crawley rejected MRG's application for a wider user clause that would have permitted MRG to start selling alcohol, groceries and convenience goods, in direct competition with the adjacent retail unit, Premier Furnace Green Supermarket – the only grocery retailer in the parade and, indeed, on the entire housing estate.

MRG launched legal proceedings, arguing that a narrow user clause preventing it from selling alcohol and groceries in competition with its neighbour would contravene the Competition Act and would therefore be unenforceable.

Key issues

- When are user restrictions in leases in breach of UK competition law?
- What are the consequences of such a breach for landlords?

The judgment

The Court held that the narrow user clause proposed by Crawley and contained in MRG's previous lease did breach competition law. In particular, it found that:

- the clause did have the effect of restricting competition in the relevant market; and

- there was insufficient evidence that it satisfied the conditions for exemption from the Competition Act.

A restriction of competition

In *MRG v Crawley,* it appears to have been accepted that the competitive effects of the agreement should be assessed by reference to a market for convenience goods (such as a pint of milk or a packet of washing powder) sold within a relatively short walking distance from the parade. The nearest alternative grocery store was a 15 minute walk from MRG's parade. Drawing the geographic scope of the market so narrowly would mean that Crawley's user restriction eliminated competition by conferring an effective monopoly on the existing convenience store.

Proving that an agreement has, or is likely to have, anticompetitive effects is usually a difficult burden to discharge, requiring detailed economic evidence of the degree of substitutability of different products and the geographic area within which customers are prepared to shop around. However, in *MRG v Crawley* the defendants conceded this point ("rightly" in the view of the Court) – presumably to avoid incurring liability for costs that the claimants would have incurred in proving it.

Competition law: the basics

Chapter I of the Competition Act prohibits agreements and concerted practices that have the object or effect the prevention restriction or distortion of competition in the UK.

Agreements that have anticompetitive objects or effects are nonetheless exempted from the Chapter I prohibition if they satisfy certain criteria. These require, broadly, that the restriction in question is indispensable for the achievement of benefits (e.g. cost savings, increased choice, greater innovation), that will be passed on to customers to a sufficient degree that they outweigh the harm resulting from the restriction of competition, and do not eliminate competition in a relevant market.

No exemption

While certain agreements are exempt from the Competition Act prohibitions (see box), It is for the person that has entered into an anticompetitive agreement to prove that the criteria for exemption are met. This typically requires copious economic evidence and analysis and, even then, is rarely successful.

In *MRG v. Crawley*, relatively little factual evidence was presented. Instead, MRG relied principally on the opinion of an asset surveyor on the likely effects of expanding the user restriction – which the Court considered to be "an expression of subjective opinion […] rather than evidence of primary fact". While written evidence of the views of local residents and traders was also submitted, this was not considered reliable by the Court, primarily because none of these written views was supported by oral evidence under cross-examination.

Consequently, the Court found that Crawley had not proved that the criteria for exemption were met. Even its most fundamental assertion – that the existence of a number of different retailers was better for consumers than a supermarket or a number of similar retailers – was found to be unproven, for lack of factual evidence.

Comment

The Court extensively cited the Office of Fair Trading guidelines on competition law and land agreements. However, those guidelines draw a distinction between user restrictions and exclusivity clauses: the latter imposes a reciprocal obligation on the landlord not to let premises to competitors; the former does not. The guidance states that user restrictions aimed at achieving the landlord's desired retail mix are unlikely to restrict competition, unless the landlord also competes in the same downstream retail market as the tenant or prospective tenant. In *MRG v. Crawley,* Crawley's objection to granting a wider user clause was a unilateral policy decision. It was not the result of an exclusivity agreement with the existing convenience store on the parade, and Crawley did not itself have any competing activities in the downstream retail market.

By paying no heed to the distinction between user restrictions and exclusivity clauses, the judgment implies that in certain circumstances landlords must be able to justify their desired retail mix by reference to proven consumer benefits (and not just higher rents).

Fortunately, those circumstances are likely to be relatively limited - for example, cases where the tenant is active (or would like to become active) in a market in which consumers are prepared to travel only a small distance for their purchases and in which no other suitable retail space is, or will be, available to let from an alternative landlord.

However, where that is the case, landlords may find tenants citing this judgment as a reason why their user clause should be relaxed. They may do so at any time – the risk is not limited to lease extension proceedings. Such challenges, if successful, may result in misalignment of economic risk between landlord and tenant and potential erosion of the capital value of the landlord's reversion, both in the leased property, and in other properties in the landlord's development.

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