

Property Update

October 2009

Supermarkets shopped by the regulator...

In early August 2009, the Australian Competition & Consumer Commission (ACCC) renewed its interest in provisions contained in major supermarket leases which restrict the entry of a second supermarket into shopping centres. The ACCC also set landlords in its sights and threatened both the major supermarkets and landlords with possible prosecution.

On 18 September 2009, the ACCC announced that it had reached an arrangement with Woolworths and Coles to remove these restrictive provisions from their leases.

Background

In July 2008, the Report of the ACCC Inquiry Into the Competitiveness of Retail Prices for Standard Groceries identified a number of barriers to the entry of smaller independent supermarket operators into shopping centres and other prime locations.

One of the key findings of the Report which was relevant to leases was that Coles and Woolworths include clauses in their leases which prevent, limit the ability of, or act as a disincentive to, shopping centre owners to lease

other premises within a shopping centre to competing supermarkets.

The ACCC subpoenaed copies of Coles' and Woolworths' leases across Australia and also questioned shopping centre and supermarket executives. The ACCC found that there are over 700 Woolworths and Coles leases which include clauses which:

- restrict the introduction of a second or third supermarket over a certain size to the centre;
- provide for a significant rent reduction if a second or third supermarket over a certain size is introduced to the centre within a specified period (with the rent reduction being so great that it would be unviable for the landlord to introduce another supermarket);
- give the major supermarkets first or last right of refusal over access to additional space in centres; or
- provide that the premises cannot be re-let to another supermarket operator once they have been vacated.

The average duration of these restrictive provisions was ten years, although they ranged from 5 years to the entire lease term.

Woolworths' response to the ACCC's findings was that it chooses supermarket premises within



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a shopping centre on the basis of the sales potential within the centre. Leases and base rents are negotiated with landlords based on this assessment of potential sales. Restrictive clauses within these leases are intended to be a mechanism whereby the environment promised by the landlord and upon which the rent is based, is protected.

Substantial lessening of competition

The Trade Practices Act prohibits the acquisition of assets if that acquisition would have the purpose or effect of substantially lessening competition in a market. The matters that the ACCC must take into account in determining whether or not this prohibition has been contravened include:

- the height of barriers to entry to the market;
- the degree of countervailing power in the market;
- the extent to which substitutes are available in the market or are likely to be available in the market; and
- the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor.

Landlords' preference to grant leases to the major supermarkets and the inclusion of clauses in those leases which prevent, limit the ability of, or act as a disincentive to lease other premises within a shopping centre to competing supermarkets, may fall foul of this prohibition.

The ACCC's position

In the Grocery Inquiry, the ACCC accepted that in certain circumstances, most notably in the case of new developments, a guaranteed period of

exclusivity may attract a major supermarket as an anchor tenant and may have a beneficial effect.

Following the publication of the Grocery Inquiry, the ACCC stated that, provided that there is no evidence of an anti-competitive purpose and good evidence that there would be no competitive entry even if the restrictive clauses were removed from the lease, it may not have significant concerns, especially if these clauses have the effect of attracting an anchor tenant to a centre which may not be built were it not for a pre-commitment by that tenant. Rather than lessening competition, in these circumstances such clauses may result in greater competition by enabling the developers to build larger shopping centres which can accommodate a higher number of specialty stores.

However, in early August, the ACCC refocused its attention on its concern that, these developments aside, the major supermarkets' principal motivation for including restrictive clauses in leases is to lessen competition and entry into the market by other supermarket operators.

At that time, the ACCC had not ruled out taking legal action for possible breaches of the Trade Practices Act and appeared to be increasing its focus on landlords:

'It depends on the reaction of Coles and Woolies and landlords – the landlords are as complicit in this – we need to be addressing both of them. Our preference would be to have this matter resolved quickly, very expediently. But if we've got anti-competitive arrangements that can't be dealt with in a satisfactory manner and that

are preventing competition thriving in the supermarket sector, then our final resort will be to go to court and prosecute.'

Removal of restrictive provisions

Following discussions with the ACCC, Woolworths and Coles have entered into a voluntary, court-enforceable undertaking, to remove all restrictive provisions in supermarket leases which prevent, or operate as a disincentive to, the opening of further supermarkets in shopping centres.

Woolworths and Coles have voluntarily agreed to avoid restrictive provisions in new leases and will not enforce restrictive provisions five years after the commencement of trade under existing leases.

The ACCC's chairman, Graeme Samuel, has indicated that the ACCC will take the same approach to other supermarkets which have similar provisions in their leases:

'There are a number of other supermarket operators not covered by these agreements, and the ACCC will now enter into discussions with a view to them adopting the same approach in their leases. We will also be talking to shopping centre landlords to ensure a smooth transition.'

However, this statement may place some pressure on the smaller supermarket chains, which also use these restrictive provisions to protect themselves against the entry of a major supermarket into shopping centres currently occupied by those smaller chains. It remains to be seen what the reaction of these smaller chains will be to the ACCC's statement.

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