

commercial property

Competition time

Now that the Office of Fair Trading (OFT) has published its draft guidance, Bill Chandler considers how competition law will be applied to property transactions when the repeal of the Land Agreements Exclusion Order takes effect in April 2011.

From 6 April 2011, all property transactions will be subject to the full rigour of competition law for the first time. Any agreements or restrictions contained in property documents will be affected, but perhaps the most obvious candidates are restrictive covenants which limit the development or use of property, together with restrictions in leases such as tenants' covenants on the use of the property and exclusivity covenants given by landlords.

The Exclusion Order

Up to now, the Land Agreements Exclusion Order ('Exclusion Order') has exempted land agreements from the 'Chapter 1 prohibition' set out in section 2 of the Competition Act 1998, which outlaws anti-competitive agreements and practices.

However, the real rationale behind the Exclusion Order was never to protect the property sector from competition law, but to avoid a huge number of precautionary notifications to the OFT for clearance in the days before competition law compliance became self-assessment. But although the OFT always possessed the power to withdraw the protection of the Exclusion Order, the existence of the Exclusion Order has, in practice, meant that competition law has rarely been given full consideration in property transactions.

Repeal

The repeal of the Exclusion Order was recommended by the Competition Commission in relation to the grocery sector, but the previous Labour Government promised in January 2010 to repeal the Exclusion Order across

the board. The seven largest grocery retailers have, however, been subjected to greater restrictions through The Groceries Market Investigation (Controlled Land) Order 2010 (see inset box on page 3).

The Labour Government failed in its attempts to repeal the Exclusion Order before the general election, but the repeal was completed by the coalition Government in June 2010 and takes effect on 6 April 2011.

Penalties

The Chapter 1 prohibition will not just apply to agreements entered into from April 2011, but will also apply to agreements which are already in place. The delayed commencement date is designed to give businesses time to adjust and to review existing arrangements.

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Welcome

Welcome to the winter edition of Hill Dickinson's commercial property newsletter, which we hope you will find of interest.

This is in fact the 20th edition of this newsletter, and it is remarkable how the circulation has grown steadily over the years, with more than 2,000 subscribers to each edition.

It is particularly pleasing to receive feedback on the newsletter, so thank you for your comments and suggestions. Please continue telling us what you think, together with any ideas for improvement or possible topics you would like to see covered in these pages.

If you have any queries relating to the issues raised in this newsletter, please contact the relevant author, or your usual Hill Dickinson contact. If you have any comments on the newsletter in general, please contact our editor, Bill Chandler at bill.chandler@hilldickinson.com

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Any agreement which breaches the Chapter 1 prohibition will be void and unenforceable, but the parties could also face significant fines - up to 10% of turnover - as well as facing possible damages claims and the inevitable adverse publicity.

Self assessment

So, how does an organisation judge whether any particular agreement or restriction offends competition law?

The OFT has now published its draft guidance on how it intends to apply competition law to land agreements from April 2011. Final guidance will be published in spring 2011 and whilst some sections of the guidance are likely to be clarified or expanded, it seems unlikely that the basic principles will change.

The first thing to note is that the repeal of the Exclusion Order does not appear to be a charter to attack every existing restrictive covenant, exclusivity agreement and other restrictions. The Government and the OFT view the repeal very much as a tidying-up exercise rather than a substantive change to the law and it is clear from the draft guidance that the vast majority of agreements and restrictions will remain valid.

The guidance contains a number of useful worked examples of commonly-encountered scenarios, together with a flowchart of the steps required to self-assess a potentially anti-competitive agreement or restriction:

- Is there a restriction over land? Any restrictive covenant and many lease covenants will pass this first hurdle.
- Is it between undertakings? So, for example, restrictions on residential properties will not generally be caught.
- Do the parties have sufficient market share? This is a combined market share of 10% where the parties are competitors or either party having a 15% share where they are not.
- Does the restriction affect competition? Blighting one site can be valid depending on the availability of suitable alternative sites, the degree of existing competition, and whether any competitors actually want to enter the market.
- Does the exemption apply? A restriction over land between undertakings which affects competition can still be justified if it benefits consumers by improving production or distribution. The guidance cites by way of example an exclusivity agreement offered by a landlord to secure an anchor tenant without whom a new development would not be viable.



Difficulties

Because the test concentrates on the effect of the restriction rather than its wording, it will be quite impossible to produce 'competition law compliant clauses'; an identically-worded restriction may be valid in one scenario but void in another.

It is also important to bear in mind that the validity of a restriction may change at a later date; a restriction which was perfectly valid when entered into may subsequently become void due to a change in the factual matrix within the relevant market.

One of the biggest difficulties will undoubtedly be identifying the extent of the 'relevant market' for the purposes of assessing the market share test and the effect on competition. Relevant factors will include how far consumers would travel for the product or service and the likely effect of a small but significant price rise.

It will frequently be difficult in practice to decide whether the restriction offers sufficient benefit to the consumer - and goes no further than is necessary to achieve that benefit - in order for the exemption to apply.

Conclusion

Despite the substantial grey areas, and the impression given by the guidance that only the worst excesses will actually be pursued, we must all become more circumspect in assessing the competition law implications of property transactions.

Even if the Government is correct that nothing really changes so far as the law is concerned, the repeal of the Exclusion Order has certainly increased awareness that the property sector is not exempt from competition law and that anti-competitive restrictions contained in property documents may be challengeable.

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Tougher rules for supermarkets



The repeal of the Exclusion Order was prompted by the Competition Commission's lengthy investigation into the groceries sector, but the large supermarket operators have already been subjected to even more onerous restrictions on what they can do.

Since 30 April 2010, the seven largest supermarket chains (Tesco, Sainsbury, Asda, Morrisons, Co-op, Marks & Spencer and Waitrose) have been subject to The Groceries Market Investigation (Controlled Land) Order 2010 ('the Order').

The schedules to the Order list specific restrictive covenants and exclusivity agreements identified by the Competition Commission's investigation as being anti-competitive. The Order requires the supermarket chains to use their best endeavours to release the offending restrictive covenants within six months and prohibit them from enforcing the offending exclusivity agreements after five years.

The Order also includes a 'white list' of restrictive covenants and exclusivity agreements identified during the investigation which do not affect competition.

But not every restrictive covenant in favour of one of the relevant supermarket chains, nor every exclusivity agreement with them, is specifically listed in the Order. In those circumstances the owner of land burdened by such a restrictive covenant, or a person who is party to such an exclusivity agreement (or who wants to develop or operate a grocery store on a site affected by such an exclusivity agreement), can ask the OFT to apply the test set out in Schedule 4 to the Order, which looks at competition within a '10-minute drive-time isochrone' of the site burdened by the restrictive covenant or exclusivity agreement.

Going forward, the Order prohibits the supermarket chains from entering into new restrictive covenants which restrict grocery retailing. Furthermore, they may not enter into any new exclusivity agreement which restricts grocery retailing and which lasts for more than five years from the date on which their store began trading.



Get connected

Electricity is an essential service for any property but, as Tony Houghton explains, failure to appreciate the legal and practical implications of the electricity supply chain can cause major problems for landowners and developers.

It is difficult to imagine a world – or a property – without electricity, but how many of us appreciate how electricity is delivered to our property and the legal framework which underpins it?

Electricity supply chain

Whether generated by traditional power stations, nuclear power or more modern, greener methods such as wind power, electricity is transported around the country through a network of high voltage overhead power lines and pylons, before transformers convert it into lower voltages for local distribution through a network of overhead lines, underground cables and substations to the end user.

Each length of cable should be protected by an easement or wayleave in favour of an electricity company and each substation should be owned or leased by an electricity company.

The main legislation affecting the electricity industry is the Electricity Act 1989, which deals with the licensing of companies engaged in the generation, transmission, distribution and supply of electricity. Section 16 requires an electricity distribution company to connect any premises to the network, subject to certain exceptions, and

section 16A sets out the procedure to be followed. The owner or occupier of a property requiring connection starts the ball rolling by serving notice on the electricity company.

Easement

The electricity company would be trespassing if it attempted to lay and maintain cables on private land without a legal right. It also requires certainty as to what it can do on the land, and to know that the landowner will not do anything which may affect the cables. So, if the electricity company needs to lay cables under your land to connect the property, it will usually require a formal deed of easement to be granted.

An easement is the legal right to do something over someone else's land; rights of way are the most commonly encountered. The right to lay and maintain electricity cables and to pass electricity through them is also an easement, and many cables across the country are the subject of express easements. Electricity companies might accept simple wayleave agreements from landowners where the electricity company is expanding its distribution network, but will almost certainly insist on a deed of easement being entered

into where a new cable is being laid to supply a property following a section 16 request; mortgagees and tenants may also need to be involved.

A typical deed of easement for electricity cables will not just allow the electricity company to lay and retain cables under the land and pass electricity through them. It will also allow the cables to be supplemented and replaced, and will usually grant wide powers to enter onto the land, to break open the land, and carry out necessary excavations. The deed will also contain covenants by the landowner not to alter ground levels, build over the easement strip, or plant trees or shrubs.

Once completed, the deed will be registered at the Land Registry and will bind future owners of the land. If the landowner fears that the permanent nature of the rights might affect future development of the land, the electricity company may agree to a 'lift and shift' clause, allowing the landowner to require the cables to be relocated at a future date, subject to a satisfactory alternative route being made available and all the electricity company's costs of the relocation being met by the landowner.

Substation

Depending on the energy requirements of the new development, a substation may be required. The electricity company will require an interest in the substation site, either the transfer of the freehold or the grant of a lease. In either case, the landowner will receive no real consideration, and the transfer or lease will also contain similar cable easements and covenants over the remainder of the property, as would be found in a deed of easement.

The recent case of [EDF Energy Networks \(EPN\) Plc -v- BOH Ltd and others](#) confirms that a substation lease is a 'business tenancy', so that the lease (and the ancillary cable easements within it) are protected by the Landlord and Tenant Act 1954.

Third parties

Difficulties can arise where the cable needs to cross neighbouring land belonging to a third party, since the electricity company will require a similar deed of easement from the neighbour. Whilst an easement will usually be forthcoming from a landowner or developer who requires an electricity supply to its own property, neighbouring landowners will rarely be as keen to allow cables across their land and are normally under no obligation to co-operate.

Even if the applicant landowner enjoys a cable easement over the neighbouring land, there are various reasons why the electricity company will not be content to rely on it:

- the easement granted may not be as wide as the electricity company's standard deed of easement, particularly in terms of rights of access to the property and what the electricity company may do in terms of replacing and supplementing the cables and/or equipment;
- the easement is unlikely to be accompanied by the covenants found in the electricity company's standard cable easement prohibiting alterations to ground levels and planting or building on the easement strip;

- even if the terms of the easement and related covenants are adequate, the electricity company requires a direct relationship with the neighbouring landowner rather than having to rely on the enforcement of rights by a third party –the electricity company does not want to become embroiled in a neighbour dispute.

If it proves impossible to obtain the necessary rights by negotiation, Schedule 4 to the Electricity Act 1989 allows the electricity company to apply to the Secretary of State for a statutory wayleave over the neighbouring property, although the electricity company must pay compensation to the neighbouring landowner.

Why this matters

No prospective buyer or tenant will be interested in a property without electricity. Developers must consider at the very outset how and where electricity will be supplied. If a developer gets it wrong and then encounters problems obtaining an electricity supply to a property, this can be a costly and time consuming mistake, as illustrated by the recent case of [William Old International Limited -v- Arya](#).

In that case, the seller of a development site granted the buyer an express easement in the transfer to enter the seller's retained land to lay cables and receive electricity through such cables. The location of the cable route was agreed and the trenches were dug and conduits laid, but the electricity company EDF refused to connect the new property unless express easements were granted to it by both the buyer and the seller; it was not content to rely on the easement granted to the buyer in the transfer. The buyer took the seller to court, but the court ruled that the grant of the easement did not imply any obligation on the seller to enter into a deed of easement with EDF.

If the Schedule 4 statutory wayleave procedure has to be invoked, the electricity company will inevitably seek to recover any compensation paid to the neighbouring landowner from the applicant developer. This will eat into

the developer's profit, but could easily be avoided if the developer and its professional advisers understand the electricity supply chain, and anticipate the likely requirements of the electricity company.

The extensive and long term nature of the rights required by the electricity company may also impact on development and redevelopment proposals and cannot be overlooked. Existing cables within the site may need to be removed or relocated for the present scheme, and new cables should be routed to maximise the potential for future development of the property.

It is not just landowners and developers who are at risk: buyers, tenants and funders who fail to spot issues may commit themselves to properties which electricity companies refuse to connect.

A final word of warning

This article only concerns electricity, but developers should also conduct a similar analysis in respect of any other necessary services to the development.

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An earlier version of this article appeared in the Estates Gazette on 28 August 2010



A new era for shared ownership

Philippa Morris and Bill Chandler consider the new model leases for shared ownership properties.



It is over 30 years since the then Housing Minister, John Stanley, introduced the first national shared ownership programme in 1979, and shared ownership continues to fulfil a vital role in the housing market.

The joint guidance issued by the Homes & Communities Agency (HCA), the Council of Mortgage Lenders (CML) and the National Housing Federation (NHF) in April 2010 estimated that 115,000 properties are the subject of shared ownership, with 18,000 properties being purchased on shared ownership terms under the 'New Build HomeBuy' banner each year. The average household income for shared ownership is £27,000 per annum, which in most areas would not be sufficient to allow a traditional house purchase.

Shared ownership operates on the basis that the buyer purchases a share of the property, usually between 25% and 75%, and pays rent on the remaining share. Over time the buyer can purchase additional shares through the 'staircasing' procedure, possibly up to 100% of the property.

Model leases

For a number of years, model leases were produced by the Housing Corporation, which was subsumed into the new HCA on 1 December 2008. It has never been compulsory to use the model leases, although, if the model forms are not adopted, then the six 'fundamental clauses', which are designed to facilitate lending to the

sector and to preserve the supply and characteristics of shared ownership, must still be utilised. These cover:

- Alienation
- Mortgagee protection
- Staircasing
- Rent review
- Service charge
- Right of pre-emption

Following consultation with Government (DCLG), the CML, the NHF and mortgage providers in late 2009, the HCA developed a new suite of six model leases, which can be found online as part of the HCA's capital funding guide.

The six leases are complemented by key information guides for tenants summarising the main terms and which are also replicated in appendix 3 to each of the new model leases. The new key information appendix is a new 'fundamental clause', in addition to the six clauses listed above.

The new leases apply to all transactions from 6 April 2010, unless a contract already in place requires the use of the previous form. This means that a single development could end up with a mix of old and new leases if some properties were sold (or at least exchanged contracts) before 6 April 2010 but some are only sold after that date.

Mortgagee protection

The most significant changes are to

the mortgagee protection clause. Mortgagees have always enjoyed greater protection in shared ownership scenarios than on conventional lettings, to encourage lending to the sector and ideally without buyers having to pay for mortgage indemnity insurance.

The mortgagee protection clause has been reworked, and now works on the basis of the 'mortgagee protection claim', which is the mortgagee's loss (which is in itself very widely defined) capped at the aggregate of:

- loans secured by a first legal charge;
- 18 months' interest on such loans;
- any rents and/or service charges which the mortgagee has paid to protect its security; and
- any fees and costs incurred by the mortgagee in enforcing its security (but capped at 3% of the market value of the leasehold interest).

The mortgagee protection claim is deducted from the premium payable on final staircasing, thereby allowing the mortgagee to sell the full interest in the property. No valuation is required on the final staircasing by the mortgagee, who can rely on the agreed sale price as being the market value of the property, provided the sale is an arm's length sale at the best price reasonably obtainable at the time of sale.

The mortgagee protection claim will only apply if the landlord has approved the lender and the terms of the mortgage advance prior to making

the mortgage advance, and the lender exercises the right to final staircasing prior to, or at the same time as, selling under the power of sale. Buyers' solicitors will therefore be in breach of the CML requirements if they do not obtain that approval.

In addition, the lender requirements in the CML handbook now typically require that the landlord has undertaken to notify the lender before taking steps to forfeit the lease.

The HCA considers that the new clause gives greater certainty following a number of disputes over 'repossession staircasing'. That may be true, but the resulting certainty is that the landlord is assuming the risk and effectively indemnifying the mortgagee from their own or (where applicable) grant resources.

Pre-emption

The pre-emption clause applies for 21 years from final staircasing, and requires the buyer to offer the property back to the landlord prior to any subsequent sale, thereby giving the landlord the opportunity to preserve its supply of affordable housing.

On houses, the right is contained in the transfer to the buyer following final staircasing rather than in the shared ownership lease; indeed, it is not possible to include such a right in the house lease since the lease would then no longer satisfy the conditions in Schedule 4A of the Leasehold Reform Act 1967 which exclude qualifying shared ownership leases from the enfranchisement rules which would otherwise allow the buyer to purchase the freehold and effectively bypass the staircasing provisions.

But where flats are concerned there will be no transfer following final staircasing (although the more restrictive lease provisions will fall away) and so the right is contained in the lease. Previously the right only took effect on final staircasing, but this has now been amended so that the right of pre-emption applies throughout the term of the lease.

Alienation

The change to the pre-emption clause protects the landlord from assignments of flat leases to unauthorised assignees and thereby allows the removal of 'back-to-back' staircasing (the landlord's right to require an 'unauthorised' assignee to conduct final staircasing following assignment) from the alienation clause in the flat lease, but not the house lease.

Rent review

The new rent review clause retains the link to RPI (with 0.5% uplift) but, following instances of rents falling during the recession, is now expressed to be upwards only. The clause has also been made clearer by including the calculation as a formula rather than explaining it verbally and by including, at appendix 2, a proposed notice from landlord to tenant setting out the calculation, and which includes a worked example.

The clause has also been extended to deal with any possible abolition or rebasing of the Retail Prices Index, and to include provisions to deal with any delay in agreeing the new rent, which includes an option for base rate interest to be payable by the tenant on any balancing payment due once the new rent is agreed.

Making good

The tenant is no longer given the ability to make good damage which it has caused to common parts. In practice, few landlords would wish to have the tenant interfering with common parts and most would instead prefer to rely on the tenant's indemnity to pay the landlord's costs of making good.

Frustration

The leases now clarify that if the lease is frustrated following damage then the landlord must pay over the tenant's share of the insurance proceeds and also the mortgagee protection claim.

Other changes

The remaining changes are mostly in terms of format and language rather than content.

Headings and sub-headings are now used and all definitions are now grouped together in a schedule (Schedule 6 in the house lease and Schedule 9 in the flat lease). The Land Registry restriction has also been updated to reflect the current standard form wording.

The HCA accepts that there remains scope to improve the service charge provisions, which have been 'translated' only with no intention of making any substantive change, which suggests that the service charge clauses may be first in line for consideration when the leases are next reviewed.

Conclusion

The new leases are generally to be welcomed. Since April, we now have a more comprehensive suite of documents which are far more modern and user-friendly in their format, language and content than the leases they replace.

Social landlords may feel that the new leases impose greater risks on them, particularly through the new mortgagee protection clause. This will increase the importance of the initial tenant selection process and mortgage approval process to minimise that risk.

Final word

April 2010 also saw the publication by HCA, CML and NHF of a new edition of their 'Shared ownership: Joint guidance for England', together with the HCA's 'Procedures for varying shared ownership leases - background information' which replaces TSA circular 03/08 and confirms that consent to vary the fundamental clauses will only be granted to correct errors or else only in 'exceptional circumstances'.

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Update



CRC - major new developments

We have reported previously on the CRC (Carbon Reduction Commitment) Energy Efficiency Scheme, which commenced in April 2010. However, two major recent developments fundamentally change the whole nature of the scheme.

1. Comprehensive Spending Review

The Treasury's Comprehensive Spending Review announced on 20 October 2010 advised that the money raised from the sale of carbon allowances to participants will not now be 'recycled' back to participants. The scheme was originally to be 'revenue neutral', with all money raised being returned to participants on a sliding scale depending on where they finished in the annual energy efficiency league table. The temptation of holding £1 billion of participants' money each year was obviously too great in the current economic climate.

This major change must affect participants' approach to CRC, which is now purely a cost with no possibility of recouping the money spent on allowances. In particular, CRC participant landlords should revisit their strategy on recharging CRC costs to their tenants; 'do nothing' is no longer a viable option.

The Comprehensive Spending Review also advised that the first sale of allowances (for 2011/12) will no longer take place in advance in April 2011, but instead at the end of the year, in April 2012. It remains unclear whether, going forward, the sale of allowances will always now be at the end of the year.

Buying allowances in arrears would certainly simplify matters, removing many of the tactical considerations and potential traps; whereas reverting to buying allowances in advance would require a double sale one year to get matters back on track, with the consequent cashflow effect on participants.

2. DECC consultation

The Department for Energy and Climate Change's consultation published on 17 November proposes that the introductory phase (during which an unlimited number of allowances will be available at a fixed price) should be extended by a year until April 2014. This basically gives the new Government, which supports the principle of CRC but has declared its intention to simplify the current scheme, a breathing space to decide what to do with CRC. Consequently, 2012-13 would become the qualification year to establish participation in the second phase rather than the current financial year.

Whilst the new Government's intention to simplify CRC is welcomed, and the decision not to rush into the 'cap and trade' second phase is a sensible move, affected organisations need to make commercial decisions now in preparation for CRC. The sooner we have certainty on the future shape of the CRC scheme, the better.

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