

Restrictive covenant by supermarket

Q&A Impact on market may determine whether retailer contravenes Competition Act

IS RESTRICTIVE COVENANT ANTI-COMPETITIVE?

QUESTION

An independent grocery retailer in the centre of a town decides to halve the floorspace of its store and sell the excess land in order to operate more efficiently. It is keen to ensure that it protects its position as the only supermarket in the centre of the town, and so includes a restrictive covenant preventing the use of the land as a supermarket. There are other supermarkets in the area, but they are further out and require travel by car. The population of the centre of the town predominantly travel by foot or bicycle. Is this restriction anti-competitive?

ANSWER

The restriction will raise a barrier to competitors entering the grocery retail market within the town. However, it is unlikely the resulting impact on competition will be appreciable, and therefore unlawful, unless the supermarket enjoys a substantial share of that market or where there is a shortage of other suitable land available for use as a grocery retailer in the town.

EXPLANATION

The Groceries Market Investigation (Controlled Land) Order 2010

After an investigation by the Competition Commission into anti-competitive behaviour in the grocery retail sector, the Groceries Market Investigation (Controlled Land) Order 2010 came into effect on 30 April 2010. It prohibits large grocery retailers from entering into restrictive covenants, such as the one proposed, which restrict grocery retailing. However, the order applies only to the major grocery retailers, not to independents.

Competition Act 1998

The Commission also decided to remove the blanket exemption, which land agreements previously enjoyed, from the prohibitions against anti-competitive behaviour contained in the Competition Act 1998. As a result, from 6 April 2011 all land agreements became subject to the prohibitions contained in Chapters I and II of that Act.

The proposed restriction potentially falls within the Chapter I prohibition. This forbids agreements between undertakings (any entity engaged in economic activity) that may affect trade in the UK and have as their object or effect the prevention, restriction or distortion of competition, unless those agreements are exempt.

The Office of Fair Trading has published guidance on the application of the Act (OFT 1280a March 2011). This is essential reading in any case where a land agreement contains a restriction on the use of land that may restrict competition by raising barriers to entry or expansion in, or

access to, a particular market in which a party is carrying out economic activity.

A restriction will not fall within the scope of the prohibition unless its impact on competition in the relevant market to which the agreement relates is appreciable.

Relevant market

In this case, the relevant consumer market (the downstream market) is the retail market for groceries. This is not necessarily limited to supermarkets, but may well include more specialist retailers, such as butchers, bakers or greengrocers, where these are competing with the supermarket for the same customer base.

The geographic scope of that market may be restricted on these facts to the town centre, within which the supermarket competes with other grocers for the custom of those travelling by foot or bicycle (although in the age of widespread car-ownership, the geographic scope would more usually be defined by reference to a drive-time catchment area).

Aside from this downstream market, it is also necessary to consider the upstream market in which the supermarket operates – in other words the market for land that is suitable and available for use as a grocery retailer within the relevant area.

Appreciable impact

The proposed restriction will raise barriers to entry in the retail grocery market in the town, but will its impact on competition be appreciable? If the supermarket's share in the downstream market (the town's grocery retail market) does not exceed 15% and it also has a share of no more than 15% in the upstream market (ownership or

control of suitable land within the town), the OFT will not regard the impact of any restriction on competition as appreciable. If this threshold is exceeded, it is a question of fact whether the impact is appreciable.

Regard must be given to the strength and number of the supermarket's existing competitors in the town's retail grocery market, but also to the extent of suitable land available in the town to potential competitors wishing to enter the market. Assuming there are sufficient retail premises within the town centre suitable and available for use as grocers other than land owned or controlled by the supermarket itself, it is unlikely that the restriction does have any appreciable impact on competition.

Exempt land agreement

Finally, if the restriction would otherwise contravene the Chapter I prohibition, it is necessary to consider whether the land agreement may be exempt. To qualify for exemption, the agreement must:

- contribute to improving production or distribution, or to promoting technical or economic progress;
- allow consumers a fair share of the resulting benefits;
- not impose restrictions beyond those indispensable to achieving those objectives; and
- not afford the parties the possibility of eliminating competition in a substantial part of the products in question.

It is unlikely that the agreement satisfies these criteria. Although the sale of the land might provide efficiency gains in enabling the supermarket to continue in operation where it might otherwise have to close, and consumers may share in the benefits of this, it would be difficult to show the restriction was indispensable to achieving those objectives, all the more so where it was unlimited in time.

The OFT expects only a minority of land agreements to be caught by the Chapter I prohibition. But land-owners need to adopt a new mindset, carefully considering the competition law implications of user restrictions in agreements to which they are parties. There are substantial penalties for breach of the prohibition.

Edward Francis is a barrister at Enterprise Chambers and Robert Highmore is partner – joint head of property litigation group at Charles Russell LLP

Questions on any topic can be e-mailed to egq@a@enterprisechambers.com and egq@a@charlesrussell.co.uk