Department for Business Innovation & Skills

PUB COMPANIES AND TENANTS

Government Response to the Consultation

JUNE 2014

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Foreword from the Secretary of State

The Great British Pub has long been a part of our history. Some brewers have been operating tied pubs since the early Eighteenth Century, and this Government is keen to see the industry build on its rich heritage and ensure we maintain the pub's place at the heart of our communities. Yet the industry has been overshadowed in the past decade by very real concerns about the unfairness which can arise in the relationship between pub owning companies and their tied tenants. On the weight of the evidence from four BIS Select Committees, our own call for evidence in 2012 and the ongoing cases of tenants facing hardship, I determined that it was time for Government to step in.

The Consultation

Our consultation on Pub Companies and Tenants sought your views on establishing a Statutory Code and an Adjudicator to govern the relationship between pub owning companies and their tenants. The response to the consultation was huge. We received 1,120 written responses and more than 7,000 responses to the online survey conducted in parallel. I thank all those who responded for contributing their views and helping to shape our understanding of the industry and how best to address the difficulties which tied tenants too often face.

While self-regulation has brought a number of improvements, in the shape of the Industry Framework Code and dispute resolution services, it is clear to me that these changes have not gone far enough. The evidence we have received shows that, while there is widespread responsible practice in the industry, many tied tenants continue to face unfair treatment and hardship. Self-regulation has not been able to effect the step change desperately needed in the industry to ensure that all tied tenants are treated fairly.

The Policy

The Government is committed to bringing about this step change in the relationship between pub owning companies and their tied tenants. A Statutory Code, supported and enforced by an independent Adjudicator, is the best way to ensure that tied tenants are treated fairly and that they are no worse off than their free-of-tie counterparts.

We will bring in a *Core* Code to protect *all* tied tenants – providing them with increased transparency, fair treatment, the right to request an open market rent review if they have not had one for five years, and the right to take disputes to an independent Adjudicator.

Tenants who are tied to a pub owning company with 500 or more tied pubs will also benefit from an additional *Enhanced* Code, which will require their pub owning company to provide them with a parallel free-of-tie rent assessment if rent negotiations for their pub fail.

The Benefits

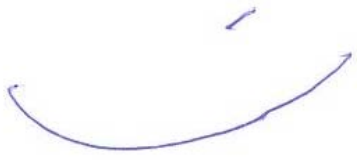
For the first time, tied tenants will be able to test whether they are indeed 'no worse off'. We are giving those tenants at risk of unfair treatment the tools to redress the imbalance in their relationship with the pub owning companies, and an independent Adjudicator to turn to if those companies aren't playing fair. The result for tied tenants is what they have sought all along: to be treated fairly and to be no worse off than their free-of-tie counterparts.

A Proportionate Package

Despite the often polarised views in this industry, there is strong support for the tie as a business model. What is important to the Government is that there are protections which can operate within the tied model. Some tenant groups and campaigners support a mandatory free-of-tie option (also known as the market rent only option). The consultation responses raised concerns that this option would create uncertainty for pub owning companies, which would have an unpredictable impact on the wider pubs sector. While the mandatory free-of-tie option had undoubted attractions, there is insufficient support to proceed with it. Our proposals for a Statutory Code and Adjudicator will therefore rebalance the relationship between pub owning companies and their tied tenants, without pursuing this more radical option.

Conclusion

This Government has a strong commitment to support a healthy and flourishing pub industry. We brought an end to the beer duty escalator in last year's Budget and cut beer duty for the second time this year. The tax on a typical pint of beer is eight pence lower than under the previous government's duty regime, and measures like the Community Right to Bid are giving community organisations in England a better chance to save their local pub. With the new Statutory Code and Adjudicator in place, I look forward to seeing a sector which struggled - like so many others - in the aftermath of the recession, flourishing – to the benefit of all those who work so hard to make the Great British Pub a mainstay of our communities.



VINCE CABLE
Secretary of State for Business, Innovation and Skills

Executive Summary

British pubs have for centuries played a core role in our national cultural identity. They contribute substantially to community spirit and cohesion and make a significant contribution to the UK economy. The sector contains many small businesses driven by hard-working people, which employ hundreds of thousands of people across the country.

There have been longstanding concerns in the pubs industry about the relationship between tied tenants and pub owning companies. The extensive evidence presented to four BIS Select Committee inquiries over the last decade, the Government's own call for evidence in Autumn 2012 and complaints made to the Government, serve to demonstrate that in too many cases tenants are unable to secure a fair share of risk and reward in their agreements with pub owning companies. It was for this reason that the Government launched its consultation on Pub Companies and Tenants, which sought views on the establishment of a Statutory Code of Practice and an independent Adjudicator to govern the relationship between pub owning companies and their tenants.

We received 1,120 written responses to the consultation and more than 7,000 responses to the online survey conducted in parallel. Based on the evidence received, the Government remains strongly of the view that the unfairness in the relationship between pub owning companies and their tied tenants is continuing and damaging. While self-regulation has brought a number of improvements, such as the industry framework code and dispute resolution services[1], these changes have taken too long and still have not gone far enough. Too many tied pub tenants continue to experience unfair treatment and hardship.

A Statutory Code

The Government is committed to ensuring fairness in the industry, and has therefore concluded that a Core Statutory Code should be introduced to provide all tied tenants with increased transparency, fair treatment, the right to request an open market rent review if they have not had one for five years, and the right to take disputes to an independent Adjudicator. We shall consult further on the precise definition of provisions to enable tenants to request a rent review within the five-year period if the pub owning company significantly increases drink prices or if an event occurs outside the tenant's control.

An Enhanced Code will additionally require pub owning companies with 500 or more tied pubs to offer parallel tied and free-of-tie rent assessments to potential or existing tenants if they request them when they are considering taking on a pub tenancy or at the time of their regular tied rent review. Pub owning companies have long held that 'tied tenants are no worse off than free-of-tie tenants'. For the first time in the history of the tie tenants will now be shown whether that is true through the free-of-tie rent assessment provision. It will strengthen the negotiating position of the tenant and incentivise pub owning companies to ensure they are offering a fair share of risk and reward in their tied agreements.

[1] The Pubs Independent Rent Review Scheme (PIRRS) and Pubs Independent Conciliation and Arbitration Service (PICAS)

A tenant would have the right to request this parallel free-of-tie rent assessment once the parties had been unable to reach agreement on a tied rent offer following a period of negotiation. If the tenant requests a parallel rent assessment, he or she would pay a £200 fee to the Adjudicator – the purpose of which is to ensure that tenants consider carefully if the parallel free-of-tie rent assessment is necessary for the negotiation to be concluded successfully. The new Adjudicator will give tenants confidence that if the parallel rent assessment provision is not properly implemented, then they can seek redress from a truly independent third party.

We have listened to concerns from both sides of the debate that the formulaic free-of-tie parallel rent assessment set out in the consultation was too mechanistic and did not take into account the diversity of pub owning company practice in the sector. To remedy this, the Government now intends that the free-of-tie parallel rent assessment should be carried out on an individual pub basis and in addition will require that they are carried out in line with Royal Institution of Chartered Surveyors (RICS) guidance.

The Code will not give tenants the automatic right to choose a free-of-tie agreement. The Government acknowledges that such a mandatory free-of-tie option – also known as the market rent only option – is popular with many tenant groups and might arguably offer the simplest way of ensuring a tied tenant is no worse off than a free-of-tie tenant. It would have required companies with more than a certain number of pubs to give their tenants adequate information to decide whether they would be better off under a tied or free-of-tie agreement and then allowed the tenants to go free-of-tie if they wished. However, it would have been likely to cause a high degree of uncertainty in the industry, with a likely negative impact on investment and the possibility that several pub owning companies would abandon the tied market. It would also have unnecessarily risked leading to higher levels of closures and job losses.

For similar reasons the Government has decided not to include a guest beer option in the Code. This would have given tied tenants the right to purchase one beer of their choice from any source. After considering the evidence received, the Government considers that this proposal also carries too great a potential to undermine the tied model as a whole because of the likelihood that tenants would use the provision to purchase their best selling beer (usually a draught lager) outside of the tie.

The consultation proposed that flow monitoring equipment (FME) should not be used in enforcing the beer tie. There was widespread agreement that FME data should not be the *sole* evidence used to enforce the tie but some confusion over whether the intention was to rule out *any* use of FME data for enforcing the tie. The intention was not to prohibit the use of FME altogether but to prevent enforcement of the tie based on FME data and the Government has decided to replicate the existing industry framework code provision so that FME data may be used to enforce the beer tie only if it is supported by other evidence.

An Independent Adjudicator

A new independent Adjudicator will enforce both the *Core* and *Enhanced* provisions of the Code with powers to arbitrate disputes, investigate systemic breaches and provide guidance on interpretation of the Code. The Government also intends that the Adjudicator will have the power to impose sanctions – including financial penalties – if it finds that the Code has been breached.

Both the Code and Adjudicator will be subject to review, initially after two years and then every three years thereafter. The Adjudicator will be funded by an industry levy which will be set in proportion to the number of tied pubs that each company owns. Over time, those companies that breach the Code will contribute more, which should provide an additional incentive for compliance with the Code.

The Government believes that this set of measures provides a proportionate and targeted response, which ensures that all tied tenants are protected. The new Statutory Code and Adjudicator, combined with the right to a parallel free-of-tie rent assessment, should provide tenants with the information and power they need to negotiate a fair tied deal. Pub owning companies that are already behaving responsibly have nothing to fear; this is not abolition of the beer tie. The Government supports the tie as a valid business model where it is used properly and is not abused. It will enable companies to demonstrate what should already be the case, namely that their tied agreements offer a fair share of risk and reward and that their tied tenants are no worse off than free-of-tie equivalents. In line with the Government's policy on business regulation, micro-businesses will be exempt from the legislation.

This Government has consistently demonstrated its support for a healthy pub industry, including bringing an end to the beer duty escalator in Budget 2013 and cutting beer duty for the second year running in 2014. A healthy pub industry also requires fairness for all the businesses involved. With the key protections of the Statutory Code and Adjudicator in place, the Government is keen to see the British pub and brewing industry build on its proud heritage – and for a sustainable and fairer industry to enable pubs to remain at the heart of our communities.

Glossary

ALMR	Association of Licensed Multiple Retailers
AWP	Amusement with prizes machines (“gaming machines”)
BACTA	British Amusement Catering Trade Association
BAPTO	British Association of Pool Table Operators
BBPA	British Beer and Pub Association
BFA	British Franchise Association
BHLA	Brighton and Hove Licensees Association
BII	British Institute of Innkeeping
BIIBAS	British Institute of Innkeeping Benchmarking & Accreditation Services
BISCOM	Business, Innovation and Skills Select Committee
CAMRA	Campaign for Real Ale
FLVA	Federation of Licensed Victuallers Associations
FME	Flow monitoring equipment
FMT	Fair maintainable trade
FPB	Forum of Private Business
FRI	Fully Repairing and Insuring [lease]
FSB	Federation of Small Businesses
GCA	Groceries Code Adjudicator
IFBB	Independent Family Brewers of Britain
IFC	Industry framework code of practice for tied tenanted and leased pubs
IPC	Independent Pub Confederation
MGD	Machine gaming duty
PICAS	Pubs Independent Conciliation and Arbitration Service
PIRRS	Pubs Independent Rent Review Scheme
RICS	Royal Institution of Chartered Surveyors
SCORFA	Special commercial or financial advantage
SIBA	Society of Independent Brewers

Introduction

'Pub Companies and Tenants: a Government Consultation' was published by the Department for Business, Innovation and Skills in April 2013[2].

The consultation document set out the Government's desire to promote and support a thriving and diverse pubs sector; while at the same time addressing long-standing concerns about the relationship between the large pub companies and their tenants – not least the balance of risk and reward between those parties. The scale of the problem has been demonstrated by the extensive evidence presented to four BIS Select Committee inquiries into the relationship between pub owning companies and their tenants over the course of a decade, along with the steady stream of correspondence which the Government has received from tenants who are facing hardship and from MPs writing on behalf of their constituents. This cumulative evidence made clear that in too many cases tenants are unable to secure a fair share of risk and reward in their agreements with pub owning companies.

Against this background, the consultation sought to explore the impact of the tied pub model – in the light of evidence that tied tenants are more likely than those who are not tied to face hardship; and concerns that the tie complicates the relationship and therefore provides additional potential for abuse.

The consultation noted that a self-regulatory approach had been in operation for almost a decade and that improvements had been made. However, following an Autumn 2012 call for evidence the Government had concluded that self-regulation had not sufficiently increased transparency in the relationship between pub owning companies and tenants; nor given tenants better access to all the information they need to make informed business choices.

With this large body of evidence in mind, the Government stated in the consultation document its intention to establish a Statutory Code overseen by an independent Adjudicator to govern the relationship between the large pub companies and their tenants. The consultation questions are at Annex B.

The Statutory Code

The Government said that it expected the new Statutory Code to be based on the existing Industry Framework Code[3] and that it would deliver two core principles:

- that the pub owning company / tenant relationship should be subject to a requirement of fair and lawful dealing; and

[2] https://www.gov.uk/government/consultations/pub-companies-and-tenants-consultation

[3] http://s3.amazonaws.com/bbpa-prod/attachments/documents/resources/21184/original/UK%20Pub%20Industry%20Framework%20Code%20Version%20Six.pdf?1360685332

- that the tied tenant should be no worse off than the free-of-tie-tenant.

The consultation then sought views on a number of potential additions to the Code to give full effect to these principles:

- that tenants should have the right to request an open market rent review;
- measures to increase transparency in the pub owning company / tenant relationship;
- that the tie on Amusement with Prizes (AWP) machines ("gaming machines") should be abolished;
- a prohibition on the tying of any products or services other than drinks;
- the right for tenants to source one guest beer outside the tie; and
- a prohibition on the use of data acquired from Flow Monitoring Equipment (FME) to enforce the tie.

It further sought views on whether the principles should be delivered through the introduction of a mandatory right for tied tenants to go free-of-tie; or through a provision in the Statutory Code requiring higher drinks prices charged under the tie to be directly compensated for by lower rent and / or other genuine and quantifiable countervailing benefits.

The consultation said that the Government intended to take a proportionate approach to the introduction of the Statutory Code. It proposed that the new regulatory regime should apply only to pub companies with more than 500 pubs; and that, for those companies within scope, the Statutory Code should apply only to their non-managed pubs.

The Adjudicator

The consultation document suggested that the powers and functions of the Adjudicator would be based on those of the recently introduced Groceries Code Adjudicator, in that the Adjudicator would:

- arbitrate individual disputes between pub companies and their tenants, in accordance with the Statutory Code;
- carry out investigations based on complaints, with wide-ranging powers to require information;
- impose sanctions, including, in the case of severe breaches, financial penalties, for breaches of the Code;
- publish guidance on enforcement policy and give advice on interpretation of the Statutory Code; report annually to the Secretary of State on his or her work; and recommend to the Secretary of State necessary changes to the Statutory Code.

The Consultation Process

The consultation ran for eight weeks from 22 April to 14 June 2013. In parallel with the formal consultation, the Government conducted an online survey to engage with a wider audience; and three roundtable discussions (two hosted by Ministers) were held with stakeholders. Officials also held bilateral meetings with interested stakeholders on request. We were grateful to those pub companies and breweries which encouraged their tenants, employees and companies they contract with to respond, and to those individuals and interest groups who also encouraged responses to the consultation. We also received a number of submissions after the consultation closing date, which we have considered in developing this Response.

The Government also commissioned independent analysis from London Economics into the potential impact on pub closures and employment levels of the proposals set out in the consultation document. This analysis, commissioned through a competitive tendering process, was published on 13 December 2013 together with the consultation responses.

Online Survey

Alongside the written consultation the Government conducted an online survey, with the aim of obtaining a wider range of responses than would have been received from a written consultation alone. To reflect the different medium and target audience, the online survey asked a shorter set of questions than the consultation document. This was intended to ensure that online respondents were not put off by a lengthy and time consuming set of questions and thereby encourage uptake. This means that not all the consultation questions have an online survey equivalent.

Some respondents expressed concern about the wording of the questions in the online survey, whilst others were concerned that the survey could be abused by individuals submitting multiple responses.

In addressing these concerns, we looked into the IP addresses used by respondents to the online survey and identified 325 IP addresses from which more than one response was submitted.

On this basis, we examined the effect on our analysis of screening out the multiple responses. There was a difference of only four percentage points between the two analyses, which we consider is not significant in this context.

We have considered the online survey within the wider context of the evidence gathered in response to the consultation, recognising the limitations of any such survey. We have allowed for the possibility that some respondents may have wished to answer ‘Don’t Know’ to questions which did not provide the express option to do so. The results of the online survey, and the numbers who responded, nevertheless provide a useful insight into the views of a wide range of respondents and serve to demonstrate the strength of feeling on the issues covered.

Use of BII call data

The consultation document made reference to the number of calls made to the British Institute of Innkeeping (BII) hotline over a three-year period and drew conclusions from these figures as to the number of complaints made against pub companies.

During the consultation, a number of respondents drew our attention to the fact that the number of calls to the BII hotline was not an accurate representation of the number of complaints made, as some of these calls may have been in respect of advice or guidance. We apologise for this error and recognise that the number of calls to the hotline does not equate to the level of complaints. We acknowledge that the figures quoted in the consultation should have more accurately referred to "calls" rather than "complaints" and this was clarified in the press statement issued by the BII on 29 April 2013. We have taken this into account in our interpretation of consultation responses from anyone who may have been misled by this reference and thank respondents for correcting our understanding on this point.

Publication of responses

In the consultation document, the Government advised that it would publish all responses to the consultation, unless specifically notified otherwise. The responses to the consultation were published on 13 December 2013, in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 and the Data Protection Action 1998).[4]

We released the vast majority of the responses received. Limited information was redacted, including:

a. personal information which would identify individuals, including tenants and junior pub owning company employees;

b. information which would be likely to prejudice the commercial interests of a business if released (wherever possible we have taken into account the views of the relevant business); and

c. information provided in confidence.

[4] https://www.gov.uk/government/consultations/pub-companies-and-tenants-consultation

Overview of Responses

The Department received 1,120 written responses[5] to the consultation document and 7,038 responses to the online survey. This was an excellent response and suggests that we managed to reach a wide cross-section of interested parties. For the purposes of analysis, respondents have been grouped according to the following eight representative categories:

a) Pub companies and breweries with 500 or more pubs; [6]

b) Pub companies and breweries with fewer than 500 pubs, including micro-breweries that do not own any pubs;

c) Pub company and brewery employees;

d) Tenants (including current or former tied or free-of-tie tenants or lessees, freeholders, single and multiple operators);

e) Interest groups, trade bodies and other organisations;

f) Supply chain (e.g. gaming machine suppliers, surveyors, maintenance contractors, etc);

g) Political representatives (national and local government); and

h) Other individuals (e.g. consumers).

A list of respondents by category is at Annex A and an analysis of written consultation responses can be found at Annex C. The online survey results are at Annex D and the analysis of these results is at Annex E.

The distribution of respondents is set out in Figures 1 and 2.

[5] Analysis of the written responses in Figure 1 was based on 1,131 responses but the revised total was 1,120. This did not significantly alter the results.

[6] Based on information from the BBPA, consultation responses and company websites.

Figure 1: Consultation Respondent Categories

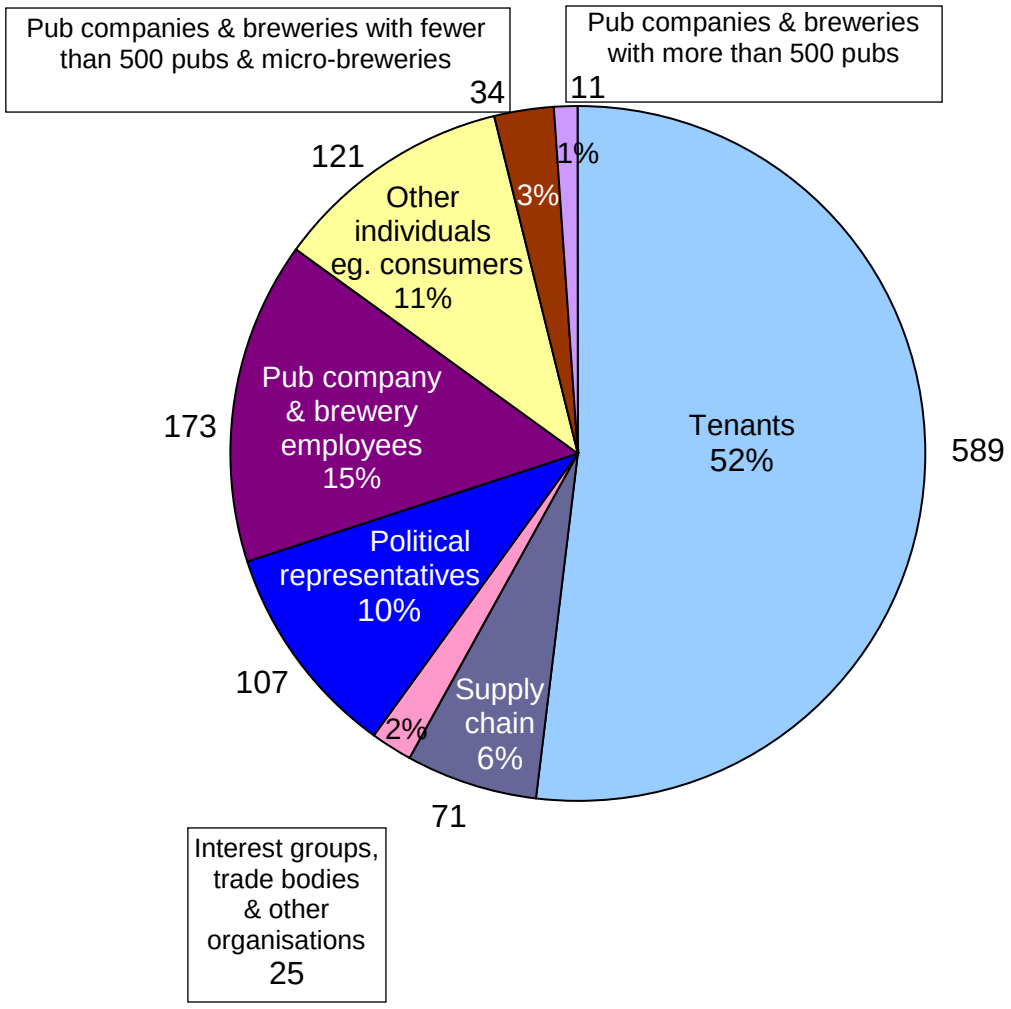
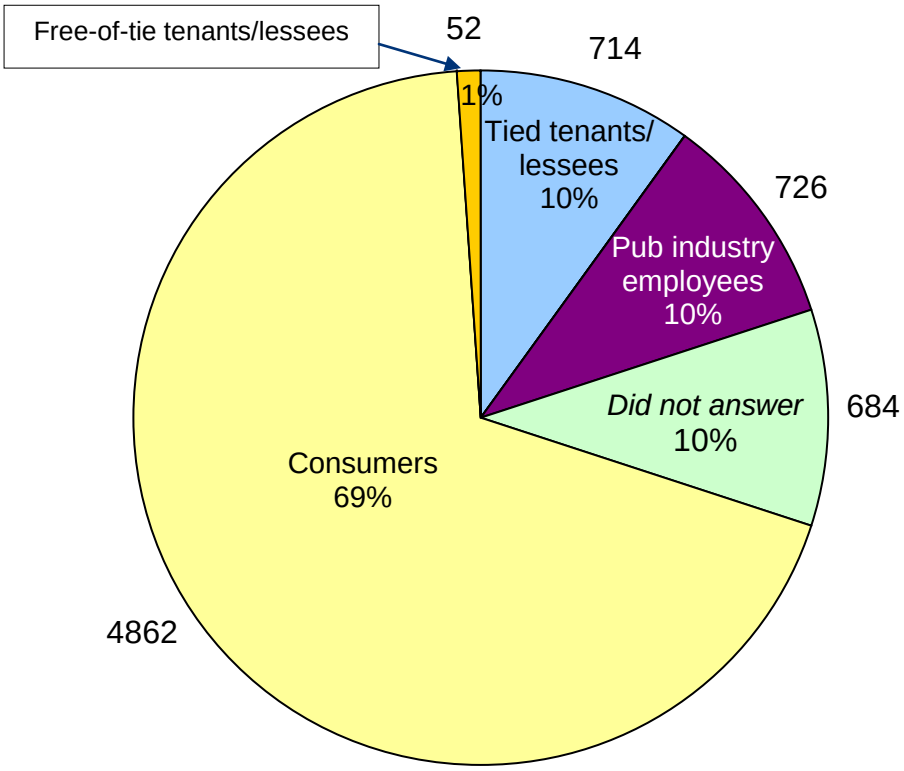


Figure 2: Online Survey Respondent Categories



Devolution

This matter is devolved in Scotland and Northern Ireland. As such, the Government's proposals for a Statutory Code of Practice and independent Adjudicator apply to England and Wales only. The intention is that tied pubs located in England and Wales would contribute towards the 500 tied pub threshold which is proposed for a pub owning company to be subject to the *Enhanced* Code, and not tied pubs located in Scotland or Northern Ireland. Similarly, the levy paid by a pub owning company would be based on the number of tied pubs located in England and Wales that it owned.

Government Response

The remainder of this document summarises the responses to the questions asked in the consultation document and sets out the Government's Response on each issue. In analysing the responses, we have considered the weight of different arguments and the broad level of support that proposals commanded from different stakeholder groups, rather than placing undue focus on the exact number of respondents who agreed or disagreed with a particular question. In many cases respondents – particularly tenants – offered accounts of their views and experiences but did not directly answer some or all of the questions set out in the consultation. We have also taken into account points made by stakeholders in meetings with Ministers and officials both during and since the close of the consultation, as well as correspondence we have received since the consultation closed.

A Statutory Code and Adjudicator

The consultation document set out that the Government was proposing to establish a Statutory Code of Practice and Adjudicator in order to ensure that tenants are treated fairly and lawfully and to ensure that tied tenants are no worse off than free-of-tie tenants.

While recognising that the current self-regulatory approach – including the industry framework code and the dispute resolution services, the Pubs Independent Rent Review Scheme (PIRRS) and Pubs Independent Conciliation and Arbitration Service (PICAS) – had constituted a step in the right direction, the Government had concluded that culture change in the industry had not gone far enough, and that too many tenants continued to experience unfair treatment and hardship. Nor could a voluntary code effect the sort of fundamental rebalancing of risk and reward between pub owning companies and tenants that the Government had concluded was necessary.

The Government therefore stated that it considered a Statutory Code enforced by a Statutory Adjudicator was required to meet its objectives. The Government proposed that the role of the Adjudicator should be based on that of the Groceries Code Adjudicator (GCA) – with both an arbitration function focused on delivering redress for individual tenants; and a power to investigate potential systemic breaches of the Code, require information and impose sanctions (including financial penalties). A draft Statutory Code was included in the consultation document.

Q.1 Should there be a Statutory Code?

<u>For</u>

Ninety-six per cent of all respondents to the online survey agreed that Government should regulate the relationship between pub companies and tenants, including 96% of the 714 tied tenants who responded. Ninety-five per cent of respondents, including 95% of tied tenants, agreed that a Statutory Code and independent Adjudicator would be an appropriate way to regulate the relationship between pub owning companies and tenants.

In terms of written responses, of the 70 tenants who answered the question, 62 agreed that there should be a Statutory Code. The remaining 88% of tenants chose not to answer the question. Ninety-three per cent of political representatives also agreed to a Statutory Code.

Responses from some tenant groups tended to reflect disappointment that the industry voluntary approach, of which they had been supportive, had not made as much progress as hoped, leading them to conclude that a statutory approach was now needed.

While some BII members believed that 'self regulation with the correct industry framework code and properly tailored individual pub-co codes of practice is the sensible way to proceed given the uncertainties which surround statute', the BII reported that 84% of its members favoured the introduction of a Statutory Code and it had concluded that 'the Government is right to seek a Statutory Code where clarity can be bought into what has proved to be an intractable problem.'

The Association of Licensed Multiple Retailers (ALMR) commented that 'The development of these bodies [PIRRS and PICAS] is arguably the single biggest step taken in direct response to the successive Select Committee Inquiries and the bodies are working to provide a vehicle for independent dispute resolution.' The ALMR went on to say:

> 'Our preference has always been for this to be delivered through self-regulation …. Negotiations on Version 6 of the Code were only concluded at the end of 2012 and, whilst it is immeasurably improved, [...] it cannot address the fundamental issue of the balance of risk and reward with which the Government is most concerned. We remain disappointed that, despite our best endeavours, faster and greater progress had not been made and agree with Government that a Statutory Code is now required.'

The Federation of Licensed Victuallers Association (FLVA) agreed that there should be a Statutory Code which 'must be detailed, universal and comprehensive in its content to avoid any potential misinterpretations. The code should be a one for all and alleviate the need for individual Company codes/interpretations.'

The Brighton and Hove Licensees Association (BHLA) said that 'there is now no choice but to adopt a statutory code. It is our opinion that having tried self regulation it has delivered too little and too late.'

The Federation of Small Businesses (FSB) commented that:

> 'the latest attempt at self regulation by the large pub companies has failed to rebalance the contractual risk and reward structure of large pub company ties. Only a quarter of FSB members tied to a large pub company have been provided with a breakdown of their pubs Fair Maintenance Trade (FMT) and an explanation of how their dry rent is calculated.'

Some responses from tenants and their representatives supported the introduction of a Statutory Code because they did not regard the self-regulatory process as transparent or independent. These included tenants who had experience of the industry dispute resolution services. The Independent Pub Confederation (IPC) considered 'the handful of complaints put to PICAS, and before them BIIBAS, demonstrates that most licensees have no faith that the system can deliver a satisfactory outcome to their primary issues, which revolve around fairness and the dominant position of the pub owning company.'

One tenant commented that 'In my experience PICAS is flawed and does not serve the purpose it was designed for.' Another tenant said:

> 'Version 6 [of the Industry Framework Code] addresses the poor readability and understandability of Version 5 and is much better in this regard' but that 'only cosmetic and meaningless changes have been made to Version 6. It is therefore pointless and wrong to continue with a self-regulatory code that still does not address the fundamental challenges of balancing risk and reward between Pub Companies and tenants and which will not contribute to the long-term sustainability of the pub industry.'

There were also concerns that awareness of the system was low among tenants. The BII noted that while 'both PIRRS and PICAS have been energetically pursued', it recognised 'that the service could and should have been better communicated.'

The Fair Pint Campaign recognised that 'some bodies may have participated [in self-regulation] in an effort to bring about some significant change and fully accept that a few concessions have been achieved.' In particular, they noted that 'The abolition of up only rents reviews and requirement that flow monitoring data is no longer sufficient to bring about an allegation of buying out, on its own, are both progressive steps.' However, they considered that 'self regulation is a sham' and that it is 'not seen as independent despite the presence of tenant organisations as the BBPA still have ultimate control all be it covertly.'

Similarly, the IPC said that self-regulation had led to 'some tentative steps forward (e.g. abolition on upward only rent reviews) and may be able to resolve some peripheral issues but the BBPA has confirmed it does not have, as an objective, the delivery of rebalancing risk and reward. There is little faith amongst licensees that self regulation can deliver anything substantial to resolve the issue of fairness in the relationship' and that this 'undermines the credibility of the self regulatory code and its enforcement.' The IPC also said that 'The very fact that the self regulatory process is unable to offer any reassurance that it seeks to deliver the same commitments as Government, indicates that their aims and objectives are NOT in harmony with those required by the wider industry and Government. The absence of such assurances undermines the credibility of the self regulatory code and its enforcement.'

The IPC also advised that it had been asked to participate in the formation of the new self-regulatory Pubs Governing Body but had declined 'on the grounds that it has yet to be confirmed that the bodies objectives will be aligned with our own (and those of Government).' [sic]

<u>Against</u>

Eighty-two per cent of pub companies and breweries with 500 or more pubs disagreed with the question, with the remaining two companies not answering. Similarly, 82% of pub companies and breweries with fewer than 500 pubs, including micro-breweries, disagreed. Eighty-nine per cent of pub company and brewery employees who responded also did not agree with the introduction of a Statutory Code.

There was a strong view expressed by pub owning companies and breweries of all sizes that because of the progress made by the industry with self-regulation, statutory intervention was not needed.

> 'The newly enhanced and robust Industry Framework Code (IFC) is working. All major pub companies have confirmed that they regard the IFC as legally binding

> and the Pubs Independent Rent Review Scheme (PIRRS) and the Pubs Independent Conciliation and Arbitration Service (PICAS) are functioning effectively. The IFC is a flexible tool which can respond to industry needs and be subject to external independent evaluation. A Statutory Code can not.' Enterprise Inns

> 'Self regulation is low cost, effective, legally binding and is working [...] Whilst progress has taken time, Version Six of the Industry Framework Code, worked through with representatives of multiple retailers which are themselves tenants and lessees, provides transparency and cultural change.' British Beer and Pub Association (BBPA)

As evidence that self-regulation was working, the BBPA cited the number of cases that PICAS and PIRRS had dealt with since their inception: PICAS 'has dealt with 8 cases with a further 10 mutually resolved by the parties prior to a panel hearing. PIRRS has settled 24 cases since 2009 with a further 18 cases settled outside the formal rent review process.'[7] In addition, a Pubs Governing Body had been created in May 2013 'to provide overall governance of the self-regulatory processes.'[8] Administered by the BII, with membership comprising an independent Chair, four pub company representatives and six lessee representatives, the Body was responsible for the IFC as well as PIRRS and PICAS.

A number of companies provided survey evidence showing that a high proportion of tenants would re-sign their contracts. They argued that this demonstrated that self-regulation was working. Admiral Taverns quoted as evidence that 70% of its tenants would be likely or very likely to recommend the company to other publicans, nearly a 10% improvement on the previous year.[9] In the same survey, '82% of AT licensees rated their BDM [Business Development Manager] as "very useful or somewhat useful" – with over 50% rating their BDM at 8 out of 10 or higher – a score exceeded by only one small family regional brewer, and well ahead of our other competitors.'

It was also argued that the voluntary approach had not been given enough time to work.

> 'Statutory intervention is unnecessary [...] The Government […] has not given sufficient time for the self-regulatory regime to mature fully or to be assessed objectively….'. Admiral Taverns

This view was shared by the Society of Independent Brewers (SIBA) who commented that 'more time should be given to assess the current self-regulatory system.'

Some companies argued that statutory intervention was not needed as pub tenants were better protected than tenants in any other industry through arbitration, as well as being the only property sector where there is a rent dispute resolution scheme in place. This view

[7] BBPA letter of 27 January 2014 to the Secretary of State

[8] BII consultation response

[9] The 2013 "Tenant Track" relationship survey conducted by HIM market research

was shared by the BII who commented that 'No other industry to our knowledge provides such a comprehensive low cost dispute mechanism for complaints.'

Some pub owning companies commented that statutory intervention was a disproportionate response because it would target companies that were already behaving fairly:

> 'a statutory code is also unfair because those companies like AT which run their businesses well and ethically, and have very good relations with their tenants, will be penalised by being subject to a highly complex, costly, bureaucratic and onerous regime.' Admiral Taverns

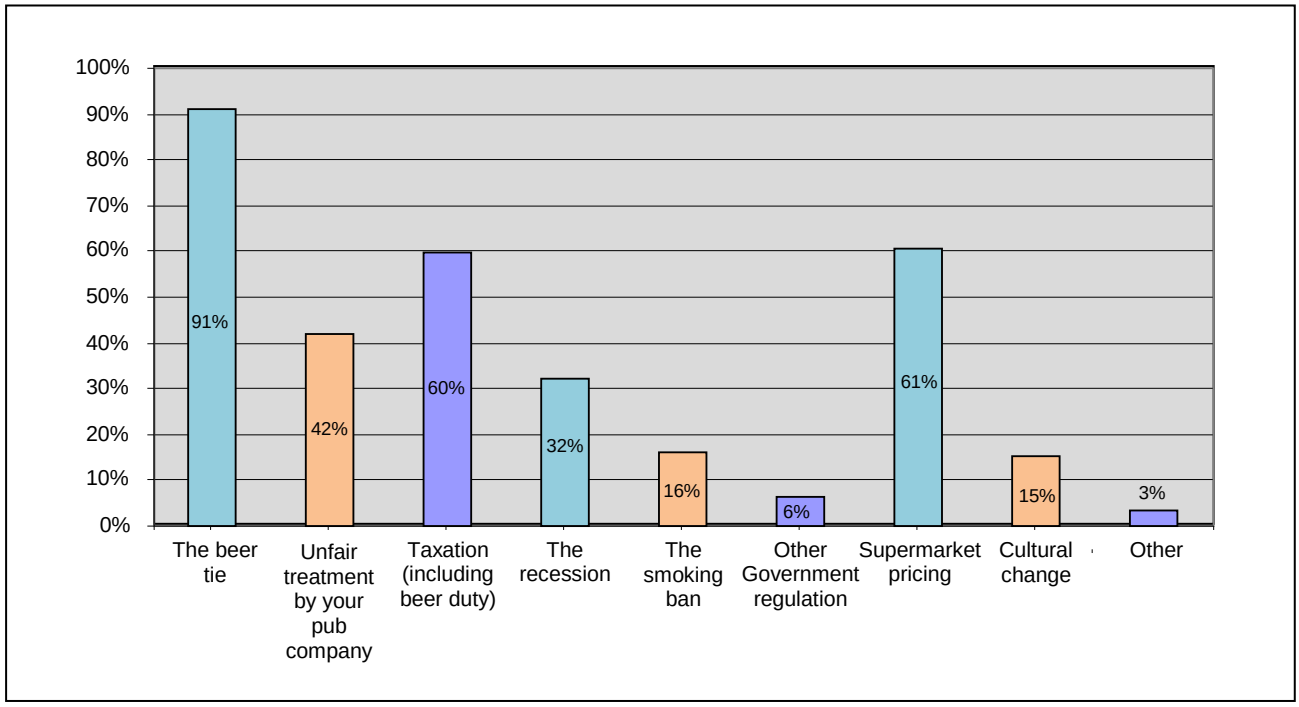
There was also a view from some that the proposals failed to address the real challenges facing the industry. In their response Heineken UK/Star Pubs and Bars commented that:

> 'The proposals fail to recognise or tackle the various challenges which must be addressed if we are to reverse the trend of declining pub visits and sales, including: fiscal pressures (e.g. high duty, business rates and VAT); reduced consumption away from home in favour of at home drinking; increased competition for leisure and household expenditure; legislative changes (e.g. smoking ban); social changes (e.g. rise in mixed-sex drinking and dining occasions); and historic lack of investment in research to understand and address changing customer demands.'

This view partly aligns with responses to the online survey question asking '*What are the three biggest challenges that you are facing as a tenant?*' Of the 714 tenants who responded to this question: 61% answered supermarket pricing; 59% taxation, including beer duty; 32% the recession; 16% smoking ban; and 15% cultural change. However, the most popular answer was the beer tie (91%), with unfair treatment by my pub company also scoring highly with 43%. Fifty-nine per cent of those who answered this question had been a tenant for five or more years and 85% were tied tenants of one of the six pub owning companies with 500or more tied pubs.[10].

[10] The Government understands that six companies operate more than 500 tied pubs: Admiral Taverns, Enterprise Inns, Greene King, Marston's, Punch Taverns and Star Pubs & Bars.

What are the three biggest challenges that you are facing as a tenant?
(Please choose up to three options)



Government Response

The Government recognises that there has been progress with self-regulation and acknowledges the efforts made by pub owning companies, their representatives and tenant groups to deliver change. Version 6 of the Industry Framework Code (IFC) was agreed in January 2013 and the Government understands that individual company codes have since completed the accreditation process. In addition, a Pubs Governing Body was created in May 2013 by pub owning companies' and tenants' representatives to oversee the IFC, as well as PIRRS and PICAS.

The consultation elicited many testimonials from tenants in support of their pub owning company; but both during the consultation and since it closed we have continued to receive evidence that individual publicans are continuing to face serious hardship. This evidence adds to the extensive evidence gathered by BISCOM over the last decade, the Committee's report in 2011 which found the voluntary approach wanting and the response to the Secretary of State's Autumn 2012 call for evidence. It thus gives further support to the view set out in the consultation that, despite the Government giving the industry time to change before proposing a statutory solution, culture change in the industry has still not gone far enough.

Responses to the consultation have demonstrated that there is a high level of acrimony in the industry and the Government has concluded that self-regulation is unlikely to deliver real change. While some tenants groups are represented on the new Pubs Governing Body, the cost of which is being met by the pub companies, we are aware that despite an invitation to join, not all tenant groups are willing to be represented because the Body does not share the core principles proposed in the consultation.

Government Response

While the industry code stipulates that all contracts must be 'fair, reasonable and comply with all legal requirements', it still does not directly address the issue of rebalancing risk and reward and the industry has not shown sufficient willingness to address this in the IFC. As the voluntary code cannot effect the sort of fundamental rebalancing of risk and reward between pub companies and tenants that the Government concluded was necessary in its consultation, we have determined that the right solution is to establish a Statutory Code of Practice to address the unfairness in the relationship between pub owning companies and their tenants that too many tenants continue to experience. Pub owning companies that are already behaving responsibly should have nothing to fear; this is not abolition of the beer tie. The Government supports the tie as a valid business model where it is used properly and is not abused. The Government's proposals will enable companies to demonstrate what should already be the case - that their tied agreements offer a fair share of risk and reward and that their tied tenants are no worse off than free-of-tie equivalents.

Q. 2 Do you agree that the Code should be binding on all companies that own more than 500 pubs? If you think this is not the correct threshold, please suggest an alternative, with supporting evidence.

In line with the Government's policy on proportionate regulation, the consultation proposed that the Statutory Code should apply only to pub companies that have 500 or more pubs, to focus regulation on the pub companies with the greatest market power and those best able to bear the compliance costs. The consultation also proposed that the Secretary of State should have the power to amend the minimum threshold.

The consultation argued that a threshold of 500 pubs would enable the Code to address almost 90% of the complaints raised but would not cover those companies about which few complaints had been made. This was based on data from the BII, specifically the "complaints" made to a BII "hotline" over a three-year period. As acknowledged earlier in this Response (see page 12), referring to BII helpline calls as "complaints" was inaccurate because the calls included technical queries and did not equate to complaints about particular pub owning companies. We have taken this into account in our interpretation of consultation responses and in the development of the Government's position on an appropriate threshold. Where responses to this question cited the BII "complaints" data as evidence to support the proposed threshold, this argument has been disregarded.

<u>Consultation Responses</u>

The proposed threshold of 500 pubs received a mixed response. None of the pub companies and breweries with 500 or more pubs thought it was an appropriate threshold.

> 'The 500-pub threshold [...] looks like a convenient way for Government to exclude family and smaller regional brewers from the code. […] Just because a pub company is large does not mean that it treats tenants in a worse manner.'
> Punch Taverns

Conversely, only one of the 16 pub companies and breweries with fewer than 500 pubs (including micro-breweries) that answered the question disagreed with the threshold. Most

shared the view of Shepherd Neame that 'If there were to be a Statutory Code, we would support this limit as it would remove traditional tenancies from the scope of the Code. Any lower limit would result in excessive red tape and impose a disproportionate burden on smaller companies.'

JW Lees, a brewery with fewer than 500 pubs, was the only company of that size to disagree with the proposed threshold and said:

> 'the introduction of a limit sets a precedent for the future and we are concerned that it endangers our route to market for our beers, ie we own pubs to sell our beers and we would worry about future legislators reducing the 500 pub limit to a lower level which may put us out of business.'

Brewers with 500 or more pubs, including Heineken and Greene King, argued that they would be regulated differently from their competitors and it would place them at a competitive disadvantage to smaller brewers who would not have to comply with the Code and fund the Adjudicator. Heineken UK/Star Pubs and Bars commented that 'Setting a 500 pub threshold would be a significant restriction of competition and we do not support it. As brewer and cider maker we cannot support a system which regulates our pubs in a different way to pubs owned by our competitors.' Similarly, Greene King said:

> 'We are concerned that a Statutory Code, aimed at only part of the industry, risks stifling investment in this sector and the acceleration of pub disposals. Having part of the Industry only subject to a Statutory Code could distort the market' and '…. setting a threshold could act as a barrier to investment and expansion as those pub owners below the threshold might be reluctant to grow beyond any threshold level to save on the costs and burdens of a Statutory Code.'

This view was also shared by some smaller brewers. For example, Fuller Smith and Turner supported 'a 500 leased/tenanted pub threshold but only if this does not lead to a material distortion in competition above and below this threshold.' The company went on to say 'Our biggest concern with the proposals is that whilst at present under the proposals we will not be covered by the Statutory Code as we have less than 500 pubs it will still in our opinion create an uncompetitive market place because of the changes that are proposed on those companies over 500 pubs.'

The largest concerns about possible distortion of the market by the proposed threshold that were raised by pub companies and breweries with 500 or more pubs related to the consultation proposals for tenants to be offered the right to offer a guest beer and to go free-of-tie. They were overwhelmingly opposed to both proposals as they considered they would undermine the tied model. As outlined at Questions 8 iv and 11 respectively, the Government is not pursuing either of these proposals.

Representative organisations of pub owning companies and breweries of all sizes supported a threshold as long as it did not lead to a distortion of competition. The BBPA, some of whose members would be above the threshold proposed in the consultation, said it 'welcomes the Government's intention to exclude smaller companies from a statutory code hence we support a 500 leased/tenanted pub threshold, however on the basis that it does not lead to a material distortion of competition.' The Independent Family Brewers of Britain (IFBB), whose members would be below the proposed threshold, said 'We support a 500 tenanted and leased pub threshold, but only on the basis that this does not lead to a material distortion in competition above and below this threshold.'

Some argued that the proposed threshold would create a two-tier system, with some tenants having less protection than others and that a fairer and simpler system would be not to have a threshold:

> 'By setting a threshold the Government would establish a two tier system where some tenants have less protection than others. We believe that companies of all sizes which operate fairly should have nothing to fear from being included.' Heineken UK/Star Pubs and Bars

> '[a threshold] could also create a two-tier system within the industry with the larger pub owners under a Statutory Code, with all its additional costs and burdens, and the smaller pub owners under a Voluntary Code, with voluntary arbitration if they wish to continue with it. This has the potential for unintended consequences.' Greene King

> 'The introduction of a statutory code covering only those companies who have over 500 pubs would weaken the self-regulatory regime for those operating fewer than 500 pubs. Whilst it is currently the case that those companies are not regularly accused of abuse, it may be an unintended consequence of this legislation to remove protection for tenants and leaseholders of smaller companies.' SIBA

The professional body for surveyors, the Royal Institution of Chartered Surveyors (RICS), also raised concern that a threshold would lead to a two-tier market, which would create difficulties in the valuation of pubs. RICS said,

> 'This is a concern to many of those valuers working in the pub industry and has been mentioned by a number of our members in their responses to us. Any creation of a two-tier market, within what is already a complex market sector, is likely to cause particular difficulty when trying to assess open market rent primarily because rents are assessed having regard to comparable market transactions. Rents are based on the assumption that there is a "hypothetical landlord" (ie that the landlord is not necessarily the actual landlord but could be any landlord). However, the Government proposals would essentially introduce two different types of landlord: those with >500 pubs and those with <500 pubs, distorting the market and creating two levels of comparable evidence, thus making it even harder for valuers to ascertain fair market rent.'

Tenant representatives were divided over the consultation proposal to limit the Code's application to companies with more than 500 pubs, with some arguing it should apply across the sector. The FLVA and the BII both argued that the Code should be binding on all companies that operate lease or tenancy agreements. Eighty-two per cent of BII members who responded to a survey undertaken by the organisation disagreed with the proposed threshold and the BII said 'our members want protection for all tied tenants and lessees.'

> 'The code should be binding on all companies who operate lease or tenancy agreements irrespective of the size of the estate. Whilst we appreciate the importance of the tie to the smaller independent brewers. The protection to these companies should come via a distinction in the legislation which whilst capturing them within the Statutory Code, the obligation to offer the Free of Tie option is waived if that provision is included within the code.' FLVA

The ALMR, on the other hand, argued that the Code should apply only to companies with more than 500 lease and tenancy agreements.

Of 56 (out of 589) tenants who answered the question, 25 agreed and 31 disagreed with the proposed threshold. Fifty-three per cent of respondents to the online survey considered that the Code should apply to all pub companies and 47% that it should apply to companies with 500 or more pubs. Seventy-two per cent of tied tenants/lessees who responded to the online survey said that the Code and Adjudicator should apply to all pub companies.

One multiple operator commented that 'The 500 pub threshold is a good idea in order to protect the smaller pub-cos who brew there own products to ensure that they have an immediate route to market…' [sic]

One tenant of a family brewer said a Statutory Code 'should include all pub owning companies no matter how small' and 'as soon as the brewers get involved with the supermarket supply chain the natural protection of their own pubs is abandoned in the drive to increase sales to the off trade to the detriment of their own tied pubs.'

Another tenant said 'I urge the committee to look seriously at the magic "500" number. Otherwise the "Family Brewers" will continue to carry on regardless, operating the same tied model as Enterprise and Punch because they can.' Another said 'There is no real distinction between the likes of ETI [Enterprise Inns] and the supposedly "cuddly family brewers". They seem to behave as one corporate monster, smashing people out of the way in their frantic stampede for cash and assets.'

One respondent[11] commented that 'Tenants of smaller Pub Cos should be entitled to the same rights as larger ones irrespective of the generally fairer treatment received by such tenants. Having said that Pub Cos with a good record i.e few complaints and no fines could be subject to 'lighter touch' regulation.'

It was also suggested that prospective tenants may be attracted to agreements covered by a Statutory Code and that this would disadvantage smaller companies:

> 'the separation of the market may in fact favour the larger companies since prospective tenants may be attracted to agreements covered by a Statutory Code rather than one that is not. This would be undesirable consequence that although not necessarily working to the disadvantage of the tenant would adversely affect smaller companies and smaller brewers might find it more difficult to recruit or find a route to the market for their beer.'
> BII

At the same time, this could lead to a positive outcome for tied tenants, as observed by J W Lees: 'We own 136 tenanted pubs, so JW Lees would be well below the 500 pub limit

[11] Who identified themselves as an 'individual'

but the commercial reality is that all companies would need to comply with the code to be competitive and to attract the best licensees.'

In recommending a Statutory Code and Adjudicator in its 2011 report, BISCOM did not propose a threshold. In its July 2013 report[12], BISCOM accepted the rationale for setting a threshold and saw merit in including a level of flexibility in legislation 'to allow the Secretary of State subsequently to alter the threshold in the interests of the industry.' BISCOM 'accepted the argument that the Statutory Code should only apply to pub companies with leased and tenanted pubs.'

Q.3 Do you agree that, for companies on which the Code is binding, all of that company's non-managed pubs should be covered by the Code?

The consultation proposed that the Code should apply to all of the non-managed pubs of companies with 500 or more pubs of any description. This was based on the view that the size of company was a good proxy for its bargaining power and thus its opportunity to abuse the tie. The consultation proposed that the Code should apply not just to tied pubs because the 'fair treatment' principle was relevant to all non-managed pubs; and a Code that covered only tied pubs would allow the statutory arrangements to be circumvented by a company taking all of its pubs outside the tie (while increasing rent).

Consultation Responses

This question met with a largely disinterested response from written respondents except from pub companies and breweries with 500 or more pubs. The majority of written responses did not express a view. Eighty per cent of all respondents to the online survey and 73% of tied tenants said there should be no distinction made between leases and tenancies.

The majority of pub companies and breweries with 500 pubs or more disagreed that the Code should cover all of the non-managed pubs of companies with 500 or more pubs of any description and there was general consensus, should a Statutory Code be introduced, that it should apply only to tied agreements. All 49 tenants who answered the question agreed (the remaining 540 did not answer). The online survey did not ask this question.

> 'In order to deliver the Government's objectives of proportionality and targeting, we believe that the Code should be binding on companies which operate more than 500 pub lease or tenancy agreements. This is because total ownership of an estate does not indicate market power in one market segment – a company with more than 500 pubs but only a small number of leases is no more likely to be abusive than a smaller company which operates only traditional pub leases or tenancies.' ALMR

It was also suggested by some pub owning companies that if a Statutory Code were to be implemented, it should be focused on the longer term, fully repairing and insuring (FRI) lease agreements, which tend to have no easy exit mechanism or notice and contain

[12] Business, Innovation and Skills Select Committee, Fourth Report, 2013-14.

significant repair liabilities for the leaseholder, rather than traditional tenancy models, which offer lower cost entry and exit. Traditional tenancy agreements are usually for a shorter term of up to five years, with repairs, alterations and insurance paid by the pub owning company or brewery.

> *'*Government identified, in 2011, the longer-term lease agreement as one of the principal causes of many of the problems faced by the pub industry. We would therefore propose that only FRI leases are governed by the Statutory Code, regardless of the pub company size.' Greene King

Similarly, Admiral Taverns called for the threshold to be calculated on the number of lease agreements held by a pub owning company as:

> 'It does appear that the vast majority of the complaints and issues which have arisen within the industry relate to [FRI] lease agreements [rather than traditional tenancy agreements] and the difference between these agreements was recognised within the IFC version 6 which places greater obligations on a pub company in advance of signing a new lease agreement.'

Admiral went on to say that if the Code applied only to FRI lease agreements:

> 'a much lower limit could be included in the legislation, potentially down to 100 lease agreements as agreed in the Version 6 IFC, with traditional tenancies being exempted from statutory regulation and still subject to the self-regulation framework.'

Responses from some tenants suggested that the Code should not focus on a specific type of agreement as there were issues with traditional tenancy agreements operated by family brewers. For example, a tenant of a family brewer said that:

> *'*The exterior of the pub has not been decorated by the brewery in at least 9 years and has looked in a sad state for the past five years or so. Repairs are rarely carried out by the brewery in pre-recession trading conditions we often undertook the repairs ourselves at our own expense*'* and *'*The rent review process is very near "take it or leave it" there are never any form of calculations produced by the brewery to attempt to justify rent levels.' [sic]

There were, however, strong views expressed that the Code should not apply to free-of-tie pubs because commercial property companies who were free-of-tie landlords, such as Wellington Pub Company, operated at arm's length from their tenants.

> 'These agreements are no different from any other commercial lease on shops, restaurants and other business premises. The pub owners in these circumstances are completely at arm's length from the pub operation and have little, if any involvement in the business, or information regarding the performance of the pub.' BBPA

> 'We are strongly opposed to the suggestion that any statutory Code that may be introduced should apply to such commercial landlords. There is no reason, or legal basis, to make commercial landlords of pubs, but not other types of premises (e.g. shops, restaurants, offices etc.) subject to a statutory Code'. Wellington Pub Company

The BII commented that 'We are unable to agree to their inclusion [free-of-tie pubs] since much of the complaint against the pub companies and hence the need for a code is the differential pricing applied to tied products. Where a pub is not tied the tenant is free to buy on the market and there is no relationship between that and the rent. As a consequence the majority of the Code would not and could not apply.' Other tenant groups such as the FLVA and ALMR shared the BII view that the Code should apply only to lease or tenancy agreements and we understand this view to mean the Code should only apply to tied and not free-of-tie agreements.

Government Response

Based on the balance of the evidence from the consultation, the Government considers that the Statutory Code of Practice should consist of *Core* and *Enhanced* provisions. The Government intends that the *Core* Code should apply to all tied lease and tenancy agreements operated by all pub owning companies so that all tied tenants are protected. Micro-businesses will be exempt from the Code.

The *Core* Code will provide all tied tenants with increased transparency, fair treatment, the right to request an open market rent review if they have not had one for five years, and the right to take disputes to a new independent statutory Adjudicator. We shall consult further on the precise definition of provisions to enable tenants to request a rent review within the five-year period if the pub owning company significantly increases drink prices or if an event occurs outside the tenant's control. In doing so, we will seek to draw on existing practice in the industry. (See also the Government Response to Question 8). This *Core* Code is based on the existing industry code and when combined with the Adjudicator will deliver the Government's fair dealing objective.

The *Enhanced* Code will contain the requirement to offer parallel tied and free-of-tie rent assessments, which will enable tied tenants to judge whether they are being offered a fair tied deal. This would apply only to tied agreements operated by companies with 500 or more tied pubs. This would capture those companies about whom the majority of complaints have been received by BIS and focuses the cost of complying with the requirement to offer parallel tied and free-of-tie rent assessments on that part of the industry about which we have received most complaints. The Government estimates the costs of the *Enhanced* Code to be around £600 per pub that requests a parallel rent assessment. Currently, we believe the following companies would be covered by the *Enhanced* Code: Admiral Taverns Ltd, Enterprise Inns plc, Greene King plc, Marston's plc, Punch Taverns plc and Star Pubs and Bars (part of Heineken UK Ltd).

This is a more targeted approach than the Government's initial proposal, as it applies only to tied pubs. The parallel rent assessment requirement applies only to pub owning companies with 500 or more tied pubs and only if a potential or existing tied tenant requests it. At the same time we are ensuring that all tied tenants are protected by a Code and have recourse to an independent Adjudicator (which was not the case under the consultation proposal).

The Government wants to ensure that no tenants, whether on a lease or tenancy agreement, would be at risk of losing the protections they currently have under industry self-regulation, should those mechanisms disappear once pub owning companies are subject to the statutory regime. Evidence suggests that it is quite possible that if a Statutory Code and Adjudicator were in place, the larger pub owning companies would

Government Response

not fund two systems, which would leave those companies below the threshold having to fund the voluntary system. If that were to prove unviable and the voluntary system disappeared, more than 3,000 tied tenants[13] who are currently protected by the industry framework code would no longer be covered by any code. The future of self-regulation following the introduction of a Statutory Code and Adjudicator is covered in more detail at Question 6.

In line with the Government's policy on business regulation, micro-businesses would be exempt from all of the Code. Pub owning companies falling below this de minimis threshold would still be able to opt into the *Core* Code on a voluntary basis, enabling their tied tenants to refer disputes and alleged breaches of the Code to the Adjudicator. A pub owning company might choose to opt in so that it was not at a competitive disadvantage when trying to attract and retain tenants. We expect that this de minimis threshold would not exempt any companies currently but it would ensure that the Code does not act as a barrier to new entrants to the market.

The Government believes that the *Core* Code would not impose disproportionate costs or requirements on smaller companies as all members of the BBPA and the IFBB are already signed-up to and funding industry self-regulation. It is only an additional cost to owners of tied pubs who are not currently signed-up to the industry framework code. The Government estimates the cost of complying with the *Core* Code to be £40 per tied pub per year (the same as the cost of complying with the current industry framework code). All owners of tied pubs would also contribute to the cost of the Adjudicator which we estimate to be £90 per tied pub per year.

We considered whether the threshold should be based on types of lease or tenancy agreement and whether certain types of agreement should be exempt from certain provisions in the Code. We considered whether the Code should apply only to longer term FRI leases. We have, however, concluded that all tied tenants should benefit from the protection of a Statutory Code, irrespective of the type of agreement because the complaints received by BIS demonstrate that problems are also experienced by those who are party to traditional tenancy agreements. All of these tied agreements share the same characteristics i.e. the complex relationship between above market beer prices and 'dry' rent based on a share of projected profits. Similarly, the Trade and Industry Select Committee observed that 'The complaints we received from tenants did not generally differ according to whether they had a tenancy or lessee agreement.'[14]

We do not have evidence of problems with free-of-tie agreements and have accepted the argument that the Code should not apply to commercial property companies that are free-of-tie landlords, operating at arm's length from their tenants.

As outlined at Question 16, the Government intends that the Statutory Code and Adjudicator will be periodically reviewed, which would enable the threshold for the *Core*

[13] IFBB letter of 30 October 2013 to MPs

[14] Trade and Industry Select Committee, Second Report, 2004-05, p28

Government Response

and *Enhanced* provisions in the Code to be kept under review.

The Government's proposals for a Statutory Code and independent Adjudicator apply to England and Wales only. The intention is that tied pubs located in England and Wales would contribute towards the 500 tied pub threshold which is proposed for a pub owning company to be subject to the *Enhanced* Code, and not tied pubs in Scotland or Northern Ireland. Similarly, the levy paid by a pub owning company would be based on the number of tied pubs located in England and Wales that it owned (see Question 17 for more information on the levy).

Q.4 How do you consider that franchises should be treated under the Code?

As well as operating tied tenancy and lease agreements, some pub owning companies have developed 'franchise agreements'. These agreements all involve purchasing obligations but do vary in other aspects. Most involve a branded approach with part of the attraction for pub owning companies being that they help guarantee a replicable standard of offer to consumers in terms of drink, food and often the ambience of the pub. Some providers of these agreements also argue that they offer a radically different means of sharing risk and reward in that they include a clearly set out and enhanced package of support for the publican and in one case they do not charge dry rent, instead charging an annual franchise fee based on a percentage share of turnover.

Franchise agreements in the pubs sector are a relatively recent development and numbers are quite low in the context of the circa 24,000 tied pubs in the sector. Marston's has the largest franchise estate with 600 agreements.

The consultation asked an open question as to whether franchise agreements should be exempted from the scope of the Code.

Consultation Responses

Marston's, Spirit, Punch and Greene King, which all provide franchise agreements, argued for the exemption of those pubs from the Code. Their argument was twofold: firstly that, aside from the purchase obligations, these agreements were fundamentally different from the tenancy and lease agreements that were in scope of the Government's proposals; and secondly that an existing voluntary code managed by the British Franchise Association (BFA) offers protection for publicans and therefore separate protection is not required.

Although a fairly recent phenomenon, it is evident from the consultation responses that the nature of franchise agreements in the pubs sector varies. On the question of whether or not 'franchise agreements' are different from traditional tied agreements, Marston's sought to make a distinction in terms of its franchise model pointing to the fact that it does not charge a dry rent. Instead franchisees pay a fixed annual franchise fee, a 1.5% share of turnover and then share turnover and profit with the franchisor (the franchisee receives 20% of turnover and 20% of profit). Therefore, Marston's argues, the risk to franchisees that they will be paying an unsustainable rent is much lower:

> 'The Franchisee is provided with premises from which to operate the Franchise Business and enters into a Franchise Agreement to sell our products and services. The Franchisee pays no rent in respect of the premises. The removal of any rental payments differentiates this from other pub company 'Franchise Agreements'. The risk to the Franchisee is minimal as the initial capital outlay is low.'

Spirit and Greene King franchises have more of a focus on the different approach to providing support for the franchisee and the replicable nature of the 'pub offer'. Spirit for example said:

> 'This level of business control and support offered by the Spirit franchise agreement goes way beyond that which has traditionally been provided to a tied lease or tenancy. Franchise enables us to take much tighter control of the delivery of the right retail offer and retail standards in a local community pub thus enabling it to satisfy and respond to customer needs locally.'

Franchises are not just the preserve of the larger companies. Charles Wells also offers a franchise agreement. This is similar to the other companies in emphasising the greater support available but in contrast it makes a point of stating that it is not a 'branded concept'.

The difficulty in defining what a pub franchise is and how it might differ from pub tenancies and leases is emphasised by this response from Admiral Taverns.

> 'The differences between pub franchise agreements and tied lease or tenancy agreements are difficult to define. All will operate a product tie, and the former may charge a turnover based rent as well as a franchise fee, whereas the latter will charge a property rent. However, the former may also charge a property rent, although the landlord may not be the same person as the franchisor. In reality, all agreements are different and there may well be a grey area where an agreement has mixed elements of both broad types of agreement [...] We are therefore sceptical whether most of the franchise agreements could be excluded from a code, but some perhaps should be.'

<u>The British Franchise Association Code of Ethics</u>

As well as the pub owning companies some bodies such as the BBPA, BII, and SIBA thought the regulatory alternative offered by the BFA ought to exempt franchises from the Statutory Code. The BBPA for example said:

> 'If franchises are regulated under the British Franchise Association they should not be covered by any Statutory Code. Companies operate the franchise agreement under the British Franchise Association Code of Ethics and have undertaken to comply with the BFA's Disciplinary, Complaints and Appeals Procedures, which provide systems and procedures for dealing with any disputes between the parties.'

In its response the ALMR agreed with this in principle and attempted to define what the qualifying characteristics of the franchise agreement ought to be:

> 'If the agreement is a genuine franchise – generally relating to a branded outlet and supported by centralised marketing of that brand – accredited under the BFA and subject to separate regulation of its terms and requirements, then we do not believe that the agreement should be covered by the proposed Code.'

A number of individual and tenant interest group responses recommended caution over the decision whether or not to exclude franchises from the Code. In broad terms they argued that franchises were not fundamentally different from tied tenancies and leases and the same risk of abuse was possible. CAMRA for example said:

> 'In some cases these pub franchises appear to be little more than a rebranding of standard tied agreements. The Code must ensure that pub companies cannot avoid compliance by simply rebranding agreements.'

The IPC responded in a similar vein:

> 'Pub franchises are rarely franchises in the true sense of the definition. They are perhaps an effort to circumvent any future developments in delivering fairness by describing the agreement as something else. There is every reason to seek to include all agreements however they are described under the banner of regulation. We have seen that Marston's, Punch Taverns and Star Pub claim to offer franchise-style agreements. Marston's and Star Pub Company are members of the British Franchise Association. A traditional franchise agreement involves taking on the operation of a branded outlet supported by centralised marketing of the brand to consumers. That would not be the case here. For example, there is no consumer awareness of Punch Taverns as a brand of pub. We feel that the pub franchise model is a tying agreement and should be governed by the statutory code.'

The possibility that franchises might become a means to avoid regulation was also raised during the BIS Select Committee hearing on the consultation proposals in June 2013. Phil Dixon, an independent pub adviser said: "[...] what will happen if these proposals come in? If they come in, they will find reasons to actually do away with their tenancies. They will put things to franchise."[15]

The online survey did not ask whether franchise agreements should be covered by the Code.

Government Response

Based on the feedback received from the consultation there are three key considerations to address in the Government response. They are:

- How 'franchise' agreements and traditional leases and tenancies are different.
- Whether any differences mean that the problems the Government is seeking to address do not occur in franchises and that they therefore should be exempt from the Statutory Code.

[15] Business, Innovation and Skills Select Committee, Fourth Report, 2013-14, Ev28, Q150

Government Response

- In the event that franchise agreements do cause the same potential risk for tenants whether or not the alternative voluntary regulatory structure offered by the British Franchise Association offers sufficient protection for pub franchisees.

At first sight there are some differences to which we can point. For example, all the agreements that pub owning companies market as 'franchises' seem to offer a clearer statement of support for franchisees than is usually the case with tenancies and leases e.g. in terms of training and/or marketing.

It is also true that in some of the franchise agreements available e.g. Greene King and Marston's, the pub offer is more standardised than is the case with tenancies and leases. In fact, the branding is often similar to the managed house operations of pub companies. The Greene King 'Meet and Eat' brand, for example, covers managed and franchised pubs.

However, it is the Government's view that these two differences do not constitute a fundamental departure from the tied pub model in a way that reduces the risk of an unfair share of risk and reward for tenants. Better explanation of the support on offer from a pub owning company is undoubtedly a positive thing; but it is only part of the equation that determines if tenants receive a fair share of risk and reward. In addition, the nature of the branding of a pub is not material to the risks facing the tenant or franchisee when seeking to secure a fair share of risk and reward from a tied agreement. Therefore the Government does not consider that these differences are sufficient reason to exempt franchises from the Code.

Marston's makes a stronger case for exemption of its franchise agreements in its submission. It argues that its agreements are fundamentally different in another aspect, i.e. the fact it charges a management fee that is tied to turnover rather than a dry rent calculated on fair maintainable trade. Owing to this fact, it argues that the risk that the tenant will receive an unfair share of the reward is low and there is a greater partnership between the pub owning company and the franchisee.

The Government recognises the difference in the Marston's approach as opposed to the other franchise agreements of which it is aware. However, given that its franchise agreements involve purchasing obligations for beer at above market prices, there is still a significant risk that this combined with the franchise fee could result in an unfair share of risk and reward for tenants. Therefore it should be covered by the proposed Statutory Code. When consulting on the final version of the Statutory Code Government will consult on the specific wording of the rent sections of the Code to ensure they deliver the intended objectives for fee-based tied agreements as well as tied agreements that charge a rent.

The third key consideration for the Government concerns the protection offered to pub franchisees by their franchisor's membership of the British Franchise Association (BFA). The BFA approach comprises a Code of Ethics which all members of the BFA must abide by, mediation and arbitration schemes and compliance checks prior to admitting a franchisor into membership. The BFA Code of Ethics shares some similarities in intent and content with the proposed pubs Statutory Code. For example, it includes standards

Government Response

regarding the information franchisees are provided in advance of signing an agreement, which are designed to ensure the franchisee can make a clear assessment of the business opportunity. It also seeks to ensure more broadly that dealings between pub franchisors and their franchisees are fair.

However, after discussing the BFA Code of Ethics and its accompanying Guide to the Code[16] with the BFA, the Government is of the view that there are a number of areas where the alternative to statutory regulation provided by the BFA does not go far enough. The first is that the Code of Ethics does not contain sufficiently equivalent provisions to the Statutory Code to ensure fair dealing. For example, the Code of Ethics does not require the level of detail of pre-contractual information that is necessary to address issues in the pubs market. Furthermore and more importantly in terms of risk and reward, the BFA Code does not contain an equivalent provision to the no worse off principle and as a consequence is unlikely to ensure delivery of that principle.

Secondly, the BFA does not offer the strength and breadth of options that are proposed for the pubs Adjudicator when seeking to enforce the Code in the face of proven breaches. As set out in the responses to Questions 14 and 15 below, the Government considers it is important for the Adjudicator to have much greater powers than the existing pub industry mechanisms. These include the ability to investigate systemic breaches of the Code and the power to impose a range of sanctions following an investigation, including financial penalties and publicising breaches.

Under the BFA Code the ultimate sanction for non-compliance is to remove accreditation. This happened to two a handful of non-pub franchisors across the whole industry in 2012-13. Although there are mediation and arbitration processes the Government does not consider that – given the history of problems in the pubs sector – they will provide sufficient protection and/or redress for pub franchisees without the backing of a Statutory Code and an Adjudicator.

In conclusion – and having explored this issue in some detail, including discussions with the BFA – we have determined that there is not a clear enough distinction between tied agreements and those agreements marketed as franchises to warrant their exemption from the Code. Even though there may be no traditional ‘dry rent’, other means of charging franchisees (perhaps through an annual franchisee fee) may combine with increases in beer prices to make franchises unsustainable. In the absence of any clear terms and conditions which distinguish a franchise from a tied agreement, there is a clear risk that pub companies would re-label their tied agreements as "franchises" so as to fall outside the scope of the Code.

Nor do we consider that it would be sufficient to allow franchisees to be protected via the BFA Code of Ethics. While containing many positive aspects, the BFA Code is voluntary and does not go far enough in ensuring the core principles behind the

[16] BFA Code of Ethics and Guide to the Code, 1991

Government Response

Government's measures for the pubs sector would be achieved, especially the no worse off principle. Nor does it offer the enforcement mechanisms required to address the problems in the relationship between pub companies and their tenants.

Q.5 What is your assessment of the likely costs and benefits of these proposals on pubs and the pubs sector? Please include supporting evidence.

Many of the responses to this question related back to comments which had been made about specific aspects of the proposals set out in the consultation. Some of these comments are dealt with in the appropriate section of this Government Response and will not be rehearsed in detail here. For example, a number of respondents from both sides of the debate raised concerns about the mechanistic parallel rent assessment formula set out in the consultation. We have taken these concerns into account and intend to pursue a more targeted approach to the formulaic approach outlined in the consultation. Instead, as outlined in the Executive Summary, we propose that the parallel free-of-tie rent assessment should be carried out on a pub by pub basis, using the same methods as are used to set free-of-tie rents in the market. This proposal and the estimated impact on pub closures are set out in further detail in the response to Question 11, while the implications of this approach in terms of costs and benefits are detailed below.

Consultation Responses

Views on Likely Benefits

For tenants, the benefits of the Government's proposals clearly lay in ensuring that they are treated fairly. As one tenant commented:

> 'It is vitally important that a fair partnership exists between Pub companies and tenants, the current situation is very one sided and many tenants are working long hours for less than minimum wage whilst some Pub Companies are making healthy profits at the Tenants expense.' [sic]

Several responses to this question from interest groups representing tenants – such as the All Party Parliamentary Save the Pub Group and the Fair Pint Campaign – argued that a mandatory free-of-tie option would deliver the full benefits of the core principles of fair dealing and no worse off and 'will mean that tied licensees would receive a fairer share of pub profit.' One tenant commented that this 'would allow us to receive a salary (we have taken nothing from the business for four years) and also provide funds to re-invest into the business.' Further to this, the All Party Parliamentary Save the Pub Group argued that the fairer share apportioned to tenants 'will encourage entrepreneurial flair where it is currently lacking, reinvestment, training jobs and most importantly profitability will ease the closure of pubs and business failure rate of tied publicans.'

While pub owning companies highlighted the additional cost of complying with the Government's proposals, the FLVA's response noted that, conversely, 'there would be no *requirement* for an individual code to be produced and no accreditation costs incurred in ensuring that the individual Company code is in accord with the industry code as at

present, this would represent a saving to Pub Co's in comparison to the current structure' [emphasis added].

Views on Likely Costs

Many of the responses from pub owning companies expressed the view that the Government's proposals would place additional costs on pub owning companies. Spirit Pub Company commented that it currently incurs annual costs of £200,000 to support self-regulation and believes that the Government's proposals 'would significantly impact on these costs.'

Some pub owning companies suggested that any increase in costs would have a knock-on effect on the way in which they operate their estate. Mitchells & Butlers, for example, commented that 'any additional administrative burden would shift some focus away from supporting our tenants', while the BBPA suggested that the proposals would reduce the overall level of investment in pubs, as 'licensees would not be able to invest in their pubs to a level comparable with the significant amount of investment by pub companies in their estate each year.' By contrast, the response from the Fair Pint Campaign rejected the risk of decreased investment as 'ludicrous' and argued that the campaign is aware 'of very few members who have had any investment from their pub company in the fabric and structure of the building.' Views on the potential unintended consequences of the proposed measures are covered in more detail in the response to Question 11.

For some pub owning companies below the 500 threshold proposed in the consultation, there was concern that there would be an impact on the cost of continuing with self-regulation. In its consultation response, Everards Brewery suggested that the introduction of a Statutory Code and Adjudicator 'will impact on smaller companies with less than 500 houses as we will still have to maintain PICAS and PIRRS as part of self-regulation.'

Others, such as Wellington Pub Company argued that 'the increased costs of owning premises let as pubs […] would inevitably lead commercial property companies such as Wellington to reduce the number of pubs in their property estates.'

Independent Research

The Government commissioned London Economics to undertake an independent analysis of the impacts of the two options proposed in the consultation[17]. Separately, the BBPA also commissioned Compass Lexecon to undertake an impact analysis on its behalf.

London Economics modelled the impact of four scenarios using data from pub owning companies. One scenario was mandatory free-of-tie, with the assumption that only those tenants who thought it would benefit them would choose this option. This produced an estimated closure figure (from the approximately 13,000 tied pubs affected) of between 700 and 1,400 pubs, with the resulting employment impact being 3,700 to 7,000 jobs lost.

[17] This analysis was published along with the consultation responses and can be found on the consultation website.

Compass Lexecon modelled the potential impacts on behalf of the BBPA and pub owning companies in view of concern that mandatory free-of-tie would drive closures in the market.[18] It concluded that if all licensees exercised the mandatory free-of-tie option, this would lead to 2,300 pub closures with the loss of 18,400 direct jobs.

London Economics also modelled the impact of a mechanistic parallel rent assessment and estimated that this option – as envisaged in the consultation – would result in the closure of 0 to 700 pubs. This was based on the observation that a high number of pubs are at the margin of viability from the pub owning companies' perspective and could therefore be impacted by even a small change to the revenues which pub owning companies draw from those pubs. However, the research also indicated that consumers would move from the pubs which closed and take their custom to other pubs, thereby helping to make those marginal pubs more viable.

London Economics was keen to emphasise the difficulty of producing estimates of this kind:

> 'It is our conclusion that the reforms proposed in the consultation will close up to 1,600 pubs, although there is very great uncertainty about the precise value; In particular, the size of the transfer from pubcos to tenants resulting from the no worse off principle is very hard to estimate, our results reflect the impact of a range of possible transfer values; However, there is clearly surplus pub capacity, in quite a volatile market where, with so many pubs on the margin of viability it is hard to determine which pubs will close.' [sic]

Government Response

Benefits

Successive Select Committees have found that tied tenants are not able to secure a fair balance of risk and reward in agreements with their pub owning company. In 2009, the Business and Enterprise Select Committee commented that 'The pubcos may share the risks with their lessees but they do not share the benefits equitably'[19]. In its report of September 2011, the Committee expressed frustration 'that within the industry there is still confusion over the status and interpretation of the principle that a tied tenant should be no worse off than a free-of-tie tenant'[20]. The key benefit of the Government's proposals for a Statutory Code and independent Adjudicator is in addressing the imbalance in the relationship between pub owning companies and tenants, and ensuring that tied tenants are treated fairly. Crucially, fairness for tenants means being

[18] BBPA Response to the Government Consultation, Annex A

[19] Business and Enterprise Committee, Seventh Report, 2008-09, vol 1, pp 50-51

[20] Business, Innovation and Skills Committee, Tenth Report, 2010-12, vol. 1 p. 24

Government Response

treated in line with the core principle that the tied tenant should be no worse off than the free-of-tie tenant.

The no worse off principle is primarily delivered through the right for tenants to request a parallel free-of-tie rent assessment once rent negotiations have failed. This will require a tenant to pay a £200 fee to the Adjudicator, the purpose of which is to ensure that tenants consider carefully if the parallel free-of-tie rent assessment is necessary for the negotiation to be concluded successfully. The Government intends that this assessment will provide the tenant with the benefit of a point of comparison and better information, to address the imbalance in bargaining power between tenants and pub owning companies.

A further benefit is that the independent Adjudicator will have greater powers and provide stronger enforcement than current self-regulatory arrangements, thereby providing greater protection for tenants. The Government intends that the Adjudicator will not only be able to investigate individual cases where breaches of the Statutory Code have been reported, but also systemic breaches of the Code occurring in the industry more widely. In finding a company guilty of breaching the Code, the Adjudicator would have the power to impose financial penalties and publicise breaches – so called 'naming and shaming'.

The Government recognises that these proposals for a statutory Code and Adjudicator will have costs, which are set out more fully below. In the Government's view, the benefits which statutory intervention will bring in terms of better enforcement and protection for tenants outweigh these costs to the industry.

Costs

The main costs of the Government's proposals relate to the setting up and running of the independent Adjudicator, the cost to pub owning companies of complying with the Code and the cost of possible pub closures. The Government estimates that the set up costs for the Adjudicator will be approximately £540k, with ongoing costs estimated at £1.8 million, including costs such as arbitration, investigations, appeals and accommodation.

The Government estimates that the cost to pub owning companies of complying with the *Core* provisions of the Code will be the same as complying with the voluntary code. The BBPA estimate that compliance with the voluntary code costs around £40 per pub per year.[21]

The *Enhanced* Code includes the requirement to provide a parallel free-of-tie rent assessment to tenants upon request once rent negotiations have failed and applies to

[21] This includes costs for compliance, training and other costs, but excludes the cost of running PICAS and PIRRS.

Government Response

tied agreements operated by pub owning companies with 500 or more tied pubs. The costs of complying with the *Enhanced* Code are therefore focused on those companies about which the Government has received the most complaints. Furthermore, pub owning companies will not be required to provide a free-of-tie rent assessment for all rent reviews, but only once rent negotiations have failed and where the tenant requests it – thus mitigating the cost for pub owning companies. The additional cost to these companies of producing a free-of-tie rent assessment will be similar to the current cost of producing a tied rent assessment, although rental assessments will be more costly where there is greater dispute around the rental amount proposed. The Government estimates that the total cost to pub companies will be approximately £2.5 million.

It is important to note that these measures represent a more targeted approach than the consultation proposals for a formulaic parallel rent assessment, upon which the London Economics research was based. In assessing the impact of the formulaic parallel rent assessment, London Economics based its estimates on a transfer of value from pub owning companies to tenants taking place across the board. This, in turn, implicitly assumes that there is unfairness in the relationship between tenants and pub owning companies across the board. In moving away from the formulaic parallel rent assessment set out in the consultation, towards a rent assessment completed on a pub by pub basis, the Government believes that the number of resulting closures will fall, as there will be a transfer from pub owning companies to tenants only where the current agreement is unfair Crucially, this means that the policy should not result in the closure of sustainable pubs; closures will be restricted to those pubs which are viable for pub owning companies only because the tenants are worse off. Our best estimate is that this would lead to a total of only 52 pub closures. By contrast to the formulaic approach set out in the consultation, the pub by pub parallel rent assessment which the Government now advocates should therefore have a more targeted impact on the industry.

Any closures should be seen in the context of the existing long-term decline in pub numbers, with 26 pubs closing a week between September 2012 and March 2013. In its report, London Economics noted that if the measures were to result in closures 'it would act as a substantial fraction of this long-term trend which is likely to occur unless major changes to tax policy and social norms take place.'

A further breakdown of the benefits and costs of the Government's proposals and the underlying assumptions can be found in the accompanying Impact Assessment.

Future of self-regulation

Q.6 What are your views on the future of self-regulation within the industry?

The consultation recognised that self-regulation had led to 'some positive impact on the industry' and suggested that the Government would strongly support it continuing until a statutory solution could be put in place. The consultation noted the positive role that PIRRS and PICAS had played in resolving disputes and the Government's view that it did not wish to discourage these from continuing to operate after the proposed Adjudicator was established. It was suggested that this would give tenants the option of referring a dispute to the Adjudicator or to the alternative dispute resolution mechanisms.

The consultation also suggested that it would be strongly beneficial if companies with fewer pubs than the proposed statutory threshold continued to operate a self-regulatory regime or voluntarily committed to use the arbitration function of the Adjudicator to resolve disputes.

Consultation response

Many responses to this open question included comments about the current state of self-regulation – for example, providing views on how it could be improved, from both those in support and those opposed. We have not rehearsed those arguments here. The question generated a mixed response from those respondents who offered a view on the future of self-regulation once a Statutory Code and Adjudicator were in place.

The BBPA commented that 'We and our members are committed to ensuring that, despite Government intervention, the self-regulatory system will continue for companies below the threshold.'

The question generated a mixed response from tenants and their representatives. One tenant commented that:

> 'In my opinion, self-regulation will never work. There is, in reality, no real desire for it to work, only the appearance that it does. It is currently used only to appease government and forestall the implementation of a statutory code. There has been no significant improvement in the lessee/landlord relationships, no redress of balance of power and no rebalancing of risk and reward.'

The Fair Pint Campaign said its members had 'absolutely no interest in the continuation of self regulation, we consider it is an ineffective and unnecessary burden on the industry as a whole and little more than a BBPA inspired illusion to avoid statutory regulation.' The IPC suggested that 'A saving could be made by dissolving the self regulatory regime once the statutory code and Adjudicator are established [...] The savings in maintaining PICAS, PIRRS, BIIBAS and/or the proposed self regulatory body could contribute to the likely costs of the adjudicator.'

The BII, the administrator of the current self-regulation mechanisms, reported that 93% of its members agreed that companies not bound by the Statutory Code should continue with a voluntary code as 'This would ensure that all tied tenants and lessees are afforded some protection whether this is by a Statutory Code or a voluntary Code.' At the same time, the BII said its members would prefer all to be protected under a Statutory Code.

The ALMR agreed 'that it will be strongly beneficial for the self-regulatory regime to continue up to and after a statutory solution is in place. We believe it to not only be beneficial but essential that it does if we are not to abandon tenants/lessees outside of the scope of statutory regime. Whilst a voluntary code may still be in operation, without the self-regulatory structure of PIRRS and PICAS, there will be no mechanism to enforce it and those individuals will be back to the same situation which applied pre-2008. There is a fear that, after legislation takes effect, companies not caught by the statutory regime will remove their support for the current voluntary Code and independent redress mechanism and we welcome the clear statement from Government that that must not happen.'

Funding was the main issue raised by respondents in commenting on the future of self-regulation once a Statutory Code and Adjudicator were in place. There was concern about the cost burden on the industry particularly the cost for smaller companies below the proposed 500 threshold, leading many respondents to support a single system.

Punch Taverns commented that 'In the event of a Code being implemented, then it should apply to all. Two systems should not be run in parallel, as this would be a dual cost to the pub sector'.

The BII said that 'As the probable administrator of any such voluntary system we would also be very concerned as to whether we could acquire the necessary level of funding given that only a relatively small number of pubs would be contributing to the cost, while the overheads in maintaining the voluntary [code] would decrease proportionally.' The BII also commented that 'A Statutory Code that applies to all tied tenancies and lessees would avoid the difficulties that will arise in trying to run the two systems together. Furthermore, the BII would have some difficulty in providing a service to what would be a small and separate part of its membership, the vast majority falling under the statutory regulator.'

By contrast, the ALMR commented that:

> 'PIRRS and PICAS offer a low cost alternative for airing and resolving commercial disagreements, and we agree with the Government that a range of options should be available to lessees. In these cases, the Adjudicator could act as a final ombudsman and it may help to reduce its ongoing operating costs, allowing the focus of resources to be on the most significant and substantive cases.'

There was some suggestion that the existing industry services could operate alongside the Adjudicator. For example, Heineken UK/Star Pubs and Bars said that 'If introduced, the Adjudicator should [...] operate alongside a continued PIRRS and PICAS service that would operate as a low cost mechanism which could also consider a wide range including smaller issues that would clog up the Adjudicator; become an appeal mechanism for tenants unhappy with the outcome of PIRRS and PICAS; and be freed up to investigate the most serious allegations of abuse.'

In its July 2013 report, BISCOM noted that 'Both PICAS and PIRRS have been positive developments in the pub industry but we are unclear as to how they will fit into a new statutory landscape. The Government needs to ensure that, whichever route it takes, the role of these two arbitration bodies is not lost as a result of a statutory/non statutory split in the oversight of the industry.'

Government Response

Views varied across the industry as to whether the current self-regulation mechanisms should and/or in practice could, continue alongside a statutory approach. The Government sees the merit in tenants having a choice of arbitration mechanism but whether PIRRS and PICAS do continue is essentially a question for the industry. Given the persuasive evidence that self-regulation may lapse after the introduction of a Statutory Code and Adjudicator, the Government intends to ensure statutory protection for all tied tenants.

As set out in the response to Questions 13 to 16, it is proposed that the Code will provide that tenants should exhaust any in-house dispute resolution procedure before taking a dispute to the Adjudicator, although safeguards will be put in place to ensure that such mechanisms are not used to prolong unnecessarily the period before a tenant can refer a complaint to the Adjudicator. The Government intends that the Code will provide that complaints can be brought to the Adjudicator for arbitration only after a period of 21 days has elapsed in which the tenant and pub owning company have tried to resolve the dispute. Tenants will continue to have the option of seeking arbitration from an independent expert or arbitrator through the RICS Dispute Resolution Service.

Content of the Statutory Code

In the consultation the Government stated its intention to base the Statutory Code on the core principles that a tenant should be treated fairly and lawfully; and that a tied tenant should be no worse off than a free-of-tie tenant (the no worse off principle). These principles aim to ensure a fair balance of risk and reward between pub owning companies and tenants, and the Government proposed that all other provisions of the Statutory Code should be interpreted purposively in the light of these core principles.

The difficulties which tenants face in securing a fair share of risk and reward in their agreements with pub owning companies have been clearly documented in the evidence gathered by four BIS Select Committees over the last decade and in the numerous reports which the Government has received from tenants, as well as from MPs writing on behalf of their constituents. In 2009, the Business and Enterprise Select Committee commented that:

> 'Increasing a pub's turnover will benefit the pubco as it increases the sale of tied products. To our surprise it does not seem to benefit the lessee to nearly the same extent. […] The pubcos may share the risks with their lessees but they do not share the benefits equitably.'

While Version 6 of the Industry Framework Code contains a number of provisions which support tenants, specifically in relation to pre-entry training and transparency, the Government considered that it did not go far enough in terms of addressing the balance of risk and reward between pub owning companies and tenants. The Government therefore stated in the consultation that, while the Statutory Code may take Version 6 as a starting point, it would need to build on and strengthen the provisions considerably to achieve the Government's policy aims, particularly in terms of addressing the balance of risk and reward.

The Government sought views on whether the core principles of fair and lawful dealing and no worse off were correct, whether the Code should include a mandatory free-of-tie option and whether the Code should address other issues related to the balance of risk and reward, including: the right to request an open market rent review; transparency; the gaming machine tie; a guest beer option and the use of data from flow monitoring equipment. In addition to this, the consultation also encouraged suggestions as to other ways to ensure that tied tenants are no worse off than free-of-tie tenants, and views on whether the draft Code should be altered.

Q.7 Do you agree that the Code should be based on the following two core and overarching principles:

i. Principle of Fair and Lawful Dealing?

ii Principle that the tied tenant should be no worse off than the free-of-tie tenant?

The core principles of fair and lawful dealing and no worse off were broadly welcomed by those who responded to the consultation. More than 600 tied tenants (86%) responding to the online survey agreed with the principles, with over 90% of all 6,992 respondents to the survey question agreeing with the principles.

The question elicited fewer answers in written submissions to the consultation, with the majority of respondents not answering the question. Answers were provided mostly by those representing interest groups and pub companies and breweries with 500 or more pubs. The responses showed that the majority of pub companies and breweries with 500 or more pubs agreed with the principle of fair and lawful dealing (73%). This was echoed by the response from interest groups; 60% of written responses in this category agreed with the principle. In the majority of the other categories of respondents, those who did respond agreed with the principle.

The consultation question on the no worse off principle was also largely unanswered in the written submissions. Those who did respond to the question were largely in favour of the principle that the tied tenant should be no worse off than the free-of-tie tenant, although views on this principle were more mixed. While the majority of respondents from the tenants, political representatives and pub company and brewery employees categories did not answer the question, all of those in these categories who did respond agreed with the principle. Tenant interest groups were more supportive, with the FLVA, BII, ALMR and IPC in favour. The IPC, for example, said:

> 'The delivery of fairness is dependent upon a tied licensee being no worse off than if they were free of tie. The challenge is how to deliver fairness and a tied licensee no worse off, this can not be achieved by a formulaic approach alone.'

In the categories of pub companies and breweries with 500 or more pubs and pub companies and breweries with fewer than 500 pubs, the responses from those who answered the question were more evenly balanced (56% of pub companies and breweries with 500 or more pubs agreed; 50% of pub companies and breweries with fewer than 500 pubs agreed). A number of the pub companies suggested that they agreed in theory with the no worse off principle but had concerns about how it would work in practice. Admiral Taverns, for example, said:

> 'Yes, certainly, to the first principle as we are entirely confident that this is how we operate anyway. As for the second principle, we would agree in theory, but are unclear as to how this would be defined or calculated in practice, and believe it to be impracticable to adopt in reality.'

In a similar vein, Punch Taverns commented that 'This is very difficult to do in practice,' while the BII expressed 'reservations as to how the second principle can be applied.' The responses indicated that there are difficulties in determining if a tenant is 'worse off' under a tied agreement than they would be in a free-of-tie agreement, due to differences in the way in which the tied and free-of-tie models function; for example, Enterprise Inns commented that 'Tied tenants operate under a very different risk/reward profile to free-of-tie tenants.'

Respondents from both sides of the debate noted that the differences in the way the tied and free-of-tie models operate meant that a parallel rent assessment of the sort proposed in the consultation document would be impractical. Star Pubs and Bars likened the formulaic approach outlined in the consultation to 'comparing apples and oranges', while Marston's commented that 'As most pubs are unique it will be extremely difficult to develop a formulaic method to compare' the two types of agreement. Similarly, the ALMR stated that it does not believe that 'a totally formulaic industry average approach is the most appropriate way forward.' Several pub companies advised that it would be impractical to specify the value of the benefits provided by pub companies to tied tenants (known as

SCORFA[22]) for the purposes of a formulaic parallel assessment, as the value ascribed to these benefits varies by tenant and is difficult to quantify.

Government Response

In reviewing the consultation responses to this question it is not straightforward to detach views on the proposed core principles from the means by which the Government proposes to deliver them. This is less the case with the first principle of fair dealing, where there is support across the board. On the principle of no worse off, however, respondents were keen to focus on the means of implementation rather than on the principle itself. While a number raised concerns about how the principle would be applied in practice, the responses showed that some pub owning companies did agree with the principle in theory. Furthermore, an analysis of the responses of tenants and their representatives clearly shows that the no worse off principle is of great importance to them and underpins in many cases their support for the mandatory free-of-tie option.

The Government considers that the core principles of fair and lawful dealing and that the tied tenant should be no worse off than the free-of-tie tenant are critical to building on the current requirements of the Industry Framework Code to address the imbalance in risk and reward between pub owning companies and their tenants. These principles will be enshrined in legislation.

However, on the basis of the evidence submitted to the consultation, the Government recognises that the formulaic parallel assessment originally proposed in the consultation does not provide the appropriate means for ensuring that tenants are no worse off under a tied agreement than they would be under a free-of-tie agreement. The options for delivering no worse off were addressed more directly in other parts of the consultation, notably in Questions 8.ii. and 11 and it is in those sections that we set out our final proposals.

[22] Special Commercial or Financial Advantage

Q.8 Do you agree that the Government should include the following provisions in the Statutory Code?

Question 8 set out a number of areas where the Government considered it may have been helpful to strengthen the Code to ensure a fair balance of risk and reward between pub companies and tenants.

i. Provide the tenant the right to request an open market rent review if they have not had one in five years, if the pub company significantly increases drink prices or if an event occurs outside the tenant's control.

The objective of proposing this measure was to enable the maintenance of a fair share of risk and reward during the life of a rental agreement. Select Committee reports have identified this as a key issue for tied tenants. It is particularly important where events outside the tenant's control significantly increase costs and/or reduce turnover to an extent that the tied agreement risks becoming unsustainable for the tenant. The 2004 DTI Select Committee report established this as an area where more should be done:

> 'Some pubcos are willing to offer rent concessions in cases where tenants are experiencing financial difficulty through no fault of their own, for example because of demographic changes or because the public house is closed for repairs. We recognise this as good practice and commend it to the industry as a whole.'

In addition to events outside the tenant's control, this measure was designed to ensure tenants on long-term agreements with widely spaced rent review intervals did not wait more than 5 years for a review.

Consultation Responses

Of the 6,491 people who answered this question in the online survey, 92% agreed that the Code should include a right to request an open market rent review at the suggested trigger points. At a disaggregated level, 84% of tied tenants agreed as did 88% of pub industry employees and 93% of individual respondents.

In terms of written responses, fewer than 10% of respondents answered the question. Of those that did answer, the majority were in favour of this proposal. The strongest response was from political representatives, where 97 were in favour, ten did not answer and none were against.

The BBPA believes that this provision is already common practice: 'A number of pub companies already have this provision within their company code.' Pub owning companies of all sizes were also at pains to explain that they try to minimise price increases and when tenants approach them with difficulties, they work hard to support them. Admiral Taverns, for example, said:

> 'We have worked hard not only to keep our Wholesale List Prices changes each year below suppliers' list wholesale prices increases and below the annual RPI increase across our product portfolio: for instance in the three years 2011 to 2013 our average wholesale list price has risen by 9.88% compared with 10.84% increases from suppliers and 12.89% for RPI.'

Just under 500 tenants wrote to support their pub owning company. Although these letters did not answer the specific consultation question, they were all positive about their company's support. This Punch Taverns tenant, for example, said:

> 'When times have been hard Punch listened when we asked for help and out business manager reduced our rent, firstly by way of temporary support to get back on our feet and then permanently by changing the terms of our lease.' [sic]

At the same time a few tenants reported that pub company support through 'business recovery plans' tended to be focused almost exclusively on how the tenants could work harder to maximise their turnover rather than looking at other issues that may be affecting trade and/or costs.

The concern that ongoing price increases threaten their profitability was common among the responses received from tenants. For example:

> 'We based our pricing on the previous Tenant, whom we know quite well and did our budgets on that information. The day we walked in the doors Enterprise put all draughts up by two pence a pint and also on the bottles [...] In February they put the beer up by a further 6 pence. I could no longer absorb this and passed it on to our loyal customers. When we took over the pub the price of a 22keg of Carling was £299, we are now paying £313 that an 8 pence increase.' [sic]

This Punch tenant wrote in support of the company and stated that he was happy with their treatment of him. Pricing was an issue however:

> 'Our only negative comment would be that the pricing levels do not enable us to compete with many other operators. In these "hard times", it would be better to lower the cost price to allow us to pass on any savings and thus hopefully increase turnover and throughput.'

Concerns at price increases were often linked to a belief by tenants that changes in wholesale prices are not passed through by pub owning companies in a transparent fashion. This is particularly important given that pub companies are able to secure significant discounts on wholesale prices. The FLVA for example argued:

> 'Pub Co's should offer beer supply to their tied tenants which provides a linkage between the wholesale prices enjoyed by the Pub Co's and those offered to their tenants, insomuch that supplier "price increases" should only apply to the tenant at the same time and in the same cash quantum as those increases are levied on the Pub Co concerned. Removing the current situation where at each price increase the differential between Tied and FOT pricing increases compounding the situation. This concept of margin maintenance is already practiced in the free trade and would be regarded as a tangible bankable aspect of "fair trading".' [sic]

A number of issues were raised about the implementation of the measure. For the ALMR the Government proposal:

> '…will be particularly beneficial to have this included as a right where there is a change of ownership of the head lease as it is this which often triggers a change in pricing or other terms. It will only be meaningful, however, if the requirement to

> provide a detailed rent assessment as outlined in Annex A of the Code also applies in these circumstances.'

Some pub companies raised concerns regarding the implementation of this measure e.g. how the triggers for the rent review, such as 'substantial price increase', would work in practice and how the code would stipulate when an adjudicated rent would apply. There was also concern that the concept of 'events outside the tenant's control' could be very broad. Enterprise Inns for example argued:

> 'The general economic consequence of the collapse of Lehman Brothers was clearly outside the control of a pub tenant but it could have impacted significantly on its trade as part of the broader economic climate. Surely these sorts of market events should not trigger a rent assessment?'

For contrasting reasons one of the main tenant groups, the FLVA, also emphasised the need to carefully define triggers. Its concern was to ensure there would be no unnecessary delays once a tenant, who might be in financial difficulty, wanted to exercise the right to a review.

Government Response

The *Core* Statutory Code will include a provision that tenants will have the right to request an open market rent review if they have not had one in five years.

The Government is mindful of the concerns from both pub owning companies and tenants that the provisions to enable a tenant to request a rent review within this period – if the pub owning company significantly increases drink prices or if an event occurs outside the tenant's control – would need to be carefully designed. With this in mind, before finalising these provisions the Government will consult on their precise definition. In doing so we will seek to draw on existing practice in the industry – such as the Everards' approach called "Material Changes and Exceptional Circumstances", which is applied when changes outside the tenant's control have a negative impact on the pub's business.

ii. Increase transparency, in particular by requiring the pub company to produce parallel 'tied' and 'free-of-tie' rent assessments so that a tenant can ensure that they are no worse off.

Concerns about a lack of transparency in dealings between pub owning companies and their tenants have been a consistent thread running through Business Select Committee reports since 2004. The 2009 report expressed concern at the lack of progress in implementing previous recommendations: 'the arrangements for assessing rents remain opaque, despite the Trade and Industry Committee's recommendations for greater transparency' and later: 'Given the industry's inability to reform itself in the past, BERR needs to look urgently at the inequalities of bargaining power between pubcos and lessees. Recommendations to improve the transparency of rent assessment should be implemented.'

The draft Code included a number of provisions which would require pub owning companies to be transparent in their dealings with tenants to ensure that tenants understand the terms of their agreement and to enable them to fully understand the business risks and opportunities. They are based largely on the existing Industry Framework Code.[23]

Specific examples of transparency provisions proposed in the Statutory Code include requirements to provide: a full description of the premises; information about the range of support programmes available to the tenant; the process for dealing with dilapidations and details of any purchasing obligations whether food, drink or services. It also would require the pub owning company to provide information alongside the rent assessment, particularly regarding the assumptions for key elements of the assessment such as Fair Maintainable Trade and information on the market comparable data used.

The draft Code also included a requirement that pub owning companies produce parallel tied and free-of-tie rent assessments which set out the turnover, gross profit, costs and divisible balance, as well as explicitly listing and quantifying any SCORFA and comparing the projected post rent balances in a tied and free-of-tie scenario for the same pub. This proposal was intended to deliver the no worse off principle, as the parallel rent assessment would provide an adjustment to the tied rent to ensure that the post-rent balance under the tied agreement was the same or greater than under the free-of-tie illustration.

Consultation Responses – General Transparency

In the written responses of those who answered the question, there was broad support for increased transparency. Of the seven pub owning companies with 500 or more pubs that answered, five were in favour; and of the seven pub owning companies with fewer than 500 pubs including micro-breweries, six were in favour. Only 44 of 545 tenant responses answered the question with all of them being in favour.

In response to the online survey, 84% of more than 6,000 people who responded to this question supported greater transparency and the requirement to provide a free-of-tie parallel rent assessment. Of these, 82% of tied tenants and 79% of pub industry employees agreed.

In written responses, a number of pub owning companies of all sizes were keen to emphasise that they had improved the transparency of their rent assessment processes and the BBPA outlined how the new voluntary industry code had clear provisions on transparency:

> ‘Version Six of the Code is a major step forward from Version Five as it provides greater transparency for tenants and lessees and seeks to tackle a range of more commercially sensitive issues.’

However, there were responses from tenants which confirmed earlier BIS Committee findings i.e. that despite the IFC provisions too many tenants did not receive

[23] IFC version 6.

comprehensive information on the assumptions underpinning pub owning company rent assessments. This in turn was causing them to sign up to unsustainable agreements. For example:

> ‘In my experience pub companies market the prospect of a pub tenancy with very "optomistic" trading figures & try as I might before actually signing a tenancy agreement. Marston’s Nor Punch pub company would show me a cost price list for drinks & gave no indication of their wet rent being so closely calculated that a tenant might only survive on a meagre existence.’ [sic]

This Enterprise Inns tenant also reported a lack of transparency:

> ‘Our rent review commenced a few months late and the first step taken was for Enterprise to ask for our figures and calculations, which is not how their Code of Practice stated it would happen.
>
> Over the course of the review they refused to show a breakdown of their calculations, showed us other pubs arbitration paperworks as a threat against us going to arbitration (this was illegal, and the pubs they showed us were London based that had no similarity with us) and refused to acknowledge our figures.’ [sic]

Another tenant was concerned at other charges that were added to the rent:

> ‘The rent for the pub that we had been quoted didn't include rent for the apartment upstairs, which we had to use as a term of the property insurance. Other charges added into this caused the monthly rent and fittings to cost us almost £5,000 per month, for a pub which, at a push, could hold sixty people at a time! They would have to eat and drink a lot to make that sort of profit in any establishment.’

Consultation Responses – Parallel Rent Assessment

As set out above, the responses to the online survey suggest significant support for greater transparency and the parallel rent assessment proposal. With regard to the parallel assessment element, comments in the written responses suggest a more qualified position. Concerns were expressed by pub owning companies of all size (including microbreweries), some of the tenant representative bodies, RICS and the OFT.

This concern was centred in particular on the attempt to apply a single formula across all agreements which could result in an ‘automatic’ rent adjustment. Responses from a range of stakeholders argued this was too simplistic. It was felt that the assumptions required to enable it to be applied to all pubs could lead to perverse outcomes. For example, it could mandate rent adjustments to rent assessments where the pub owning company was already behaving fairly. Admiral Taverns raised this as a concern:

> ‘The average licensee with a tenancy agreement pays a rent to Admiral that is only 8.6% of their estimated turnover (ex-VAT) – which is well below market norms – indicates why we have never had a rent review referred to PIRRS or settled by any other external body, and why there is very little current demand for FOT rent quotes from our licensees. It is difficult to see how a bureaucratic requirement which is highly open to misinterpretation would do anything other than create antagonism where currently it does not exist and so we would disagree with this proposal.’

Concerns were also raised about whether the 'formulaic approach' could capture the nuanced differences in risk between a tied and free-of-tie rent agreement. Punch Taverns, for example, argued:

> 'In a practical scenario, the overarching principle of comparing a single pub on a free-of-tie basis and on a tied basis, as set out in the example in Annex A of the Code, is at best flawed and at worst impossible for a single property pub valuation. The principle of valuation should be about evidence of comparable market transactions, not a statement taken out of context and developed by a tenant's advisor.'

The professional body for surveyors, RICS, also had concerns at the practicability of the parallel rent assessment proposal:

> 'The rent assessment statement asks the valuer to specifically quantify everything that he/she has considered to obtain a free of tie rent and from this series of balance and measures will then calculate an appropriate rent for its tied equivalent [...] this simple formulaic approach takes no account of the real world in which it sits. The open market does not work in this way, and valuation which interprets it, is different to this form of mathematical accounting.'

There was nevertheless support for the principle of a parallel rent assessment from tenants and their representatives. The ALMR argued:

> 'A detailed rent assessment statement, ideally providing parallel assessments of tied vs free of tie terms, must be provided not only ahead of initial rent setting but also rent review and lease renewal. This will equip the lessee with the information required to enter into a genuine commercial negotiation and to assess the fairness and full implications of the deal being offered to him.'

Government Response

The consultation responses have confirmed the findings of past Business Select Committee inquiries that often rent review processes and the assessments they produce are not sufficiently transparent and as a result of the imbalance in negotiating power lead to tenants signing unsustainable agreements that are unlikely to deliver a fair share of risk and reward. There is also proof of shortcomings in transparency about the contractual rights and responsibilities of tenants, e.g. for repairs, which means that the tenants may not have a complete understanding of the costs they may incur in running the pub.

The Government, therefore, will include in the Statutory Code a range of provisions to address problems in the transparency of the agreement being offered to tenants. It will stipulate the pre-contractual information that must be provided to prospective tenants and the information and assumptions that are to be provided alongside rent assessments. This is a central element of the ability of the Statutory Code to ensure fair dealing between pub owning companies and their tied tenants.

The Government has accepted the feedback that the design of the parallel rent assessment as proposed in the consultation has drawbacks. It could lead to rent

Government Response

adjustments to tied agreements where the pub owning company is already providing a rent subsidy. It also is difficult to account for the different risk factors involved in a free-of-tie agreement as opposed to a tied agreement when applying the suggested approach in a single formulaic approach across the industry. A more specific pub level approach can better account for these variables, and this is set out in the response to Question 11.

iii. Abolish the gaming machine tie and mandate that no products other than drinks may be tied.

Beer is not the only product which pub owning companies can require tenants to purchase from them. Tenants can also be tied for goods and services such as soft drinks, spirits, snacks and gaming machines.

Many tied agreements include a 'Gaming machine tie', also known as the Amusement With Prizes (AWP) machine tie, which places an obligation on tenants to source their gaming machines through approved suppliers. Tenants then share the profit from the machines with their pub owning company, usually on a 50:50 basis. The 2004 and 2009 Business Select Committee inquiries established that the cost of rental of these machines was usually higher than on the open market and both inquiries concluded that the 'machine tie' brought little benefit to tenants and should be removed. The 2009 report said:

> 'In 2004 the Trade and Industry Committee concluded that "In our opinion, pubcos do not add sufficient extra value from their deals to justify their claims to 50% of the takings from AWP machines. We remain unconvinced that the benefits of the AWP machine tie outweigh the income tenants forgo and we recommend that the AWP machine tie be removed." That conclusion remains valid.'[24]

The 2010 Select Committee report echoed these conclusions and suggested another option:

> 'It is unacceptable that pub companies have again failed to address the AWP tie or to seriously offer free of tie options. If the AWP tie offers the benefits claimed for it, offering such a choice on an informed basis would demonstrate goodwill at little if any cost to the pub companies as lessees will freely chose to retain the tied machines.' [sic] [25]

In the consultation, the Government agreed in principle with the view that the gaming machine tie served no good purpose. It also expressed concern that were it to be removed the lack of willingness by pub owning companies to act on this matter might mean they

[24] Business and Enterprise Committee, Seventh Report, 2008-09, p39

[25] Business Innovation and Skills Committee, Fifth Report, 2009-10, p18

respond by tying another product. The Government therefore proposed to mandate in the Code that no product other than drinks could be tied.

Consultation Responses

In response to the online survey question – which focused solely on the gaming machine tie – 51% were in favour of abolition. Of these, 67% of tied tenants were supportive and 51% of consumers.

Very few written responses (12%) directly answered the consultation question, with 85% of those who responded in favour of a ban, over half of whom were tenants There was support for the BISCOM view that the benefits of the gaming machine tie to the tenant are not clear and do not outweigh the costs; some respondents felt that abolition of the tie would deliver increased revenue and profits for some tenants. This tenant for example said:

> 'Currently we are tied on all games machines and are subject to the terms of the contract between the Pub Company and the machine provider. The Pub Company receives an income for doing nothing whilst we, in the case of Quiz machines, make a small loss and yet have to keep records, provide electricity, submit paperwork and pay HMRC. This cannot be fair.'

Some gaming machine suppliers (generally not pub company approved suppliers) stated that if the tie were abolished, tenants would enjoy lower free-of-tie rental costs. The British Association of Pool Table Operators (BAPTO), the representative body for pool machine suppliers, submitted a price list in support of this claim and estimated that tenants with tied machines were paying £30 a month more than if they were free-of-tie for the same machines. Tenant representative bodies including the FLVA and IPC agreed. They suggested too that royalty fees continued to be levied and recovered despite the prohibition on this in the industry code.

Some tenant respondents questioned whether tenants currently benefit from their pub owning company's contracts with third party suppliers; and suggested that greater benefits could be achieved through separate contracts with suppliers. Evidence from the ALMR showed that managed chains and their multiple lessee members were able to generate more gaming income on average than either tied or free-of-tie pubs. Their figures suggested that managed and multiple lessee outlets were generating £450 net per pub per week whereas leased pubs were averaging £250. The ALMR set out its views on how gaming machine revenue could be maximised:

> 'We note the concerns expressed by some that proactively managed machines outperform the market in terms of income generated. We would concur with this, but would dispute the suggestion that it is the tie which is critical to delivering this. It is the management and oversight of the estate which is key – ensuring a regular turnover of new machines, monitoring performance and rotating games – and our multiple lessees are able to do this themselves and generate market equivalent returns from their free of tie machines. Equally, there are independent companies and games machine suppliers who will provide a similar service to individual tenants.'

Responses from two representative bodies of gaming machine suppliers, BAPTO and the British Amusement Catering Trade Association (BACTA), indicated that there are a

number of suppliers outside current tied agreements. This suggests that abolition of the tie could increase competition by removing barriers to entry. BAPTO calculated that there are around 50 pub owning company approved suppliers but around 600 further suppliers that are not on the approved lists.

Pub owning companies of all sizes argued that although free-of-tie tenants would in theory pay less for machine rental, they would lose out from not having the scale and know-how to manage machines in a way that maximises their income. Enterprise Inns, for example, quoted 2008 research by the machine supplier Gamestec which showed that the AWP machine income in free trade houses was, on average, at least 26% worse than in tied houses.

It also argued that the risk of illegality was greater, given that tenants would not benefit from the dedicated staff that pub owning companies employ to ensure illegal machines do not enter their estate. In similar terms it considered that the risk of incorrect or illegal avoidance of Machine Games Duty (MGD) would increase, particularly given that tenants would now be directly responsible for MGD collection.

Pub owning companies also argued that the latest version of the industry code has addressed most of BISCOM's concerns by removing machine income from the divisible balance; phasing out royalty payments in new contracts with suppliers; establishing clear company policies and terms and conditions; and improving transparency on fees.

The gaming machine tie was raised as a potential source of competition distortion above and below the proposed 500 pub threshold. The threshold would provide an incentive for pubcos to own fewer than 500 pubs and the abolishing the gaming machine tie would increase the size of this incentive.

Not all pub companies were enthusiastic supporters of the machine tie. Admiral Taverns, for example, said:

> 'We at AT are agnostic on the gaming machine tie and try to encourage licensees to consider going free-of-tie as it simplifies our business and, because we do not rentalise tenant gaming machine income if they are tied, we would be no worse off if the licensee went FOT on machines when we would include a licensee's gaming machine income in the rent calculation.'

Both tenant and pub owning company representative bodies, such as the BII, FLVA and BBPA, responded in favour of greater tenant choice in line with the 2010 Select Committee recommendation quoted above. The BII and FLVA stated that some of their tenant members see advantages in the tie. The FLVA noted that 'large scale management of machine income can be beneficial to both parties.' The BII surveyed members asking: *Do you feel it would be in your interest to pay extra rent for all AWP Machines to be free of tie?* It received a mixed response with half of respondents disagreeing and 30% agreeing. It drew the conclusion that the difference in members' views suggested providing tenants a choice would be the best option.

Government Response

In the consultation document the Government set out its intention to abolish the Gaming Machine Tie, which was the original recommendation of the Business Select Committee going back to its 2004 report.

Responses to this consultation, however, have demonstrated that the concerns that have historically led to criticism of the gaming tie have largely been addressed by pub owning companies. The removal of royalty payments in particular is an important step in ensuring that machine-tied tenants are not in effect 'paying twice' for being tied.

The Government also recognises that some tenants support the machine tie as they prefer to avoid the 'hassle factor' of managing their own machines and appreciate the benefit they can receive from the tie. The Government also accepts that the active management of gaming machines that pub companies seek to provide can maximise income for both tenants and pub companies.

However, the Government does not accept that it is necessarily pub owning companies that are best placed to deliver active management of machines. It is clear that multiple operators or outside management companies can achieve the same and sometimes greater returns. There is strong evidence that there are providers in the market who could provide this service. There is also strong evidence of tenant appetite to be free-of-tie.

In addition there is some evidence that pub owning companies are already prepared to be flexible with gaming machine arrangements in their tied pubs.

Therefore, rather than abolish the machine tie, the Government has decided to include a provision in the Core Code that stipulates, in line with the recommendation of the Business Select Committee report in 2010, that pub owning companies may no longer oblige their tied tenants to source machines through them. Instead tenants would be allowed to have the choice to be tied or not for machines. The impact of this on dry rent should be taken into account as part of the wider negotiation of a rent assessment and therefore subject to the fair dealing provisions of the Code.

Very few submissions referenced tied products beyond beer and gaming machines. In expressing concern at the price of beer some tenants also raised similar concerns about non-alcoholic tied drinks. The Government considers that those issues are dealt with through the fair dealing 'transparency' proposals and the Core Code proposal for a parallel rent assessment provision. Owing to the lack of evidence on the other tied products, the Government therefore considers that it has insufficient evidence to justify obliging pub owning companies to remove the tie for all non-drink products beyond gaming machines. We propose instead that this be included within the scope of future reviews of the Code.

iv. Provide a 'guest beer' option in all tied pubs.

The Government consultation proposed that a Guest Beer Option should be included in the Statutory Code. This would give tied tenants the right to purchase one beer of their choice from any source. The consultation suggested that the benefits of this option could

accrue to the tenant as a means of lowering their cost base, to consumers as a means of widening choice and/or to smaller independent brewers as a means of spreading demand for regional and craft beers.

Consultation Responses

A large majority of respondents to the online survey who declared themselves to be tenants, lessees, consumers and pub industry employees (91%, or 5,812 out of 6,354) agreed that the guest beer option would strengthen the Code.

Of the written respondents, 12% (136 out of 1,131) were in favour of the proposed guest beer option – mostly tenants and individuals; while 3% (31 in total) were opposed and 85% did not answer the question directly. At the category level: 48 of 51 individuals who answered were in favour, as were all the 21 political representatives who answered. All of the 14 pub companies and breweries which answered the question were opposed.

Many tenant responses pointed to the high costs, as well as the restricted choice, of purchasing beer through the tied landlord. One publican recounted the occasions when he had received a wholesale bill by accident and remarked on the large mark-up applied by the pub owning company. Therefore, many of these responses supported the guest beer option as a means of reducing tenant overheads; for example:

> ‘Real ale and real cider should be exempted from the tie with any pub company. They have created the need for an industry body called SIBA which means I pay even more for local ale than I do from their own tied list, which is still double than the market price for a nationally recognized but less popular real ale. Considering they know this is the only growth sector we have as an industry this is plainly wrong. They say you can get an ale from their own list but these are not popular.’

CAMRA also focused on the impacts of the tied model on the provision of beer from smaller brewers:

> ‘Despite the growth in the number of small brewers the pub market is substantially foreclosed to them because they are unable to supply the minimum volumes, discounts and logistics demanded by large wholesale and pub owning companies.’

Several tenant responses also suggested that this measure would assist them in competing with free-of-tie real ale pubs in their area by increasing their ability to stock real ale and doing so at a lower cost. This was echoed by responses from some individual consumers.

SIBA argued that its ‘Direct Delivery’ scheme (DD) had widened the range of locally brewed beers that were on offer through tied pubs. Pub owning companies echoed this and Enterprise Inns pointed out that it offered 1,500 beers from 470 brewers. SIBA expressed concern that the guest beer option could undermine its scheme.

Significant concern was expressed by pub companies and breweries, above and below the 500 threshold, that the guest beer provision as worded would undermine the tied model to an extent that it no longer became viable. This is because significant numbers of tenants could exercise their guest beer option to buy their biggest selling beer outside of the tie or even buy another high volume beer from another producer. Star Pubs and Bars for example said:

> 'There is limited space on the bar and there is a risk that tenants would use the Guest Beer Option, not to bring new local and regional beers to the pub, but to replace high selling mainstream products. The Government should reject this proposal as it would fundamentally undermine the legitimate operation of the beer tie.'

This view was not just the preserve of pub owning companies and breweries. Representative bodies such as the BII, FSB, FLVA and CAMRA all indicated that it was likely that tenants would use the provision to stock a high volume selling beer in competition to those provided by their pub owning company. Some of these same organisations discussed these concerns with BISCOM at its June 2013 hearing. SIBA's consultation response said:

> 'In its current form we believe the guest beer provision would destroy current routes to market for independent brewers; our research shows that the leading brand in over 97% of pubco pubs is a standard lager, which as the free of tie guest could lead to significant independent brewery closures.'

CAMRA and the FSB suggested that the guest beer provision could be limited to beers of a specific type (e.g. cask ales) and/or breweries of a specific size (i.e. smaller regional brewers). They argued that this would prevent high volume selling lagers being chosen as the guest beer. SIBA stated it was concerned that any attempt of this kind would be open to legal challenge, possibly from producers of other beer styles. A small number of cider producers responded to request that cider be explicitly included in the definition of beers available under the guest beer option. The difficulties of defining a Guest Beer provision were also discussed at the BISCOM hearing in June 2013. Kate Nicholls of the ALMR, for example, said:

> 'The legislation cannot be drafted in that way; we know to our cost, from what happened with the beer orders, that you cannot draft legislation in a way that means that that guest beer right is only exercised to allow you to get a locally sourced product that is crafted or brewed by a small brewer. There is no other way, legally, I can see of drafting it other than the way it is set out in the statutory code, and that hands the choice over to the lessee.' [26]

An associated concern raised was the impact the guest beer provision could have on rent. The Fair Maintainable Trade (FMT) for a pub informs the 'dry rent' and the beer chosen as a guest beer would affect that calculation. Were a tenant to replace a guest beer volume lager with a lower volume real ale, they may find it more difficult to achieve previous profit levels. In a similar vein some responses pointed out that the guest beer option would probably increase dry rents as pub owning companies sought to compensate for lost income. The BII surveyed their members on the consultation proposals and found:

[26] Business, Innovation and Skills Select Committee, Fourth Report, 2013-14, Ev 23

> ’Members were even more definitive in their view that it would not be in their interest to have a ‘guest beer’ provision if it meant their rent would increase, 62% stating their opposition on that basis. On the contrary view 30% were in favour.’

Pub companies and breweries (above and below the 500 threshold) and their representative bodies expressed a strong view that, with the 500 pub threshold proposed in the consultation, there would be a market distortion because tied chains under the threshold would be able to compete in the market without having to comply with the guest beer measures.

Government Response

While there is a lot of support for the guest beer option – particularly with reference to reduced costs for tied tenants, the consultation raised legitimate concerns about the potential for the proposal to undermine the tied model. This is because of the high proportion of sales accounted for by the biggest selling beer in most pubs and the high likelihood, supported by respondents from all sides of the debate, that most tenants would choose this beer as their guest beer option.

In addition, the benefit to tenants in terms of a fair share of risk and reward would be very unpredictable and uneven. It would depend on the beer chosen and its volume of sales and on the impact of the exercising of the option on dry rent negotiations. These same arguments also mean that the secondary benefits that the consultation pointed to, i.e. to smaller brewers, would also be impossible to guarantee.

The Government has not yet seen any workable restriction of any permitted type of guest beer which would be sufficiently certain to provide a sustainable and lawful basis for a more limited guest beer option. There is a historical precedent that supports this position, for example through limiting the guest beer to a beer of a particular type. This measure was introduced in the beer orders in 1989 and led to the European Commission instituting proceedings against the UK on the basis that it represented a quantitative restriction on imports of bottled beers.

The prime purpose of this proposal was to provide another means to improve the share of risk and reward for the tenant. Given this and the risks and difficulties of introducing this measure, the Government has decided not to include a Guest Beer option in the Statutory Code.

v. Provide that flow monitoring equipment may not be used to determine whether a tenant is complying with purchasing obligations, or as evidence in enforcing such obligations.

The consultation proposal was to include in the Statutory Code a provision providing that ‘flow monitoring equipment may not be used to determine whether a tenant is complying with purchasing obligations, or as evidence in enforcing such obligations.’ This was largely based on the provision in the voluntary code which requires that evidence, other than that provided by flow monitoring equipment (FME), must be provided before enforcement action is taken on purchasing obligations.

The consultation question on the use of FME data met with a largely disinterested response. The majority of written respondents, except pub companies and breweries with 500 or more pubs and interest groups, expressed no view. Only 31 out of 589 tenants (5%) supported this proposal, 11 disagreed (2%), and the rest chose not to answer.

Seventy-three per cent of pub companies and breweries with 500 or more pubs and 21% of pub companies and breweries with fewer than 500 pubs disagreed with the proposal, while the remainder in both groups chose not to answer the question.

Sixty-one per cent of the 3,984 respondents who answered this question in the online survey agreed that the use of FME should be addressed in the Statutory Code. The survey explained that this would mean that 'a pub company could not use evidence from FME to fine a tenant for breaking their contract.' Seventy-one per cent of tied tenants agreed, while 29% did not answer this question.

Respondents interpreted the proposal in different ways, with some interpreting it as data from FME should not be the sole evidence and others that FME data could not be used at all.

In response to the consultation suggestion that it has been possible to operate a tied estate and enforce the tie since the 18th century without the use of FME, Vianet Group plc, the principal supplier of FME to pub owning companies, commented that while 'it was possible to detect a breach and enforce the tie using methods available prior to flow monitoring, what it [the consultation] fails to acknowledge is that these methods were ineffective, resource intensive and highly intrusive with a low rate of success.' Similarly, the BBPA described as 'flawed' the consultation statement that it is possible to operate a tied estate and to enforce the tie without the use of FME.

Vianet saw the proposal as an 'effective ban' on FME and argued that 'the equipment is not used to "determine" whether the tenant is complying, it simply provides information and trends that may lead to further investigation and evidence gathering. That information may be supported by, or contradicted by, other sources of information. Unless the parties agree, it is the court that "determines" whether the tenant is complying with the tie.'

The Trading Standards Institute supported a Statutory Code that prohibits sole reliance on FME evidence.

The Fair Pint Campaign believed that 'It is simply not acceptable that an unproven method of measurement can be used to fine licensees.'

The BBPA commented that it would be 'fair and reasonable' to place the existing industry code provisions on a statutory footing. As Vianet argued, FME provides:

> 'management information to drive improved profitability for pubs. It allows pub groups to focus investment and support, multiple operators to maintain standards across a group of pubs as well as providing site operators with an essential tool kit to drive greater profit from draught beer [...]. The management support tool this provides has driven significant economic benefit to their licensees with no cost to them for these services. This value is underlined as our web reporting services are accessed over 8,000 times per month by licensees and their management team.'

Government Response

The intention behind the consultation proposal was not to prohibit the use of FME altogether but to prevent enforcement of purchasing obligations based on FME data. The intention was that pub owning companies would still be permitted to install FME to obtain management information and they would be able to use that data to trigger an investigation into buying outside of the tie, but that the data from FME would not be able to determine whether a tenant had bought outside the tie.

The Government understands that there was confusion about the wording proposed in the draft Code and, based on the evidence from the consultation, the Government believes that the most proportionate way forward is to replicate the existing industry framework code provision in the Statutory Code so that FME data can be used to enforce the beer tie but only if this is supported by other evidence. This would allow the benefits of FME while reducing the risk that tenants are wrongly accused of buying out.

The Government intends that the Statutory Code will provide that: 'Information obtained from flow monitoring equipment may only be relied upon by a Pub Company as evidence when taking enforcement action on purchasing obligations if there is other evidence corroborating the flow monitoring data.'

The Government intends that the Adjudicator would be able to arbitrate individual allegations of a breach of the Code or carry out an investigation if there was evidence that a pub owning company was systemically breaching this provision.

Q.9 Are there any areas where you consider the draft Statutory Code should be altered?

We received a variety of comments from consultation respondents on the provisions set out in the draft Statutory Code. Some of these comments are dealt with in the appropriate section of this Government Response and will not be rehearsed here. For example, suggestions relating to the parallel rent assessment formula proposed in the consultation document are covered in the response to Question 8.ii and suggested alterations relating to the clauses on use of FME can be found in the response to Question 8.v. As in the responses to many of the consultation questions, tenants and interest groups, such as Justice for Licensees, the FSB and the All Party Parliamentary Save the Pub Group, reiterated their calls for the Statutory Code to include a mandatory free-of-tie option. Views on this option are covered in the Government's response to Question 11.

Consultation Responses

Definition of 'Pub'

The BBPA's submission to the consultation noted that 'attempting to define a 'pub' is always a difficult task' and suggested, along with a number of pub owning companies replying to the consultation, that the definition of 'Pub' proposed in the draft Statutory Code would not apply to tied establishments which are primarily food-led, thus exempting 'gastro-pubs' from the provisions of the Code. The Fair Pint Campaign also expressed

concern that the definition could include restaurants 'if they have a high level of food turnover and have no specific licensing conditions relating to consuming food at the premises.'

Lease and Tenancy Agreements

In its response to the consultation, RICS contended that the consultation did not adequately address the distinction between a lease and a tenancy. While the two terms are interchangeable in law, RICS noted that they are typically employed to describe different types of agreement in the pub industry, with the term 'lease' designating an agreement which is similar to a standard commercial lease, while a tenancy is typically an agreement 'used to support a trading/commercial relationship between a vertically integrated supplier/property owner and the operator of the premises.'

Property Maintenance & Transparency

The draft Statutory Code proposed that before making an agreement with a tenant, a pub owning company must provide the tenant with clear information, to allow the tenant to establish the costs and risks of trading. As part of this commitment, the draft Code proposed that pub owning companies should provide tenants with a full description of the premises, including a Schedule of Condition, specifying the state in which the premises are being provided and clarifying what remedial work is required and expected during the course of the agreement. Further to this, the draft Code also specified that pub owning companies should provide tenants with a protocol governing the treatment and procedures to be followed in dealing with dilapidations, such as the process for agreeing a schedule of wants and repairs in line with the schedule of condition.

In response to these proposals some pub owning company respondents and interest groups, such as the BBPA, highlighted the distinction between the requirements which leases and tenancies put on tenants for upkeep and maintenance of the property. In particular, the consultation response from Marston's signalled disagreement with the proposals, on the basis that the company's tied tenancy and lease agreements 'have obligations on the licensee to put the property in good order and keep the property in good order' – so called 'put and keep' requirements. Tenants do not therefore necessarily have to return the property in the same condition as when they entered the agreement, but return it in a 'good condition'.

Rent Assessments

A number of respondents, including the BBPA and ALMR, commented that the draft Code did not make clear whether provisions applied to the initial rent assessment carried out when a tenant enters an agreement for a pub or to rent reviews completed for existing tenants. Version 6 of the Industry Framework Code already states that a detailed rent assessment statement must be provided not only at initial rent setting but also at any rent negotiation, particularly rent review and lease renewal. The recommendation from the ALMR was that all rental negotiations should be subject to the same provisions and protections, in line with the IFC.

Government Response

Definition of 'Pub'

The Government intends that the protection and provisions of the Statutory Code will apply to all tenants of tied pubs, with the *Enhanced* Code (and thus the requirement to provide a free-of-tie rent assessment to tenants on request) applying to tied agreements operated by companies with 500 or more tied pubs. The Government will seek to reflect this in the definition of 'Pub' which will be set out in the legislation.

Lease and Tenancy Agreements

The Government recognises that the pub industry uses the term 'lease' and 'tenancy' to refer to agreements which differ in terms of the length of the agreement, the ability to 'assign' the agreement to another person and in terms of the responsibility for repairing the premises. It is clear to the Government, however, that the protection of the Statutory Code and Adjudicator should be afforded to both tenants and lessees. We therefore intend that the provisions will apply to all agreements, whether they be tenancies or leases, save where the provision has no relevance to the terms of the agreement. For example, if the agreement does not permit the tenant to assign the agreement to another person then the provisions relating to assignment will not be relevant in those circumstances.

Property Maintenance & Transparency

The requirements on tenants in relation to dilapidations and property maintenance vary depending on their agreement with the pub owning company. Some tenants are expected to 'put and keep' the pub premises in a good condition, while in other instances the landlord bears the property risk and maintains the property – as in the tenancy agreements operated by some brewers. Pub owning companies have a responsibility to ensure that tenants understand the diversity of agreements available and the terms of their agreement. It is therefore our intention in the Statutory Code to stipulate that pub owning companies must inform tenants as to the extent to which the agreement will place obligations on them to maintain and repair the property. The Government also intends that a Schedule of Condition and protocol governing the treatment and procedures to be followed in dealing with dilapidations should be provided to all tied tenants, even if they operate a 'put and keep' agreement.

Just as it is important for tenants to understand their obligations for maintaining or improving the property, it is also important that tenants are aware of the condition of the premises for which they are entering an agreement. The condition of the pub may, for example, affect whether it has to close for refurbishment or have an impact on the level of sales which the tenant can achieve. For this reason, the Government intends to retain the requirements for pub owning companies to provide a Schedule of Condition and protocol governing the treatment and procedures to be followed in dealing with dilapidations to all tied tenants, even if they have a 'put and keep' agreement. This should allow tenants to better understand the obligations being placed on them and the condition of the property, so that they can assess the costs and risks of trading.

Disputes regarding compliance with the respective repairs and maintenance

Government Response

responsibilities of pub owning companies and tenants are a continuing concern for tenants in terms of how they can impact on the fair share of risk and reward. In consultation on the final draft of the code Government will consult on the precise wording of provisions related to these kinds of disputes to ensure tenants are adequately protected under the code.

Rent Assessments

The Government intends that the provisions of the Statutory Code will apply to all rental negotiations, whether at initial rent assessment, for the assignment of a pub to a tenant or at rent review for an existing tenant, except where the provision has no relevance to the terms of the agreement.

Q.10 Do you agree that the Statutory Code should be periodically reviewed and, if appropriate amended, if there was evidence that showed that such amendments would deliver more effectively the two overarching principles?

Written responses to the consultation were largely in favour of the proposal that the Statutory Code be periodically reviewed.[27] The majority of pub companies and breweries with 500 or more pubs supported this proposal, with seven of the eight companies which answered the question expressing agreement, as did all of the 13 interest groups which answered the question. The majority of respondents in other categories did not provide a response to this question. The minority who did respond were in each instance in favour of the proposal. As one tenant noted: 'A "health check" would be a good idea, seeing if the principles and code [are] working, and if it can be improved.'

A number of responses, such as that from the IFBB, suggested that the 'Statutory Code should [..] be reviewed on a similar timescale' to the current arrangements for the self-regulatory system, which is reviewed on a three-yearly basis. For pub owning companies – the majority of which were opposed to the introduction of a Statutory Code – the review was seen as an opportunity to take stock and assess both the effectiveness of the measures and, as Greene King commented, their 'impact on the industry as a whole including pub closures'. By contrast, some interest groups representing tenants suggested that regular reviews would be critical to ensure that pub owning companies could not 'game' the system. Against the backdrop of the broad support for regular reviews of the Statutory Code, there was also recognition here from Admiral Taverns that 'any revisions will need at least 12 to 24 months to bed down fully.'

Government Response

As proposed in the consultation document, the Government will provide for the Statutory Code and Adjudicator to be periodically reviewed by the Secretary of State, who will be given the power to amend the Statutory Code if the review provides evidence that doing so would help to deliver the two core principles (fairness and no worse off) more effectively. The Government proposes that the initial review will take place two years after the Code and Adjudicator come into force[28], with subsequent reviews to take place each successive period of three years after the initial review has taken place. This is in line with the approach taken for the recently established Groceries Code Adjudicator.

This measure will provide an opportunity for Government and stakeholders to assess how the Statutory Code and Adjudicator are working, and ensure that the Statutory Code can respond to new developments in the pub industry, whether they be new business practices, new legislation or new technological developments. It will also provide an opportunity to consider whether an Adjudicator is still needed to ensure that

[27] The online survey did not feature this question.

[28] The period ending on the first 31 March that is at least 2 years after the Code and Adjudicator come into force.

Government Response

tenants are treated fairly and are no worse off.

The Secretary of State will have the power to make amendments to the Statutory Code, including to the minimum threshold above which the Code applies. The Business, Innovation and Skills Committee recommended in its Fourth Report in July 2013 that the Government should include 'a level of flexibility in any Bill to allow the Secretary of State subsequently to alter the threshold.'[29]

If the Secretary of State decides on the basis of a review that the Code should be amended, then the Secretary of State will need to consult on the revised draft of the Code. The amended Code would be subject to scrutiny and approval by Parliament. In taking this approach, the Government aims to ensure that the Statutory Code and Adjudicator have the flexibility to respond to changes in the industry, but that any changes to the Code are subject to proper scrutiny.

Q.11 Should the Government include a mandatory free-of-tie option in the Statutory Code?

It is widely accepted across the pubs industry that at the heart of the tied model is the notion that the tied tenant will pay an above market price for their tied beer products in exchange for countervailing benefits. These benefits include the lowering of market rent through rent subsidy and other forms of support provided to the tenant at a rate lower than they can achieve in the open market.[30] This in effect is the means by which a tied tenant can be said to be no worse off than a free-of-tie tenant.

In practice the precise terms of tied agreements are determined by a negotiation between the tenant (or prospective tenant) and the pub owning company. This involves an assessment of the 'Fair Maintainable Trade' (FMT) of the pub and an estimate of the resulting profit after taking into account costs. This provides a 'divisible balance' which is then shared between the tenant and the company. The pub owning company's share is then paid as a rent by the tenant (often called the dry rent). If this process is fair, the final settlement should secure a fair share of risk and reward for both parties. The guidance for valuation of licensed premises from the RICS explains it thus:

> 'How the divisible balance is apportioned will be a matter for discussion and negotiation. In simple terms, it must provide adequate reward to each party to reflect the risk each take in owning or operating the property.'

[29] Business, Innovation and Committee, Fourth Report, 2013-14, p15

[30] Trade and Industry Committee, Second Report, 2004-05, vol 1 p41

The evidence of four BIS Select Committees and many tenant testimonials received by Government have clearly established that in too many cases tenants are unable to secure a fair share of risk and reward in their agreements. The April 2009 Business and Enterprise Select Committee for example said:

> 'Increasing a pub's turnover will benefit the pubco as it increases the sale of tied products. To our surprise it does not seem to benefit the lessee to nearly the same extent. Over 50% of the lessees whose pubs had turnover of more than £500,000 a year earned less than £15,000. The pubcos may share the risks with their lessees but they do not share the benefits equitably.'[31]

The same Select Committee also found that the notion that tenants were receiving countervailing benefits that compensated for higher tied beer prices was also questionable:

> 'There is no evidence demonstrating that a tied lessee receives benefits not available to free of tie tenants or freeholders. Nor are we in a position to say with confidence that rents for tied pubs are invariably lower than rents for equivalent free of tie premises. We have been given examples where free of tie premises cost more to rent than tied ones and examples where they cost less.'[32]

The fact that there is evidence that these issues still remain was shown at the BIS Select Committee inquiry in 2013 into the Government's proposals. For example, in giving evidence to the committee Kate Nicholls of the ALMR quoted its benchmarking report which showed: 'Last year [2012] for the first time, rent as a percentage of turnover in the tied estate overtook the free of tie estate.'[33] The Government understands that this finding was repeated in the ALMR survey for 2013.

To address these issues the Select Committee concluded that a free-of-tie rent should be offered to all tenants and lessees, something that was confirmed by the subsequent 2010 inquiry which said: 'We remain convinced that over a period of time offering lessees the option of being tied or being free of the tie is the only way to judge properly the fairness of the tie.'[34]

In the face of this cumulative evidence the Government consultation did not seek to establish whether there was a problem in the relationship between pub owning companies and their tenants, as the case was already proven. Therefore, the Government asked an open question as to how best to achieve the principles that tenants should be treated fairly and that a tied tenant should be no worse off than a free-of-tie tenant, whether by mandating that higher beer prices must be compensated for by lower rents, by a mandatory free-of-tie option, or by another means. The online survey contained a question

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[31] Business and Enterprise Committee, Seventh Report, 2008-09, vol 1, pp50-51

[32] Business and Enterprise Committee, Seventh Report, 2008-09, vol 1, pp69

[33] Business Innovation and Skills Committee, Fourth Report, 2013-14, Ev 17

[34] Business Innovation and Skills Committee, Fifth Report, 2009-10, p53

on the same topic.

In seeking evidence on this question the Government indicated in the consultation that its preference was for the first option, described as: the 'parallel rent assessment' approach to delivering the no worse off principle. It would require pub owning companies at rent review to supply tied tenants with a comparative free-of-tie rent assessment for their pub. They would do so following a formula set down in the Code. Where necessary the formula would adjust the tied rent so that the tenant would receive the same or a higher profit under the tied agreement when compared to the free-of-tie agreement.

The mandatory free-of-tie provision would give tenants the right to request a free-of-tie rent assessment alongside their tied rent assessment. If the tenant then considers they would be better off free-of-tie, they could choose that option.

The consultation set out some of the potential costs, benefits and unintended consequences of mandatory free-of-tie in relation to the parallel rent assessment approach and sought views on how likely it was that they would occur.

The benefits included the fact this was a simpler more market based approach than the parallel rent assessment proposal. It also suggested there may be benefits in terms of opportunities for microbrewers and greater choice for consumers.

The unintended consequences of this option included: the possible loss of economies of scale for pub companies; a negative impact on pub investment; the potential that the market becomes dominated by a few small international brewers; the possible market exit of a major company and/or the brewery collapse or downsize of a major brewer. Given the uncertainty around potential consequences the Government committed to undertake more analysis of the impacts of the measures on gross and net pub closures, and employment levels.

Consultation Responses

Of the nearly 7,000 responses to the question in the online survey, 68% supported mandatory free-of-tie and 30% the option favoured in the consultation proposals i.e. parallel rent assessment. At a more disaggregated level, 58% of tied tenants said they thought that a compulsory free-of-tie option was the best option, as did 55% of pub industry employees, 72% of consumers and 46% of free-of-tie tenants/lessees. Tenants were also asked a specific question on mandatory free-of-tie in the survey: "If you were offered a free of tie option, would you take it, even if it meant paying a higher rent (provided the rent was assessed fairly)?" Of the 706 tenants who responded, 92% answered yes.

There was support for the parallel rent assessment approach in a different section of the online survey. In Question 6 of the survey, 84% of respondents agreed that increased transparency and the requirement for 'pub companies to publish parallel "tied" and "free-of-tie" rent assessments so tenants can check they are no worse off' should be addressed in the Code.

In terms of written responses, the vast majority of respondents (89%) did not answer this question clearly. Where respondents did answer, views were polarised. Tenants, individuals and political representatives (largely MPs and local councillors) were in favour. Pub owning companies and breweries of all sizes and their employees were against.

Support for mandatory free-of-tie

The tenants and tenant representative bodies supporting mandatory free-of-tie focused on the complex relationship between 'wet rent' and 'dry rent' as the main reason why this intervention was needed. They argued that the complexity of the beer tie and the concepts and calculations that underpin the tie in practice was something used by pub companies to their advantage. The following quotations from tenant responses to our consultation are representative of this view, starting with one centred on the notion of Fair Maintainable Trade (FMT). This projection of what trade a pub ought to deliver underpins how dry rent is established at the beginning of an agreement:

> 'FMT does not take into account the beer tie. We pay a further (average) £25k per year (half of our rent) to Punch in addition to rent. I don't mind being tied per se, however that should be reflected in the rent. It is the reason so many estate pubs have failed and are continuing to fail. Fair market rent MUST include the premium we are being charged for beer.'[35]

A common concern amongst tenants who wrote in support of mandatory free-of-tie was that although they might be recognised as a good pub operator and be performing well in terms of sales, they still did not benefit because of subsequent increases in dry rent. Take the case of this ex-landlord recounting the factors that led him to assign his lease:

> 'Due to redundancies, [Redacted] years ago I lost my job and took a lease of a country pub in the lake district. [Redacted] years ago I managed to give the lease away – 7 years ago it was worth £200k. Turnover remained steady around the £[Redacted]k however rent went up from 8% to 14% of turnover while the brewery-enhanced margin on liquor made them a further £30k. While this was happening my profits dropped from £70k to -£12k. The brewery was making in excess of £100k off me. I don't think the new leasee has a chance and fear the future of this successful village Inn. I am not asking Government to abolish the tie; I just want it to work fairly.' [sic]

This experience was not only related by single pub operators. One multiple operator drew attention to the gap between overall pub turnover and the profit that his company actually receives:

> 'Enterprise are in complete control of the owner-tenant relationship. Their model ensures that almost all profit goes to them and very little is left for the tenant. Our own example is of a company turning over in excess of £[Redacted]M pa and generating a net profit of just £20-£30k pa. We pay rent and other service costs to Enterprise of £1XX [Redacted]K and can estimate loss of discount through tie fees of between £150k - £200k with no investment required from them and giving them a profit of many times ours. Furthermore, if our circumstances improve, the rent will be sure to increase on the next review.'

A number of other tenants were of the view that they were being or had been forced out of

[35] Tied Tenant quoted in FSB consultation response p15

the business so that the pub owning company could turn it over to a new tenant, this is often referred to as 'churn'. Licensees Supporting Licensees argued:

> 'The use of bullying, Brulines and bailiffs is an almost constant occurrence before they are churned out, hit with dilaps, assets seized, charges placed on property and bankruptcy enforced.' [sic]

Supporters of this option argued that the fair dealing provisions set out in the consultation document would not be enough to address these issues. Their arguments were essentially that only mandatory free-of-tie would incentivise the pub owning companies to work harder to ensure that the combination of above-market beer prices and 'dry rent' resulted in a fair share of risk and return. Supporters of mandatory free-of-tie argued that it is a simpler and quicker solution than the parallel rent assessment. CAMRA for example argue:

> 'Among the benefits of a Market Rent Only [equivalent to mandatory free-of-tie] option would be that pubcos would be incentivised to act in a competitive manner and make their tied deals fair and attractive, as failure to do so would result in a high proportion of their tied licensees choosing to become free of tie. We would anticipate that as pub companies improve their deals to better compete with new free of tie options, only a small minority of existing licensees would opt to go free of tie.'

There was a view on the part of some respondents that mandatory free-of-tie would be less likely to be 'avoided' by pub owning companies:

> 'Without this option we fear the entire statutory intervention will be wasted. All other provisions are capable of being circumvented as we have discovered to our cost. RICS guidance, self regulation and altering agreement names (to franchise) are all attempts to game the intentions of progressive reform. The option is swift, simple and cheap.'

Some tenants argued that if the tied model delivers the significant benefits claimed by pub companies, then it could be assumed that it would continue to be an attractive model and the free-of-tie option would not be taken up by the majority of tenants.

<u>Opposition to mandatory free-of-tie</u>

Pub owning companies and breweries of all sizes were overwhelmingly opposed to mandatory free-of-tie.

One argument against mandatory free-of-tie was that it would undermine pub owning companies' ability to invest in tied pubs. This was because if tenants go free-of-tie, it could lead to a tipping point at which it would become uneconomic for companies to continue to sustain a mixed model of tied and free-of-tie leases. This, it was argued, could in effect lead to the end of the beer tie and all the associated benefits – even for those tenants who still want it. The BBPA summarised this viewpoint thus:

> 'Even a significant minority of tenants taking up a mandatory free-of-tie option could be enough to render a pub company's infrastructure unviable, as the free-of-tie tenants would not be contributing to its support. Companies are unlikely to be able to operate a hybrid free-of-tie and tied estate on a large scale, and would have to

> move towards a fully free-of-tie estate (along the Wellington model) with a purely rent-based commercial property relationship.‘

This view was supported by a number of companies who are currently contracted by a pub owning company to supply services to that company’s tied pubs. They expressed concern about the impact on their business and on investment in the sector more broadly. Many of these are small companies and include builders, solicitors and gaming machine suppliers. As an example Bridgewater Contracts said:

> ‘Imposing a mandatory free of tie option within a statutory code would inevitably lead to a reduction in investment levels within the industry were it to be enforced [...] Without the tie investment is unlikely to take place to the same level which could have serious implications for our company and those working in it.’

Brewers with fewer than 500 pubs echoed these concerns, which were summarised in the response of the IFBB:

> ‘The imposition of a mandatory free-of-tie (FOT) option would destroy the basis of the traditional tenancies that our members operate and that have served the industry so well over a period of many centuries.’

Brewers were also concerned about losing the pub companies as a route to market. Marston’s, one of the companies that have 500 or more pubs and brew beer, said:

> ‘We currently sell products which we produce through our tied pubs, if there was a mandatory free of tie option, we would lose sales through these outlets which would not only adversely affect the profitability of the business it would affect the viability of the current supply chain and distribution network, this would lead to price rises through loss of economies in scale.’ [sic]

Some pub owning companies questioned whether the proposal to introduce mandatory free-of-tie was lawful in the context of human rights law. Punch Taverns, for example, said:

> ‘As drafted, the proposed Code would be in breach of Article 1, Protocol 1 of the European Convention of Human Rights (A1P1). By depriving pub companies of future income, the proposals would clearly constitute the exercise by the State of ”control” over Punch’s possessions (and those of other pub companies). There are clear and serious adverse consequences for Punch and the other relevant pub companies.’

In addition to this, some responses from pub owning companies seemed to suggest that tied tenants might not be aware of the risks of going free-of-tie, particularly in terms of the support that accompanies the provision of tied products. Trust Inns, for example, said:

> ‘We do have concerns that some of the tenants who are calling for a free of tie option do not understand its full implications. It is not simply having the right to buy beer cheaply from a wholesaler. It also means that Landlords do not have to provide any support with the provision and maintenance of the dispense equipment, stocktaking, brand promotion and merchandising services..[…….] anecdotally a tenant who has recently taken a free of tie lease rang late last Friday afternoon panicking that his beer dispense system was broken. If he had been a tied tenant, the company would have arranged for an engineer to call within an agreed time

> window and attend to the repair. In this case, the Free of Tie tenant was advised to contact his supplier.'

Three of the largest trade bodies representing tenants: the FLVA, ALMR and BII were either opposed to mandatory free-of-tie as the best way of delivering the no worse off principle or concerned that the possible impacts should be further investigated. The FLVA, for example, stated that under mandatory free-of-tie:

> 'Any potential Pub Co/tenant relationship would become commercially impracticable as the Pub Co's would essentially become property companies with little shared interest in the trading entity of the pub. This would manifest itself in reduced investments in pubs, and a total emphasis by the emergent property company on rental return.'

The ALMR, although supportive of the no worse off principle was concerned about mandatory free-of-tie as the means to achieve it. It said:

> 'There is clearly a need for additional evidence to determine conclusively what the impact will be, not just on the tied lease model adopted by the major pub companies, but the sector as a whole.'

The BII also argued that more work was required to understand the impacts of mandatory free-of-tie and said:

> 'The consultation recognises that there are potential benefits and possible harms in the introduction of a Mandatory Free of Tie option. The BII is concerned that the introduction of such a provision would have the effect of removing choice from the market place which would be governed very much more by price than any other consideration.'

Impacts and Unintended Consequences

The Government commissioned London Economics to undertake an independent analysis of the impacts of the two options proposed in the consultation. The BBPA also commissioned Compass Lexecon to undertake an impact analysis. The Government's response to the findings of these studies are covered in Question 5 and in the impact assessment. The consultation document also asked for further quantitative information about the possible impact of the proposals but very little was received.

Pub owning companies highlighted the strategies they might employ in response to a Statutory Code that included mandatory free-of-tie provisions, and the negative impacts they could have on tenants. Enterprise Inns, for example, said:

> 'Enterprise Inns has approximately 1300 agreements expiring over the next few years. If the Government proposals come to fruition Enterprise Inns may decide to position itself as a large managed pub estate and retain its economies of scale. Enterprise Inns would consider this a huge shame for thousands of its great publicans whose livelihoods would be taken away. Unfortunately a hybrid model would not operable for Enterprise Inns– its either all or nothing.' [sic]
>
> Alternatively, Enterprise Inns can trigger a free-of-tie option in all of our leases at any time. This in turn would trigger a rent review, which would be upwards only. We

> would then create a structure to enable us to become a REIT [Real Estate Investment Trust].'

Admiral Taverns also indicated it would most likely become a property company and withdraw from the tied market:

> 'At some point, we at AT would be forced to convert to a fully FOT model, i.e. just become a property landlord whose only interaction with its tenants is as a rent seeking landlord. This would involve us reducing our work force by over 75% as we would only need a small team of property surveyors, estate managers and finance staff in a very small head office, supported by a small letting and administrative team.'

Their rule of thumb was that this decision would be forced when between 15 and 25% of its 1030 non-managed pubs moved to free-of-tie.

A number of the supporters of mandatory free-of-tie, particularly representative bodies such as Fair Pint, Justice for Licensees and Save the Pub, thought the possible unintended consequences were overstated. For example, the Save the Pub group argued that pub owning companies, big breweries and the BBPA: 'hysterically claim that reform would be bad for the 'industry' and economically damaging.' They go on to say: 'This is in effect a self-regulatory mechanism. If the tied agreements are fair and competitive then tenants will seek to remain in such agreements rather than go free of tie.'

However the tone and content of responses by others on the tenants' side and fractious nature of some pub owning company/tenant relationships suggests that there are a significant number of tenants that would take up the mandatory free-of-tie offer regardless of whether pub owning companies were to improve their tied arrangements in their favour. The STP response itself suggests that a 'Mandatory Free of Tie' provision would drive change in the ownership structure of the industry:

> 'A statutory code, delivering the prime principle via a market rent only/genuine free of tie option, would free up the pub sector would encourage growth as a result of a renewed, rejuvenated pub sector, with more diverse ownership that will promote entrepreneurial flair …'

<u>Views on the 'Parallel Rent Assessment' Option</u>

The main focus of responses to Question 11 was in regard to the mandatory free-of-tie option. The Government's preferred option, mandating that higher beer prices be compensated by lower rent through the application of the parallel rent assessment calculation, received little comment by comparison. Where there was comment, most of this centred on whether what was frequently referred to as the 'formulaic' approach would work and the Government's views on this are set out in the response to Question 8 (ii).

There were a few comments on the principle of a parallel rent assessment as an alternative to mandatory free-of-tie.

Enterprise Inns was opposed:

'Enterprise Inns objects to the Government intervening in commercially negotiated agreements to impose a formula for the calculation of rents and overturning the fundamental principle of free market negotiation.'

Where tenants' groups and those supporting them commented on the parallel rent assessment proposal, their views varied. Some mentioned it in unfavourable comparison with the mandatory free-of-tie option. For example, in this case the IPC argued that the parallel assessment was not strong enough on its own:

> 'The delivery of fairness is dependent upon a tied licensee being no worse off than if they were free of tie. The challenge is how to deliver fairness and a tied licensee no worse off; this cannot be achieved by a formulaic approach alone.'

The All Party Parliamentary Save the Pub Group had a similar view in focusing on the unnecessary work that parallel free-of-tie would create for the Adjudicator:

> 'What this is suggesting is that even to determine fair rents and fair pricing versus rents, it would be down to the adjudicator. This is impossible as the adjudicator would have to deal with thousands of cases and means that they would be overwhelmed, which is setting up the system to fail.
>
> Whichever of the two mechanisms BIS Ministers decide to opt for, it is then for the adjudicator to deal with alleged breaches or abuses of these mechanisms – but the whole point of the code is that it will deliver a mechanism that will in most cases deliver the prime principle without the need to enforce.'

Another tenant group, the ALMR, took a different view. It was concerned at the possible unintended consequences of the mandatory free-of-tie option and suggested that a measure that focused on the rent assessment process would be enough:

> 'We believe that the principle that a tied tenant should be no worse off than a free of tie tenant is most effectively delivered through regulation of the rent assessment process and the assumptions made within it.'

Government Response

This consultation question sought views on how to achieve the no worse off principle and how to ensure a fair share of risk and reward between tenants and pub owning companies. It put forward two alternative proposals: the first was a formulaic approach to compensating tied tenants for high beer prices by mandating lower dry rents and the second was the mandatory free-of-tie option.

<u>Mandatory free-of-tie</u>

In many ways mandatory free-of-tie does represent the simplest and quickest way of delivering the Government's aim of ensuring that no tied tenant is worse off than a free-of-tie tenant. It fits with the process of negotiation that is the norm in the industry and does not require the application of a complex comparative formula in order to produce a transfer of income via adjustments to rent levels.

Government Response

However, we recognise that there are concerns at the uncertainty that mandatory free-of-tie provisions in the Code could cause. In particular **opponents of this option argue that it would cause uncertainty for pub owning companies with an unpredictable impact on the wider pubs sector.** Faced with a significant number of their tenants going free-of-tie, pub owning companies may genuinely take the decision that it makes business sense to leave the tied market. This is, of course, less likely for brewers but is a realistic option for the three large companies that are non-brewers. Some tenants may be content to see the tie broken but from the responses we have had, we believe that even some of the voices in the industry that are most critical of pub owning companies support the principle of the tie. Despite the assertion from supporters of mandatory free-of-tie that the risk to the tied model is exaggerated, the Government is also very conscious of the impacts of previous legislative changes, in particular the Beer Orders, and the unintended consequences they had.

Therefore the Government has decided not to include a mandatory free-of-tie option in the Code.

Our Final Proposal

Our original proposal for a formulaic 'parallel rent assessment' drew widespread criticism from respondents to the consultation, largely because it was too simplistic in design to be able to capture all of the variables in what is a complex business arrangement. As we set out in 8 (ii), we have listened to this criticism and instead the Government will include an amended version of the parallel rent assessment proposal as part of an *Enhanced* section of the Code.

If rent negotiations between the pub owning company and tenant fail, the Code will require that pub owning companies prepare, on request, a parallel rent assessment that focuses on the circumstances of each pub and will not mandate an automatic formulaic rent adjustment. Nevertheless, in line with the long held industry view, the Government expects that the parallel assessments will show that the tenant will be no worse off under the tied agreement than if he or she were free-of-tie. In doing so it will directly address the incentives on pub owning companies to ensure they take a fair share of the profits from a tied pub business.

The Code will require pub owning companies to prepare assessments which will focus on the circumstances of the pub in question, drawing on relevant market information and carried out in line with RICS guidance. A tenant in receipt of fair parallel rent assessment statements, with projected post rent balances, will be able to determine whether he or she is no worse off in a tied agreement and may be able to use the assessments provided to negotiate a better tied deal. In addition, we expect the Code to ensure that tenants take professional advice when entering into an agreement.

The Adjudicator will ensure compliance with these provisions in the Code. If a tenant believes that a tied or free-of-tie assessment breaches the Code, they will be able to appeal to the Adjudicator. If the Adjudicator finds in favour of the tenant, then the pub owning company will be required to produce a new assessment.

Government Response

Unintended Consequences

Our parallel rent assessment approach avoids the potential unintended consequences of mandatory free-of-tie that were set out in the consultation document. In particular, it will not generate the uncertainty that would be caused from pub companies not knowing whether pubs will remain tied or not. It will not affect the route to market of brewers covered by the *Enhanced* Code nor will it negatively impact on the economies of scale from which pub owning companies benefit. It is also estimated to lead to a lower number of pub closures, 52, compared to the predicted 390 closures estimated under mandatory free-of-tie. Finally, it will not lead to the scenario where, faced with a significant number of their tenants going free-of-tie, pub owning companies take the decision that it makes business sense to abandon the tied market.

Furthermore, by moving away from the formulaic approach to the parallel rent assessment, this provision will not risk penalising pub companies that are currently behaving fairly towards their tied tenants. Our solution enables the fairer negotiation of a tied agreement where it does not already occur rather than an unreliable calculation of an automatic rent adjustment.

Implementation

To ensure a smooth transition to the Statutory Code, we propose a rolling approach to the introduction of the right to request a parallel free-of-tie rent assessment. Tied tenants will be able to choose the option at the next rent review. The Code will limit the time that can elapse before the option may be exercised to five years after the previous rent review.

We intend that tied tenants will be able to exercise their right to request a free-of-tie rent assessment after negotiations have taken place and agreement has not been possible. This will reduce the burden on business of having to produce two assessments when the tenant may have no need for the free-of-tie assessment.

Tenants will have the right to request a parallel free-of-tie rent assessment which would include an estimate of the tenant's likely profit (known as "post-rent balance"). They will make their request for this to the Adjudicator. If the tenant requests a parallel free-of-tie rent assessment then he or she will pay a £200 fee to the Adjudicator, the purpose of which is to ensure that tenants consider carefully if the parallel free-of-tie rent assessment is necessary for the negotiation to be concluded successfully. However, at any stage, it would be open to the pub owning company to offer to provide the tenant with a simple estimated free of tie rent based on the pub company's knowledge of the market.

Q.12 Other than (a) a mandatory free-of-tie option or (b) mandating that higher beer prices must be compensated for by lower rents, do you have any other suggestions as to how the Government could ensure that tied tenants were no worse off than free-of-tie tenants?

The consultation set out the Government's proposals for a Statutory Code and Adjudicator, and explicitly requested views on a mandatory free-of-tie option. We postulated that the core principles could be achieved without a mandatory free-of-tie option, by requiring that higher beer prices be compensated for by lower rents, as set out in the parallel rent assessment formula in the consultation. For further details of the views expressed in the consultation on the mandatory free-of-tie option and parallel rent assessment, along with the Government's response, please turn to the response to Questions 11 and 8.ii respectively.

Against this background, the purpose of this question was to explore whether respondents to the consultation had any other suggestions as to how the Government could ensure that the tied tenant is no worse off than the free-of-tie tenant.

Consultation Responses

The majority of responses to this question used the opportunity to reiterate views expressed elsewhere in the consultation on whether the Government should pursue a mandatory free-of-tie option, or on whether statutory intervention is in fact required. These views are covered in greater detail in the responses to questions 1 and 11.

For example, several tenants' groups argued in their response to this question that the mandatory free-of-tie option and compensation for higher beer prices through lower rents are linked. Justice for Licensees, for example, contended that 'the provision of a Free of Tie option would ensure that higher beer prices are compensated for by lower rents.' The result, the All Party Parliamentary Save the Pub Group argued, is that 'this is not an either or deal.'

By contrast, the BBPA and pub owning companies tended to approach this question from the stance – expressed throughout their responses to the consultation – that the Government's proposals for a Statutory Code and Adjudicator were unnecessary, as 'the self-regulatory system and SCORFA already delivers this.'[36] This response was echoed by breweries such as JW Lees & Co and WH Brakspear & Sons.

Some individual tenants responding to this question contributed other suggestions on how to ensure that tied tenants are no worse off than free-of-tie tenants. One such suggestion was to:

> '"cap" the amount of benefit the pubco and brewer gets from the tie. Since the extra cost of the tie is usually justified by the claim of countervailing benefits, it should be quite easy for the pubco/brewer to quantify those benefits financially for each pub.

[36] BBPA consultation response

> This amount could then be converted into the extra profit in relation to a barrelage figure at the current tied pricing.
>
> Once the target barrelage sales figure is met, any further stock should be supplied at open market prices.'

This call for greater transparency and quantification of the value of SCORFA was echoed in a response from another tenant, who stated that:

> 'I believe it will all be about quantifying the "countervailing benefits" […] it should be possible for identify values to all these "benefits" which must be unique to being tied.' [sic]

Yet a number of responses also recognised that the value of SCORFA benefits varies both by tenant and by pub. As the ALMR noted in its response, for any quantification of SCORFA to be meaningful, it 'must be specific to the individual circumstances of a particular pub, rather than […] industry wide assumptions about the value of SCORFA.' The individual circumstances of tenants differ, as does their appetite for risk and need for support from their pub owning company. One tenant who had recently joined the industry told us that 'the help and support that we have received so far has made what would seem a very daunting task seem very achievable,' while other tenants ascribed little or no value to the SCORFA benefits offered by their pub owning company. The responses to the consultation also served to demonstrate that the value which pub owning companies put on SCORFA benefits often differs from the value which tenants ascribe to those same benefits. In its consultation response, Admiral Taverns estimated that the support services it offers to tenants '(excluding development capex support) are worth approximately £15,000 to each licensee each year on average if they were to have to buy these services on the open market, plus the development capex cost of £4000 per pub.' Yet some tenants told us that 'the SCORFA argument should be dismissed as irrelevant as in our experience we have no additional support from our pub company.'

In addition to the call for greater transparency around SCORFA, another tenant proposed that 'pub companies should be fined if too many of their tenants go into administration,' so as to provide them with an incentive to support tenants and encourage them to succeed.

Government Response

While the responses from the BBPA and pub owning companies tended to point to SCORFA as the means by which the industry already ensures that tied tenants are no worse off than free-of-tie tenants, the suggestions from tenants in answer to this question reinforced the Government's view that greater transparency is needed. The tenants' suggestions outlined above centre around quantifying the value of SCORFA, reflecting the disparity which emerged in the consultation responses between the value which pub owning companies place on SCORFA and the value which tenants ascribe to these 'countervailing benefits'. In 2009 the Business and Enterprise Select Committee found:

> 'There is no evidence demonstrating that a tied lessee receives benefits not available to free of tie tenants or freeholders. Nor are we in a position to say with confidence that rents for tied pubs are invariably lower than rents for equivalent

Government Response

> free of tie premises. We have been given examples where free of tie premises cost more to rent than tied ones and examples where they cost less.' [37]

The Government considers that its proposals for a Statutory Code and independent Adjudicator, combined with the requirement for pub owning companies with 500 or more tied pubs to provide a parallel free-of-tie rent assessment on request if rent negotiations fail, address the concerns which tenants have raised about the transparency of SCORFA and the difficulties in establishing whether a tenant is worse or better off under a tied agreement. These measures focus on addressing the imbalance in information and negotiating power which go to the heart of the problems in the relationship between pub owning companies and their tenants.

[37] Business and Enterprise Committee, Seventh Report, 2008-09, vol 1, pp69

Powers of the Adjudicator

The consultation proposed that the Statutory Code should be enforced by an independent Adjudicator and suggested the functions and powers that the Adjudicator should have. Not surprisingly, respondents to the consultation who were opposed to statutory intervention were opposed to the idea of an Adjudicator with the powers set out in the consultation. They qualified their responses to the following questions about the Adjudicator by stating that as they saw no need for a Statutory Code, they saw no requirement for an Adjudicator to enforce it.

Q.13 Should the Government appoint an independent Adjudicator to enforce the new Statutory Code?

The consultation argued that enforcement of the Statutory Code by an independent Adjudicator would ensure that the Code was genuinely complied with and provide a means of statutory dispute resolution so that tenants had an option other than court.

Consultation Responses

Ninety-five per cent of tied tenants who responded to the online survey agreed there should be an Adjudicator. Of 589 tenants who submitted written responses, only 55 (9%) agreed that there should be a Statutory Adjudicator to enforce the Code, while the remainder chose not to answer the question.

In agreeing with the consultation proposal, one tenant commented ‘Yes, it [the Adjudicator] should be completely independent from any influences from any party connected with the brewing/pub industry’ and another responded that ‘few licensees can afford to take on a pub chain or brewery at law.’

The ALMR commented that ‘if a statutory code is to be introduced, then an independent adjudicator to enforce it would be helpful as otherwise the only alternative form of enforcement would be through the courts. This is prohibitively expensive for lessees and unduly adversarial.’ The FSB agreed ‘that a statutory code must be backed up by an independent adjudicator.

The BBPA and pub owning company responses referred to the existing dispute resolution services already available to tenants: the independent conciliation and arbitration service provided by PICAS for complaints about breaches of individual company codes or the industry framework code; and the option of PIRRS or the RICS Dispute Resolution Service in the case of rent review disputes. In addition, they noted that tenants also had the option of court action. They also raised concerns about the additional financial cost of supporting both a statutory as well as a voluntary system.

The BBPA noted that ‘the pub industry now offers comprehensive arbitration services as part of its self-regulation reforms’ and ‘we do not accept the need for a costly and bureaucratic Adjudicator.’

Enterprise Inns contended ‘There is no need for a Statutory Adjudicator in the pubs industry. Tenants (and pub companies) already have means of redress (including fines and censures) through PIRRS, PICAS, the court system, arbitration or alternative dispute resolution. Adding another layer will simply add cost, bureaucracy and red tape.’ Similarly, Marston’s considered that ‘The appointment of an Independent Adjudicator would replicate

the systems already in place. It would also place a heavy financial burden upon the Pub Companies' and Punch Taverns said 'The quality and awareness of the self-regulatory system is high, and the cost is low. There is no need for a further system which could compromise the current system by spreading the case loads even further.'

On the other hand, Admiral Taverns commented that 'any Code needs an Adjudicator to conduct the investigation of complaints.' This view was shared by Heineken UK/Star Pubs and Bars who said 'If the Government chooses to proceed with a Statutory Code, it is logical to appoint an Adjudicator to oversee it.' Trust Inns commented that it was 'not against an adjudication system, but please just for simplicity make it clear and cost effective.'

Admiral Taverns also noted that:

> 'The terms of remit of such an Adjudicator and the skill set required by it needs very careful consideration. The PICAS and PIRRS bodies set up under self-regulation have an excellent mix of objective and independent industry experts who are able to investigate quickly and efficiently whether a complaint or claim has merit or not. Any Adjudication body needs to have the respect of genuine licensee representative bodies, such as the FLVA, pub owners, RICS etc. Appointing people with little practical experience or expertise in the sector would not gain the respect of the key parties and lead to the Adjudication body being ineffective.'

Apart from 92% of political representatives who agreed that an Adjudicator should be appointed, the question met with a largely disinterested response from other respondent groups: the majority of written respondents in those groups – pub owning companies with fewer than 500 pubs, supply chain, individuals and employee groups – expressed no view.

Q.14 Do you agree that the Adjudicator should be able to:

i. Arbitrate individual disputes?

ii. Carry out investigations into widespread breaches of the Code?

The consultation proposed that the Adjudicator would have two main functions, based on the model of the Groceries Code Adjudicator. The arbitration function would enable the Adjudicator to consider disputes between a pub owning company and tenant, and to deliver redress to individual tenants where the Adjudicator finds in favour of a tenant who complains about a breach of the Code by the pub owning company or is dissatisfied about how their rent has been calculated.

The investigation function would allow the Adjudicator to undertake proactive investigations based on complaints that have been received, provided there were reasonable grounds to suspect a pub owning company of breaching the Code. This function would provide protection for a wider group of tenants, not just those who complain.

<u>Consultation Responses</u>

The questions about the Adjudicator's powers met with a largely disinterested response, with the majority of written respondents, except pub owning companies with 500 or more pubs and interest groups, choosing not to answer the question.

Arbitration

The eleven pub owning companies with 500 or more pubs were divided in their response on arbitration, with two pub owning companies being in favour and five against (but this is likely to reflect the fact they all disagreed with any form of statutory intervention). The main concerns raised related to the Adjudicator's proposed role in rent disputes.

Greene King said:

> 'We do not believe the Adjudicator's arbitration role should cover rental disputes. There are established processes for the determination of rental disputes through the RICS Dispute Resolution Service and PIRRS. The processes for dealing with rent disputes, through either arbitration or referral to an independent expert, are well established. Arbitrations are subject to statutory control under the Arbitration Act 1996 and referrals to independent experts are on the basis of a duty of care.'

Enterprise Inns commented that 'any proposed pubs Adjudicator would require a team of industry specialists to advise him/her on rent valuations. Valuers of pubs are highly specialised in their particular market. They have knowledge of the operational aspects of the industry and they have a fundamental understanding of market transactions and how these are analysed.'

The BBPA said 'The adjudicator would have to arbitrate on "issues (such as rent) that will be specific to each pub" which leads to the conclusion that this hypothetical sports match would have thousands of players on the field where one referee would have to deal with each disputed tackle on an individual basis. For example, it is estimated that there are around 5000 "rent events" (reviews, renewals, new agreements) across the leased/tenanted sector each year.' The BBPA also observed that the GCA 'has no power to arbitrate or influence commercial decisions (such as rent), simply to punish abuse – a major difference with the proposed pub sector Adjudicator.'

RICS raised similar reservations about how the Adjudicator's proposed role in rent dispute arbitration might work in practice and noted the expertise this required. It commented that mechanisms already existed which enabled a tenant to refer the matter to a third party when it did not agree with the landlord's rental proposal and agreement could not be reached by negotiation. As well as the appointment of either an Independent Expert or Arbitrator through the RICS Dispute Resolution Service, this also included PIRRS.

RICS said it was 'concerned as to where the Adjudicator function would sit in relation to already successful established processes, embedded in law (i.e. the lease or tenancy agreement).' It commented that 'both Independent Experts and Arbitrators are usually appointed having relevant experience in the profits method of valuation, and thus will have a better understanding of, and the ability to weigh, the respective merits of the arguments of the parties.'

RICS also expressed concern if the Adjudicator were given powers to override a decision made by an Arbitrator or Independent Expert or PIRRS and commented 'We would have extreme reservations concerning this as the decision is usually regarded as final and only subject to appeal in law.'

The FLVA also commented on the expertise required:

> 'If the adjudicator were to deliver an open market rent review then that individual should be practiced in the role of arbitration or that of the expert witness role in the specific area of expertise required as the results of any such adjudication would have impact upon the market as a whole, this may require therefore that the adjudicators role may well be better served by an overview rather than individual case work which may well be suited to current bodies. The adjudicators role should police the policies and procedures of the individual and specific bodies in situ'. [sic]

Of 589 tenants who submitted written responses, only 50 (8%) agreed that the Adjudicator should be able to arbitrate individual disputes, while the remaining 539 tenants chose not to answer the question. Ninety-four per cent of online respondents agreed that the Adjudicator should have `the ability to arbitrate individual disputes about the Code, to ensure tenants could get compensation for any losses they had suffered,' including 92% of tied tenants.

The ALMR noted the Government's suggestion that it should be free for a tenant to bring a complaint for arbitration but commented that 'under the current self-regulatory arrangements, tenants and lessees make a small contribution to the costs of a case – £200. We believe that it would be a helpful model to filter frivolous or vexatious complaints while not deterring genuine substantive cases.'

Some consultation feedback also suggested that tenants ought to contribute towards the cost of arbitration when they bring a rent review case to the Adjudicator. The All Party Parliamentary Save the Pub Group, in setting out its plans for 'Market Rent Only', suggested that it would be reasonable for the cost of an independent rent assessment for arbitration purposes to be split 50/50 between tenant and pub owning company.[38]

Investigations

In terms of the investigatory function, 94% of online respondents agreed that the Adjudicator should have the 'ability to carry out investigations to discover widespread breaches of the Code by pub companies', including 88% of tied tenants. Of 589 tenants who submitted written responses, only 50 (8%) agreed that the Adjudicator should be able to carry out investigations into widespread breaches of the Code, while the remaining 539 tenants chose not to answer the question.

The FSB commented 'Giving the adjudicator an investigative power is in our view essential to protect tenants tied to the large pub companies who fear retribution if they speak up' and 'A complaint by one tied tenant may well uncover evidence to suggest that a large pub company is systemically breaching the statutory code. In such a situation an investigative power would allow the adjudicator to probe further.'

The ALMR welcomed the proposed remit of the Adjudicator, including the investigatory function, and said 'We have always been concerned that the current self-regulatory regime can only addresses those cases which are raised by lessees; it is possible that many other

[38] Letter of 13 November 2013 to the Secretary of State

breaches go unnoticed because tenants either do not know their rights or are unaware of how to seek redress if they feel that they have been unfairly treated.' [sic]

The FLVA commented that the investigatory function would be 'a welcome addition to the current raft of procedures and bodies which are available to the tenant. Current procedures allow purely for restitution and as previously expounded allows a pub co to take the risk with no real penalty other than "putting things right". A wide spread concern against an individual pub co could be investigated as could an industry issue.'

The eleven pub owning companies with 500 or more pubs were divided in their responses on the proposed investigation powers, with two in favour and four against. Marston's commented that *'*investigations into breaches of the Code would have to be based on sound evidence, and specify where exactly the Code has been breached'*.*

Many of the comments about the Adjudicator's investigation function from pub owning companies with 500 pubs or more centred around the need for measures to address vexatious complaints and for sanctions to be imposed on those found to have made such complaints.

For example, Punch Taverns said that 'if there is to be an Adjudicator they will need provisions to deal with frivolous or vexatious claims and if the claim is shown to be either then the Adjudicator must impose the cost on the complainant.' Similarly, Marston's considered that 'systems should be in place to prevent vexatious and speculative complaints being escalated, with the resultant time and financial cost of unnecessary investigations.' Admiral Taverns also proposed that there should be 'sanctions, such as an award of costs, against complainants if the latter's case is adjudicated as being without merit or vexatious*.'*

Q.15 Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including:

i. Recommendations?

ii. Requirements to publish information ('name and shame')?

iii. Financial penalties?

The consultation proposed that if, following an investigation, the Adjudicator considers that the Code has been breached by a pub owning company, the Adjudicator should have the power to impose a range of sanctions. A range of sanctions would allow the Adjudicator to tailor the severity of the sanction to the severity of the breach, ensuring that non-compliance with the Code was penalised proportionately.

Consultation Responses

The questions about the Adjudicator's sanctions met with a largely disinterested response, with the majority of written respondents in all categories except pub owning companies with 500 or more pubs and interest groups expressing no view. The proposal that one of the sanctions should be a financial penalty attracted the most interest from those who provided comments to support their answer.

The responses from the pub owning companies were based on there not being a need for a Statutory Code so they saw no requirement for an Adjudicator to have sanctions to enforce it. They were united in the need for transparency and proportionality in the imposition of a sanction. There was also a suggestion that a further consultation was needed on the range of sanctions, once the Code content and Adjudicator role were clarified.

Admiral Taverns said 'We have always supported the argument that the self-regulatory regime should have teeth in the form of a range of reputational, restorative and financial sanctions, and indeed we originally proposed the introduction of financial sanctions during the discussions about Version 6 of the IFC. However, any sanctions need to be proportionate and not aggressively punitive.'

Greene King said 'We strongly believe that any sanctions imposed should be in proportion to the breach committed and should be clear and transparent.'

Heineken UK said 'Until there is clarity on how the Adjudicator would operate and the content of the Code that it would oversee, it is difficult to comment on what powers of sanction or fines it should have. We believe that the Government should consult on this separately if it goes ahead with the Statutory Code and once its final content is known.'

Of 589 tenants who submitted written responses, 42 (7%) agreed that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including making recommendations. The same number agreed that 'naming and shaming' should also be a sanction available to the Adjudicator. The remainder chose not to answer either question. A slightly higher number of tenants (48) agreed that the range of sanctions should include financial penalties, while the remaining 541 chose not to answer the question. Based on the comments submitted, a financial penalty was considered the most important sanction the Adjudicator should have.

Ninety-four per cent of respondents to the online survey, including 89% of tied tenants, agreed that the Adjudicator should have 'the ability to impose fines on pub companies that breach the Code.' The survey did not seek views on the other proposed sanctions.

The BII agreed that it was 'important that the adjudicator has at its disposal a range of punitive measures which can be applied.' One multiple operator commented that 'any pub-co that has breached the code should pay large financial penalties to avoid a situation whereby "[it] is cheaper to pay the fine" and continue on with there current practices [sic].' The Forum of Private Business said 'Because the power [to impose a financial penalty] is there does not necessitate its use. A fair-minded Adjudicator can determine when it is appropriate. But its mere presence will help ensure the Adjudicator is taken seriously.'

Some tenants and their representatives suggested that the Adjudicator should have the power to compensate tenants if a breach of the Code is found. The FSB commented that it was 'concerned that current proposals would not give the adjudicator the power to compensate tied publicans where necessary. If a breach of the code results in tied publicans being over-charged, for example in relation to dry or wet rent, the adjudicator must have the power to ensure that the tied tenant is repaid promptly.'

The BII also said it would expect `that the adjudicator would seek to re-dress problems and compensate tenants, award costs and where deemed necessary pending on the level of a breach apply a financial sanction. This could go towards the costs of the adjudicator by

only penalising those who breach the statutory code [sic].' Similarly, the ALMR said that 'the most important power that the Adjudicator must have is the ability to offer compensation or redress to the aggrieved party for any detriment suffered and to have that put right. That must be the key focus of the Adjudicator's role.'

The pub owning companies and their representative, the BBPA, said that there should be an appeals process following the imposition of an Adjudicator's sanction. The BBPA commented that the 'the consultation contains no detail of appeals process for companies. Recourse to such a system should be in place to prevent unfair decisions being reached.'

Government Response

The Government recognises the mixed views of respondents on an Adjudicator and its proposed powers and sanctions, but views the creation of an independent Statutory Adjudicator as a vital component of statutory intervention for the pubs sector. The Government is persuaded that the current voluntary dispute resolution mechanisms are not seen as sufficiently independent by many tenants and as not having sufficient powers to enforce the voluntary code. Therefore the Government considers it is important for the Adjudicator to have much greater powers than the existing industry mechanisms, including the ability to investigate systemic breaches of the Code, as well as to have the power to impose a range of sanctions following an investigation, including to impose financial penalties and to publicise breaches.

The mechanism to ensure that the terms of the Code are being observed lies in the freedom of the tenant to take his or her complaint to the Adjudicator if they are not satisfied that their statutory rights have been respected. Statutory intervention is about delivering the benefits of the Code – the office of the Adjudicator is a means to achieving that, and not an end in itself.

The Government considers that the contents of the Code and the existence of the Adjudicator should lead to improvements at an earlier stage in the pub owning company and tenant relationship through providing an incentive for those pub companies which are accused of treating their tenants unfairly to change their behaviour. Enforcement by an independent Adjudicator with the power to impose a range of sanctions will ensure that the Code is genuinely complied with. The Government believes that it will provide a statutory dispute resolution mechanism in which tenants can have confidence and trust - one viewed as independent and transparent in a way that the current industry mechanisms are not, according to the consultation responses of some tenants and their representatives.

Arbitration does little to tackle underlying or systemic issues and the Government believes that investigations will allow the Adjudicator to tackle and publicise any widespread abuses in the industry, providing protection for a wider group of tenants, not just those who complain. Sanctions such as requiring a pub owning company to publish incidences of Code breaches will raise awareness of unacceptable practice.

The Government does not want to be prescriptive in the way that the arbitration and investigatory functions are delivered. We intend that the Adjudicator should have discretion as to how best to manage cases. This could include ruling on paper evidence

Government Response

and/or whether to allow the parties to submit expert evidence from a third party to help the Adjudicator reach a decision on whether there has been a breach of the Code, as well as discretion as to whether to hold a panel hearing similar to the PICAS model.

We intend that the Adjudicator will consult on and publish guidance about how these functions will be undertaken. This would include guidance on the Adjudicator's role in arbitrating rent disputes, including whether the tied rent assessment, and the free-of-tie rent assessment where appropriate, have been prepared in line with industry guidance and the Code.

The Adjudicator will have finite resources and will have to prioritise the workload to fit the budget, including the number of investigations that can be undertaken in any one year. The Adjudicator will be expected to consult on guidance outlining how investigations will be carried out, including how decisions will be taken to prioritise those that have the highest impact for the resources required. For example, we might expect the Adjudicator to sift out at an early stage any complaints which are without any merit. The guidance would also cover how the Adjudicator would apply the enforcement powers available.

The consultation proposed that access to the Adjudicator should be free for a tenant to bring a complaint or rent dispute for arbitration. While we have received complaints about the current voluntary arbitration system, none have raised concerns at the level of fees. Based on the evidence from the consultation, it would seem reasonable to expect a similar level of registration fee – £200 for PICAS – with the fee returned to the tenant if the complaint is upheld. This should encourage tenants to ensure the cases they refer to the Adjudicator have merit.

The Government has listened to concerns about possible frivolous or vexatious complaints. The Government intends that the Adjudicator should have discretion to assign costs against a tenant if they are found to have brought a vexatious case. Where the Adjudicator finds a tenant has brought a case which is `without merit`, we do not intend to give the Adjudicator similar discretion because we do not want to deter tenants with genuine cases making a referral to the Adjudicator.

As proposed in the consultation, the Government intends that complaints can be brought to the Adjudicator for arbitration only after a period of 21 days in which the tenant and the pub owning company have tried to resolve the dispute including through the in-house dispute resolution process. This should help prevent frivolous complaints from being referred to the Adjudicator.

In terms of investigations, the Government intends that the Adjudicator should require pub owning companies to pay some or all of the costs of an investigation if they are found to have breached the Code. As proposed in the consultation, if an individual has made a complaint that is found to be vexatious and wholly without merit, then that complainant should pay some or all of the costs of an investigation. We consider that interest groups rather than individuals will make referrals for investigation and that it is reasonable that the Adjudicator should have the discretion to recover costs for vexatious and without merit referrals.

Government Response

We are proposing that the Adjudicator should issue advice and guidance to pub owning companies and tenants on interpretation of the Code. This would help encourage compliance with the Code and help prevent disputes occurring in the first place, as well as ensure that tenants know their rights under the Code. Guidance will also ensure that standards of fair and lawful dealing are promoted across the sector.

The Government intends that there should be a maximum financial penalty that could be imposed on a company if, following an investigation, the Adjudicator finds the company has breached the Code and that a fine is the most appropriate sanction. The proposed level of the maximum financial penalty will be subject to consultation.

In terms of appeals, for arbitration cases, the decision of the Adjudicator will be binding and final on both the pub owning company and tenant, with the exception that either party may appeal on the grounds set out in the Arbitration Act 1996 (sections 67 to 69). For investigations, with the exception of penalties, any appeal against a decision of the Adjudicator shall be subject to Judicial Review. The imposition of penalties will be subject to a full merits appeal. A person required to pay costs of an investigation will have a right of appeal including the amount to the High Court.

Q.16 Do you consider the Government's proposals for reporting and review of the Adjudicator are satisfactory?

In the consultation the Government proposed that the Adjudicator should provide an annual report on his or her work, setting out details of the arbitrations conducted, investigations carried out and any breaches of the Code identified. The consultation suggested that the information provided in the report would be useful to the Secretary of State and Parliament in evaluating progress within the pub industry and the Adjudicator's effectiveness in ensuring that tenants are treated fairly and are no worse off.

The Government also proposed that the Secretary of State should be required to review the Statutory Code and Adjudicator every three years. The review would examine how the Code and Adjudicator are functioning, whether the Code needs to be amended and whether the Code and Adjudicator are still necessary.

<u>Consultation Responses</u>

This question elicited few responses from tenants, supply chain companies, political representatives, individuals and pub companies and breweries with fewer than 500 pubs. Of the 42 tenants who responded, all agreed that the Government's proposals for reporting and review of the Adjudicator were satisfactory. This response was echoed in the political representatives category, with all of the 16 respondents who answered the question expressing satisfaction with the consultation proposals.

The responses from pub companies and breweries with 500 or more pubs were more mixed; 50% of those which answered the question were in favour and 50% were not. This reflected the fact that many of the respondents in this category maintained that there was no need for a statutory Adjudicator in the pubs industry. Those companies which did agree with the Government's proposals recognised that 'if [an independent Adjudicator] is

introduced, regular reporting would be essential.'[39] In the interest groups category, nine of the 12 groups which answered the question were in favour of the Government's proposals. The ALMR agreed that regular reporting is essential to ensure that the Adjudicator is accountable for his or her actions. Representatives of pub owning companies, the IFBB and BBPA, said a review was also an opportunity to take stock and assess whether the Statutory Code and Adjudicator were effective 'and more importantly, actually required.'

From the perspective of tenants' representative body the FLVA, the annual report would also 'provide a useful reference for all interested parties, Government or an individual prospective tenant, who could check out the reputation and actions of their potential partner.'

Government Response

The Government considers the requirement that the Adjudicator report annually on his or her work to be vital in ensuring both that the Adjudicator is accountable for his or her actions and that the Secretary of State and Parliament have the information needed to assess how the Statutory Code and Adjudicator are functioning.

As proposed in the consultation document, the Government will provide for the Statutory Code and Adjudicator to be periodically reviewed by the Secretary of State. In line with the Groceries Code Adjudicator Act 2013, the Government intends that the legislation should provide for an initial review two years after the Code and Adjudicator come into force[40], with subsequent reviews every three years. The period between reviews is designed to allow enough time for any revisions or changes to bed down fully, while ensuring that the Code and Adjudicator can adapt as necessary. The review would consider the Adjudicator's effectiveness in enforcing the Code, whether there are any areas of the Code which need to be amended and whether the Code and Adjudicator are still necessary to ensure that tenants are being treated fairly.

The Secretary of State will be given the power to amend the Statutory Code, including the threshold, if the review provides evidence that doing so would help to deliver the two core principles (fairness and no worse off) more effectively.

For a more detailed explanation of the procedure for the review of the Statutory Code and Adjudicator, please see the response to Question 10.

[39] Greene King consultation response

[40] The period ending on the first 31 March that is at least 2 years after the Code and Adjudicator come into force.

Q.17 Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code more paying a proportionately greater share of the levy? What, in your view, would be the impact of the levy on pub companies, pub tenants, consumers and the overall industry?

The consultation proposed that the Adjudicator should be funded by an industry levy with each of the companies covered by the Code paying a share of the levy. This was considered appropriate as it was the conduct of pub companies that led to the need for an Adjudicator. The consultation also proposed that the levy should be divided amongst the large companies in proportion to the number of pubs that each owns and that, over time, those companies that breached the Code should pay more.

Consultation Responses

The majority of written respondents in all categories except pub companies and breweries with 500 or more pubs and interest groups did not express a view about whether the Adjudicator should be funded by an industry levy. The question was not asked in the online survey.

All but one of the small number of tenants (39 out of 589) who answered the question agreed that the Adjudicator should be funded (or at least partly funded) by an industry levy. One multiple operator agreed that the Adjudicator should be funded by an industry levy and suggested that 'abiding by the code should become a badge of honour for the pub companies to achieve.'

One tenant commented 'I do not feel that it is appropriate for the costs of the Adjudicator to be passed on to Pub Tenants or customers but that it should be wholly paid by the Pub Companies. Ultimately it is because of their actions that we are now having to change the code and overwhelmingly I suspect they will be the organisations who will try to find ways around its implementation.'

Tenant groups were supportive of the consultation proposal. The ALMR commented that 'the industry already pays a levy per pub to fund the ongoing costs of the self regulatory regime and alternative dispute resolution mechanisms, PIRRS and PICAS. The principle of a levy-based contribution to costs is therefore established, but it must be fair, targeted and proportionate if it is not to impose an undue burden on the sector.' The FLVA agreed: 'The proposals as drafted seem a fair and equitable way of funding the proposals as currently outlined.'

The majority of pub companies and breweries with 500 or more pubs did not agree with the consultation proposal. Admiral Taverns commented that 'the pub sector is already massively over-taxed in terms of business rates, alcohol duty, machine gaming duty, VAT etc. Yet another levy/cost imposition is simply unjustifiable, especially when there is no clear evidence justifying Statutory Regulation.'

Of the 19 political representatives who answered the question, 18 agreed with the proposal. One MP, Peter Luff, commented that 'there will be enhanced compliance costs for the Pubcos but the distribution of power is so uneven in the commercial relationships between them and their publicans that this is a reasonable price to pay for change.'

One tenant disagreed that the Adjudicator should be funded through a levy on pub owning companies and said:

> ‘I strongly believe that the adjudicating body should not be funded this way [by an industry levy], because as with many organisations already out there, the pub co’s have too much control over them! As publican’s I think it is about time we had an organisation that we can trust to do what is right for us and not for the pub co’s. The pub co’s would only pass it on to us somewhere down the line anyway. Maybe it could be funded by the publicans ourselves, if it was truly an impartial body and by the fines that were imposed to the pub companies’. [sic]

Other tenants also agreed that it would be reasonable for them to contribute to the cost of the Adjudicator. One commented that ‘I would gladly pay towards a body which protects me properly’ and another said ‘I would be happy to pay a small levy if it guaranteed that I would see the rewards of my own hard work fairly distributed between myself and the company that has given me that opportunity. If this is done well tenants and the consumer should benefit.’

One multiple operator agreed that the Adjudicator should be funded by an industry levy but also suggested that the Government ‘should also bear some of the cost as I feel that if the code is funded wholly by the pub companies it would not be independent, the cost could be met by increased tax returns from individual tenants due to improved profitability within pubs or a levy could be placed on each individual pub connected to business rates.’

The consultation proposed that the levy should be divided amongst the large companies in proportion to the number of pubs that each owns. Consultation responses on this tended to reflect an individual’s view about the threshold for the Statutory Code and the type of agreements that should be protected by the Code. A number of respondents shared the view that the Code should apply only to companies with tied pubs and therefore if a levy was imposed, it should relate only to the number of tied pubs owned by a company.

The ALMR commented:

> ‘The scope of work of the Adjudicator and therefore the size of the proposed levy will be directly affected by the number of companies on which the Code is binding and for, the basis on which the threshold is determined. If the Code is applied on the basis of pub ownership, then the potential workload and hence levy required to fund the operating costs will be huge. If the Code is applied to those whose core business is leased/tenanted operations, then it will be correspondingly reduced.’

Mitchells and Butlers observed:

> ‘If costs towards the adjudicator are […] based on the total number of businesses operated and not just the number of leased pubs operated, not only would Mitchells & Butlers be included in the statutory regulation but the size of our managed estate would mean that despite having only 60 leased businesses we would contribute one of the largest shares of the initial cost of the adjudicator at the commencement of the statutory code. This would be wholly inequitable and disproportionate.’

Spirit Pub Company said that ‘introducing a standard levy per tied pub within an estate enables more stability for both the pub company and the licensee. This is the way PIRRS and PICA-Service work and this should be allowed to continue in our view.’

As well as proposing that the levy should be divided amongst the large companies in proportion to the number of pubs that each owns, the consultation also proposed that, over time, those companies which breached the Code should pay more.

Respondents generally agreed with this consultation proposal. One tenant commented 'It is only right that those who breach the code should pay the most'. The BII agreed that 'companies who breach the code more, should pay a higher levy.'

Heineken UK/Star Pubs and Bars commented 'If introduced, the Adjudicator should [...] be funded predominantly by the largest businesses, with a higher contribution made by companies where the Adjudicator has found against them in referred cases.' Admiral Taverns agreed that 'clearly the principle that errant companies should pay more than those which do not breach a code is better than the alternatives.' While Mitchells and Butlers agreed with the proposal that 'the industry levy should revert to a system based on those generating most complaints bearing the biggest share from the second year onwards,' it also commented that 'this initial cost alone would be considerable and disproportionate.'

To address concerns from some groups about the cost burden on smaller companies if the Code were to apply to all, Heineken UK/Star Pubs and Bars said 'We have heard concerns from some groups that while in principle they do not oppose the Code covering all companies, they are concerned at the cost burden on smaller companies. We believe this could be resolved by a funding arrangement where large companies pay the bulk of the cost.'

The consultation sought views on the impact of the levy on pub companies, pub tenants, consumers and the overall industry. While it was generally considered undesirable for the cost of the levy to be passed on to tenants and ultimately the consumer, there were mixed views from all groups of respondent on whether this would happen in practice.

While CAMRA agreed that the proposed industry levy was the appropriate way to fund the Adjudicator, it also noted 'We expect the cost of this to be borne by the pub companies as the cost per pub would be infinitesimally small. However, even if the pub companies transfer this cost to the consumer and we split the cost of the Adjudicator across every pint sold in a pub in the UK, this works out as just 0.006p a pint.'

Spirit Pub Company said 'The impact of introducing the proposed levy could be significant in terms of increased costs to the licensees and pub companies [...] The impact at an industry level might mean us passing on additional costs to our licensees and ultimately the consumer.' On the other hand, Admiral Taverns suggested that it could not pass the levy on to tenants as 'they are over-taxed anyway and we would simply have to absorb it, which would reduce the funds we have for investing in our pubs and supporting licensees.'

Greg Mulholland MP commented that 'the costs associated with the adjudicator and statutory regulation will largely depend on the behaviour of the pub owning companies. Worse behaviour would lead to more complaints which would lead to more work and higher costs.'

A 'pub customer' commented that 'the existence of such codes would hopefully encourage compliance without referral to an adjudicator so financial impact should be minimal.'

One multiple operator said 'In my opinion if the full cost of implementing and running the regulator the levy imposed on the pub companies would be re charged back to there tenants and disguised in some way.' [sic]

One individual working in the supply chain believed 'The impact would fall on tenants but most likely not customers. The pub company can levy fees for other items, such as an 'application fee', which would be paid by the tenant and would cover the administrative costs. This is not necessarily unfair, if it protects the tenant overall.'

Another tenant commented that 'the big companies may see a drop in their profits due to a levy. However if these profits have been gained through unfair means that disadvantage small businesses and the consumer then they should not have enjoyed them in the first place.' Another tenant thought the levy would have 'virtually no impact. The cost of the levy would reduce in time as Pub Companies complied with the code and the industry in general became better acquainted with its implementation. Should a pub Company be found to be in breach of the code then any fines could be fed back into the system to ensure costs to compliant Companies was minimised.'

One respondent who identified themselves as an individual thought that there would be little impact on pub owning companies that breached the Code: 'It isn't expensive to comply with good practice. Where possible the scheme should be funded entirely through fines with refunds to those with a clean bill of health to cover their costs.' In addition, tenants 'should get a fairer deal and the opportunity to expand and diversify their business' and consumers 'should gain through the removal of constraints on tenanted pubs and greater competition.'

Government Response

The Government intends that the Adjudicator will be funded through a levy on pub owning companies in scope of the *Core* Code. In addition, the levy will be set in proportion to the number of tied pubs that each company owns, as is currently the case for funding industry self-regulation. This means that the levy will be paid by pub owning companies operating tied agreements, including franchises. If a company operates only managed and/or free-of-tie pubs, it will not have to contribute. Those companies with the most tied pubs will contribute more. Over time, the funding model will shift so that those companies which breach the Code will contribute more, which should provide an additional incentive for compliance with the Code.

The Government's view remains, as outlined in the consultation, that the cost of a levy on pub owning companies might be passed on to tenants and ultimately to the consumer. However, on balance, the Government considers that as the market is already competitive, the price paid by the consumer is unlikely to change, and thus revenues would be unaffected.

The Government has considered the views expressed by some respondents that tenants and/or the Government should contribute to the cost of the Adjudicator. As noted earlier in response to Question 14, the Government considers that, in line with the current industry practice of tenants paying a £200 fee to register a complaint for arbitration with PICAS, a similar fee based approach should be adopted for arbitration

Government Response

requests to the Adjudicator. If the complaint is upheld, the fee will be returned to the tenant; and the pub owning company will be liable for this payment. As well as providing a mechanism to prevent frivolous complaints being made, this will also contribute to the cost of the Adjudicator.

The level of the levy each year will be for the Adjudicator to recommend and for the Secretary of State to approve. The Government has revised its estimate of the likely cost of the Adjudicator from £820,000 to £1.75 million a year which is equivalent to £90 per tied pub per annum. As with the creation of the Groceries Code Adjudicator, the Government intends to fund the set-up costs of the Adjudicator.

Conclusion

The Government's consultation on Pub Companies and Tenants stimulated a large number of responses from a wide range of stakeholders, including 1,120 written responses and more than 7,000 responses to the online survey which was conducted in parallel. Views were often polarised, ranging from the view that there is no need for Government intervention, to calls for a mandatory free-of-tie option to be introduced.

The evidence received confirmed the Government's view that although self-regulation has brought a number of improvements to the industry, such as the industry framework code and the PIRRS and PICAS dispute resolution services, the changes have been too long coming and have not gone far enough to address the problems in the relationship between pub owning companies and their tenants.

A Statutory Code

The Government is committed to supporting a healthy pub industry and believes that the core principles – that tenants should be treated fairly and that the tied tenant should be no worse off than the free-of-tie tenant – are critical to addressing the problems which have dogged the relationship between pub owning companies and their tied tenants. On the basis of the evidence submitted to the consultation, the Government has concluded that the best way to deliver these core principles is to introduce a Statutory Code to govern the relationship between pub owning companies and their tied tenants.

In deciding the best way forward, the Government has been mindful of the concerns, expressed both by those calling for reform and by those who believe self-regulation is working, that the introduction of a Statutory Code and Adjudicator could inadvertently create a two-tier system. Respondents argued that tenants of companies above the threshold would be protected by the Statutory Code, while those below the threshold risked losing the protection of industry self-regulation if these mechanisms were to disappear. The Government recognises these concerns and has therefore concluded that the *Core* Code should provide *all tied tenants* with increased transparency, fair treatment, the right to request an open market rent review if they have not had one in five years, and the right to take disputes to an independent Adjudicator. We will also consult on the precise definition of provisions to enable a tenant to request a rent review within the five-year period if the pub-owning company significantly increases drink prices or if an event occurs outside the tenant's control.

In addition to these core protections, the *Enhanced* provisions of the Code will require pub owning companies with *500 or more tied pubs* to offer parallel tied and free-of-tie rent assessments to potential or existing tenants on request if rent negotiations fail.

Taking into account the concerns expressed by both sides of the debate that the formulaic parallel rent assessment set out in the consultation did not adequately account for the diversity in the sector, the Government now intends that parallel rent assessments should be carried out on an individual pub basis and will require that they are carried out in line with Royal Institution of Chartered Surveyors (RICS) guidance. A tenant who requests a parallel free-of-tie rent assessment will pay a £200 fee to the Adjudicator, the purpose of which is to ensure that tenants consider carefully if the parallel free-of-tie rent assessment is necessary for the negotiation to be concluded successfully.

The introduction of this parallel free-of-tie rent assessment measure will mean that, for the first time in the long history of the tie, tenants will be able to test the pub owning companies' assertion that tied tenants are no worse off than free-of-tie tenants. The parallel rent assessment will help to strengthen tenants' bargaining position, which has for too long been out of balance with the negotiating power of pub owning companies. For pub owning companies, it offers the opportunity to demonstrate that their tied agreements do offer tenants a fair share of risk and reward.

Crucially, the introduction of an independent Adjudicator should give tenants the peace of mind that if the Code is not being adhered to, their concerns can be heard by an independent third party.

The Code will not give tenants the right to choose a free-of-tie agreement. While 58% of tied tenants responding to the online survey felt that mandatory free-of-tie represented the best option, the Government considers that this option would be likely to cause a high degree of uncertainty in the industry, with a likely negative impact on investment and the possibility that several pub owning companies would abandon the tied market. It would also have generated the unnecessary risk of higher levels of pub closures and job losses in the sector.

Another proposal which the Government has decided not to include in the Code because of its potential to undermine the tied model is the guest beer option. This option would have given tied tenants the right to purchase one beer of their choice from any source, and was supported by 91% of respondents to the online survey. After considering the evidence received, however, the Government considers that this proposal carries too great a potential to undermine the tied model as a whole, due to the likelihood – noted by respondents from all sides of the debate – that tenants would use the provision to purchase their best selling beer outside of the tie.

The consultation responses also showed that many of the concerns about the gaming machine tie have now largely been addressed by pub owning companies and in changes to the industry framework code. The active management which pub owning companies provide for gaming machines can help to maximise income for both tenants and the pub owning company. On the basis of this evidence, the Government has decided not to abolish the gaming machine tie. Instead, the Government intends to stipulate in the Statutory Code that tenants should have the choice whether to be tied or not for gaming machines.

An independent Adjudicator

Both the *Core* and *Enhanced* provisions of the Statutory Code will be enforced by a new and independent Adjudicator, with powers to arbitrate disputes, investigate systemic breaches of the Code and provide tenants and the industry with guidance on how to interpret the Code. The Government intends that if the Adjudicator finds the Code has been breached, it will have the power to impose sanctions, including financial penalties.

Both the Code and Adjudicator will be subject to review, initially after two years and then every three years. The Adjudicator will be funded by an industry levy which will be set in proportion to the number of tied pubs that each company owns. Over time, those companies which breach the Code will contribute more, which should provide an additional incentive for compliance with the Code.

The Government believes that this set of measures provides a proportionate and targeted response, which ensures that all tied tenants are protected. The new Statutory Code and Adjudicator, combined with the right to a parallel free-of-tie rent assessment on request, should provide tenants with the information and power they need to negotiate a fair tied deal. Pub owning companies that are already behaving responsibly have nothing to fear; this is not abolition of the beer tie. The Government supports the tie as a valid business model where it is used properly and is not abused. It will enable companies to demonstrate what should already be the case, namely that their tied agreements offer a fair share of risk and reward and that their tied tenants are no worse off than free-of-tie equivalents. In line with the Government's policy on business regulation, micro-businesses will be exempt from the legislation.

This Government has consistently demonstrated its support for a healthy pub industry, including bringing an end to the beer duty escalator in Budget 2013 and cutting beer duty for the second year running in 2014. A healthy pub industry also requires fairness for all the businesses involved. With the key protections of the Statutory Code and Adjudicator in place, the Government is keen to see the British pub and brewing industry build on its proud heritage – and for a sustainable and fairer industry that will enable pubs to remain among the mainstays of our communities.

Next Steps and implementation

The Government intends to establish a Statutory Code and Adjudicator through primary legislation. To this end, we will be seeking to legislate at the earliest opportunity.

ANNEXES

Annex A: List of Respondents

Pub companies and breweries with 500 or more pubs

Admiral Taverns Ltd
Enterprise Inns Plc
Greene King Plc
Heineken UK and Star Pubs & Bars
JD Wetherspoon Plc
Marston's Plc
Mitchells & Butlers Plc
Punch Taverns Plc
Spirit Pub Company Plc
Trust Inns Ltd
Wellington Pub Company Plc

Pub companies and breweries with fewer than 500 pubs, including micro-breweries

AB InBev UK Ltd
Adnams Plc
Arkell's Brewery Ltd
Castle Rock Brewery
Charles Wells Ltd
Daniel Batham & Son Ltd
Daniel Thwaites Plc
Dartmoor Brewery Ltd
Enville Ales Ltd
Everards Brewery Ltd
Frederic Robinson Ltd
Fuller Smith & Turner Plc
George Bateman & Son Ltd
Hall & Woodhouse Ltd
Harvey & Son (Lewes) Ltd
Hook Norton Brewery Co Ltd
Hydes Brewery Ltd
Joseph Holt Ltd
JW Lees & Co (Brewers) Ltd
McMullen & Sons Ltd
SA Brain & Co Ltd
Sharp's Brewery Ltd
Shepherd Neame Ltd
St Austell Brewery Co Ltd
T&R Theakston Ltd
Thornbridge Brewery
Timothy Taylor & Co Ltd
Wadworth & Co Ltd
Wharfe Bank Brewery
WH Brakspear & Sons Ltd
Young & Co's Brewery Plc

Interest groups, trade bodies and other organisations

Association of Licensed Multiple Retailers
Brighton and Hove Licensees Association
British Amusement Catering Trade Association
British Association of Pool Table Operators
British Beer and Pub Association
British Institute of Innkeepers
CAMRA
Fair Pint Campaign
Federation of Licensed Victuallers Associations
Federation of Small Businesses
Forum of Private Business
GMB Union
Guild of Master Victuallers
Independent Family Brewers of Britain
Independent Pub Confederation
Justice for Licensees
Licensees Supporting Licensees
Office of Fair Trading
Parliamentary Save the Pub Group
Pubs Advisory Service
Royal Institution of Chartered Surveyors
Scottish Beer and Pub Association
Scottish Licensed Trade Association
Social Liberal Forum
Society of Independent Brewers
Trading Standards Institute
University of East Anglia

Supply chain

365 ODS Ltd
ADS Design
AG & G Chartered Surveyors
Andrews Electrical Ltd
ASJ Facilities Building Management Ltd
Astra Gaming Group
Barhouse Joiners & Builders Ltd
Bell-Fruit Group Ltd
Ben Fairall
Blacknoll Ltd
Border Automatics Ltd
Bridgewater Contracts (Projects) Ltd
Brighter Homes
Brownill Vickers Ltd — Lee Sidebottom
Brownill Vickers Ltd — Martin J Nicholson
Callow Building Services Ltd
CP Construction (Gwent) Ltd
Davis Coffer Lyons
Design Management Partnership
Dunn Building and Joinery Ltd
Edgedale Developments Ltd
Eurosafe UK Ltd
Gamestec Leisure Ltd
Gleeds Cost Management Ltd
G Oakley & Sons Ltd
Haycock & Jay Associates Ltd

Howard Day
Humberstones
Inndecs Ltd
Insignia Signs Ltd
(The) Institute of Licensed Trade Stock Auditors
lOA Group
Ivor Thomas Amusements Ltd
James A Baker Property Consultants
JW Fazey Limited
M & G Recovery Fund
Mark Two Ltd
Midwest Electrical Services Ltd
MR Contracts Ltd
Nook's Yard Ltd
Peter Gunning & Partners LLP
Pinner & Sons Ltd
PJ Lilley Ltd
Plus One LLP
Quality Amusement Ltd
RDF Building Services Ltd
RK Martin Ltd
RMS Construction & Developments Ltd
Roslyns Licensed Trade Accountants
Sceptre Leisure Solutions Ltd
SE Leisure Group
Soda Ltd
South Eastern Electrical
Spencer Swinden Design Ltd
Talent Direct Ltd
TM Browne Ltd
TOGEL Contractors Ltd
Vianet Group Plc
Watling Hope
Wensley Group
Wilkinson Maintenance
Willows Building Maintenance Service (Lincoln) Ltd
Winter Hill Accountancy

Political representatives

Alan Quinn — Bury Council
Andrew Sosin — Chelmsford City Council
Andy Petch — West Sussex County Council
Bally Singh — Coventry City Council
Bob Neill, MP
Bob Riley — Corby Borough Council
Brian Ayling — Southend on Sea Borough Council
Brian Simpson, MEP
Carole Jones — lpswich Borough Council
Cathy Watson — Welwyn Hatfield District Council
Charlotte MacCaul — Canterbury City Council
Chris Candish — Trafford Metropolitan Borough Council
Chris Garrard — Allerdale Borough Council
Christine Hill — Harrogate Borough Council
Clare Neill — Erewash District Council
Darren Johnson — Member of the London Assembly
Dave Anderson, MP
David Ellesmere — lpswich Borough Council

David Stark — Plymouth City Council
Derek Twigg, MP
Dilys Cluer — Scarborough Borough Council
Eric Carter — Telford & Wrekin Council
Eric Drinkwater — Lichfield District Council and Burntwood Town Council
Eric Fazackerley — Preston City Council
Eric Seward — North Norfolk District Council
Geraldine Dyer — Ashford Borough Council
Gordon McAra — West Sussex County Council
Graeme Morrice, MP
Graham Compton — Salford City Council
Graham Morgan — Gloucestershire County Council
Greg Mulholland, MP
Guy Roberts — Birmingham City Council
Harry Howard — Halton Borough Council
Helen Armitage — Suffolk County Council
Henry Potter — Chichester District Council
Hod Birkby — Kent County Council
Hywel E Jones — Ynys Mon (Anglesey) County Council
Ian Reynolds — Selby District Council
Jacqueline Parry — Cardiff City Council
James S Evans — Neath Port Talbot County Borough Council
Jane Ellison, MP
Jenny Willott, MP
Jeremy Lefroy, MP
Jim Sheridan, MP
Joan Walley, MP
Joe Cullinane — North Ayrshire Council
John McMahon — Oldham Council
John Mowles — lpswich Borough Council
John Pettman — Broadland District Council
Josef Ransley, Chichester District Council
(Rt Hon) John F Spellar, MP
Judy Brandis — Aylesbury Vale District Council
Karl McCartney, MP
Keith Baldry — South Hams District Council
Kelvin Hopkins, MP
Kevin Quartley — Bristol City Council
Kirsty McCullagh, MP
Leonard Jacklin — Suffolk County Council
Mandy Gaylard — Suffolk County Council
Margaret Isherwood — Wakefield Council
Margaret Morris — Suffolk Coastal District Council
Mark Anderson — East Lindsey District Council
Mark Bailey — Bristol City Council
Mary Lloyd — Southampton City Council
Michael Breslin — Argyll and Bute Council
Michael Thornton, MP
Mike Adams — Caerphilly County Borough Council
Mike Byatt — Dorset County Council
Mike Wood, MP
Nic Coome — Chilton Foliat Parish Council
Nick Small — Liverpool City Council
Nigel Pearson — Somerset County Council
Paul Beck — Hartlepool Borough Council
Paul Farrelly, MP

Paul Murphy, MP
Peter Aldous, MP
Peter Luff, MP
Philip Hickson JP — Derby City Council
Richard Edis — Runnymede Borough Council
Richard White — Newport City Council
Rod Blyth — Oldham Council
Rod Jones — Rushcliffe Borough Council
Roger Lord — Essex County Council
Roger Stone — Rotherham Metropolitan Borough Council
Ron Round — Knowsley Council
Royce Longton — West Berkshire Council
Sandra M Kabir — London Borough of Brent
Sandra Osborne, MP
Sandy Martin — Suffolk County Council
Sherie Murphy — South Tyneside Council
Simon Hughes, MP
Simon Morrow — Tandridge District Council
Simon Reevell, MP
Simon Wright, MP
Stephen Doughty, MP
Sue Anderson — Harrow Council
Thomas Martin — Sunderland City Council
Tim Farron, MP
Tom Brake, MP
Tom Clarke, MP
Tom Maddison — Dartford Borough Council and Kent County Council
Tony Howard — East Lindsey District Council
Tony Richardson — Wakefield Council
Trevor Moncrieff— Melton Borough Council
Tudor Evans — Plymouth City Council
Uta Clay — City and County of Swansea Council

Other responses – mainly from tenants, from employees of breweries and pub owning companies and from other individuals – have been anonymised or withheld.

Annex B: List of Consultation Questions

Q.1 Should there be a Statutory Code?

Q2. Do you agree that the Code should be binding on all companies that own more than 500 pubs? If you think this is not the correct threshold, please suggest an alternative, with supporting evidence.

Q.3 Do you agree that, for companies on which the Code is binding, all of that company's non-managed pubs should be covered by the Code?

Q.4 How do you consider that franchises should be treated under the Code?

Q.5 What is your assessment of the likely costs and benefits of these proposals on pubs and the pubs sector? Please include supporting evidence.

Q.6 What are your views on the future of self-regulation within the industry?

Q.7 Do you agree that the Code should be based on the following two core and overarching principles?

i. Principle of Fair and Lawful Dealing

ii. Principle that the Tied Tenant Should be No Worse Off than the Free-of-tie Tenant

Q.8 Do you agree that the Government should include the following provisions in the Statutory Code?

i. Provide the tenant the right to request an open market rent review if they have not had one in five years, if the pub company significantly increases drink prices or if an event occurs outside the tenant's control.

ii. Increase transparency, in particular by requiring the pub company to produce parallel 'tied' and 'free-of-tie' rent assessments so that a tenant can ensure that they are no worse off.

iii. Abolish the gaming machine tie and mandate that no products other than drinks may be tied.

iv. Provide a 'guest beer' option in all tied pubs.

v. Provide that flow monitoring equipment may not be used to determine whether a tenant is complying with purchasing obligations, or as evidence in enforcing such obligations

Q.9 Are there any areas where you consider the draft Statutory Code should be altered?

Q.10 Do you agree that the Statutory Code should be periodically reviewed and, if appropriate amended, if there was evidence that showed that such amendments would deliver more effectively the two overarching principles?

Q.11. Should the Government include a mandatory free-of-tie option in the Statutory Code?

Q.12 Other than (a) a mandatory free-of-tie option or (b) mandating that higher beer prices must be compensated for by lower rents, do you have any other suggestions as to how the Government could ensure that tied tenants were no worse off than free-of-tie tenants?

Q.13 Should the Government appoint an independent Adjudicator to enforce the new Statutory Code?

Q.14 Do you agree that the Adjudicator should be able to:

i. Arbitrate individual disputes?

ii. Carry out investigations into widespread breaches of the Code?

Q.15 Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including:

i. Recommendations?

ii. Requirements to publish information ('name and shame') ?

iii. Financial penalties?

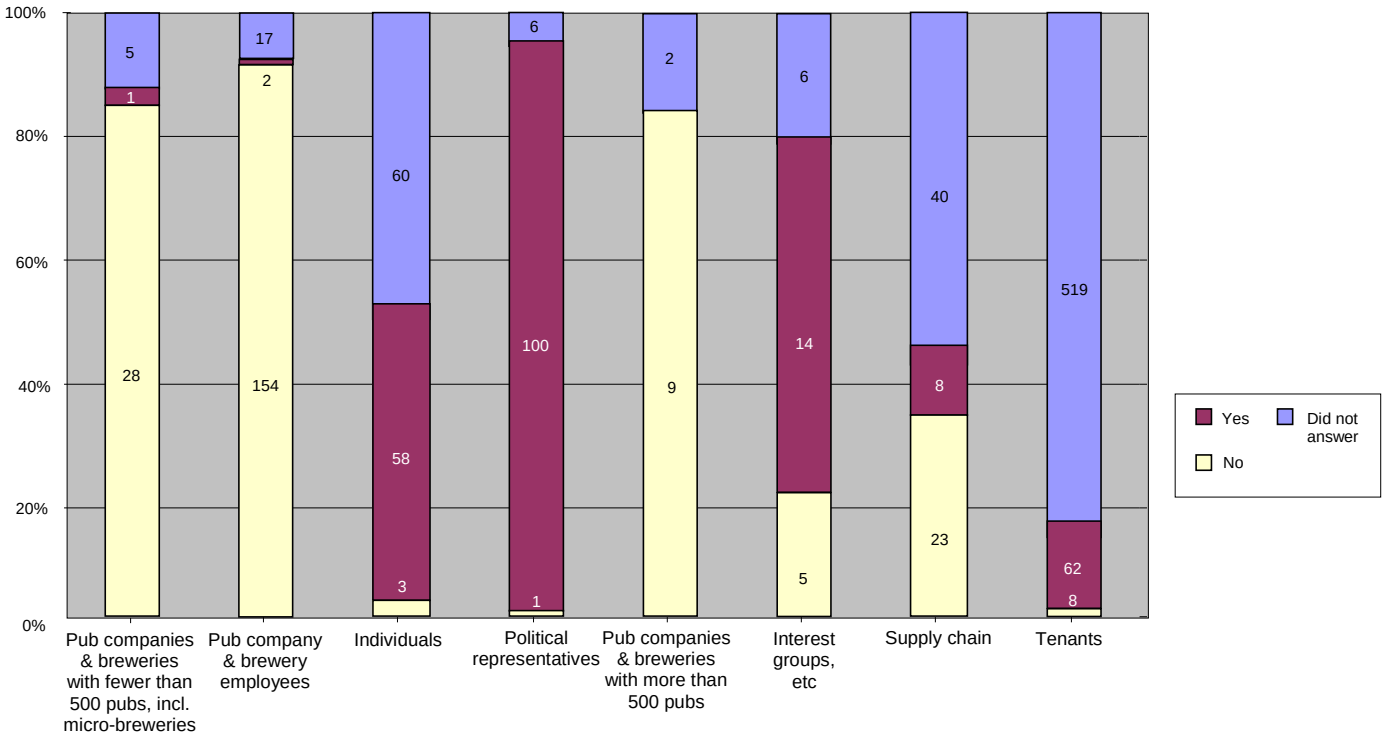
Q.16 Do you consider the Government's proposals for reporting and review of the Adjudicator are satisfactory?

Q.17 Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code more paying a proportionately greater share of the levy? What, in your view, would be the impact of the levy on pub companies, pub tenants, consumers and the overall industry?

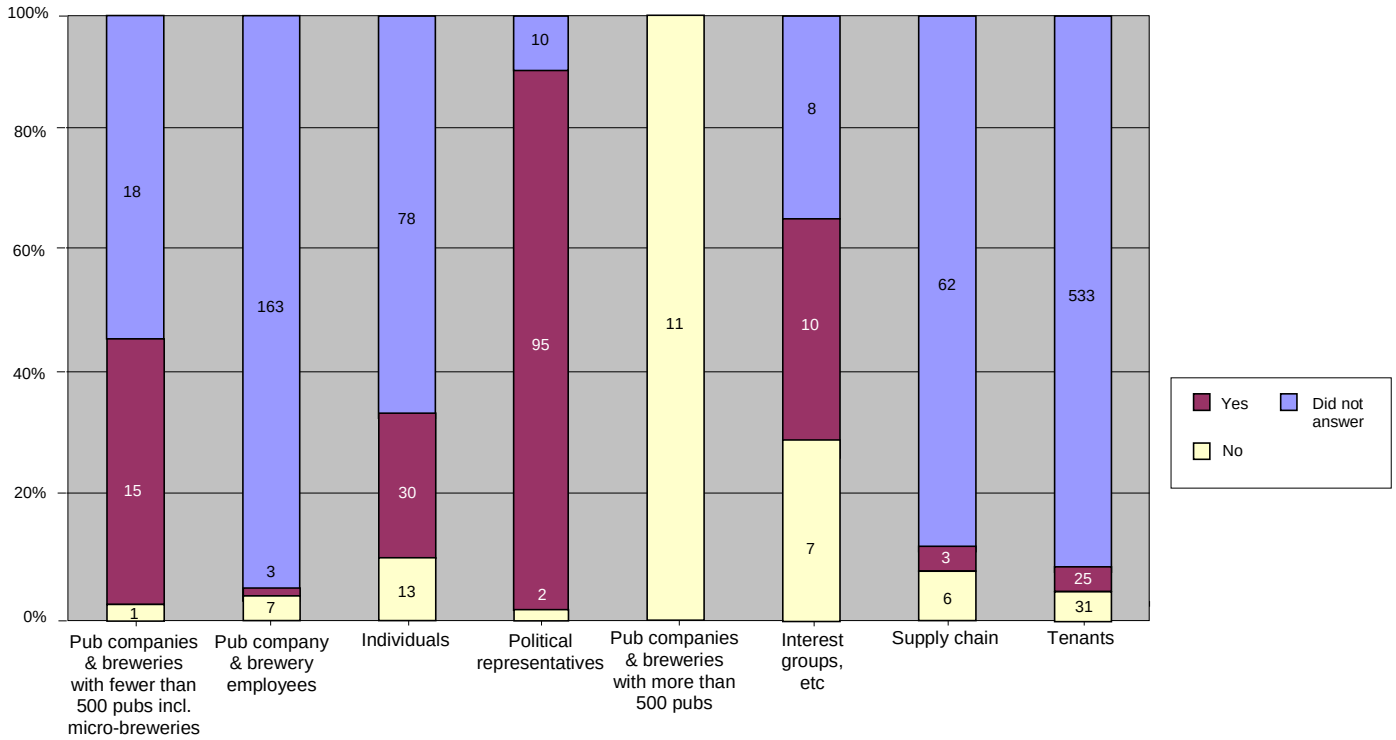
Annex C: Analysis of Written Consultation Responses

These charts relate to all consultation questions except those requiring a narrative response.

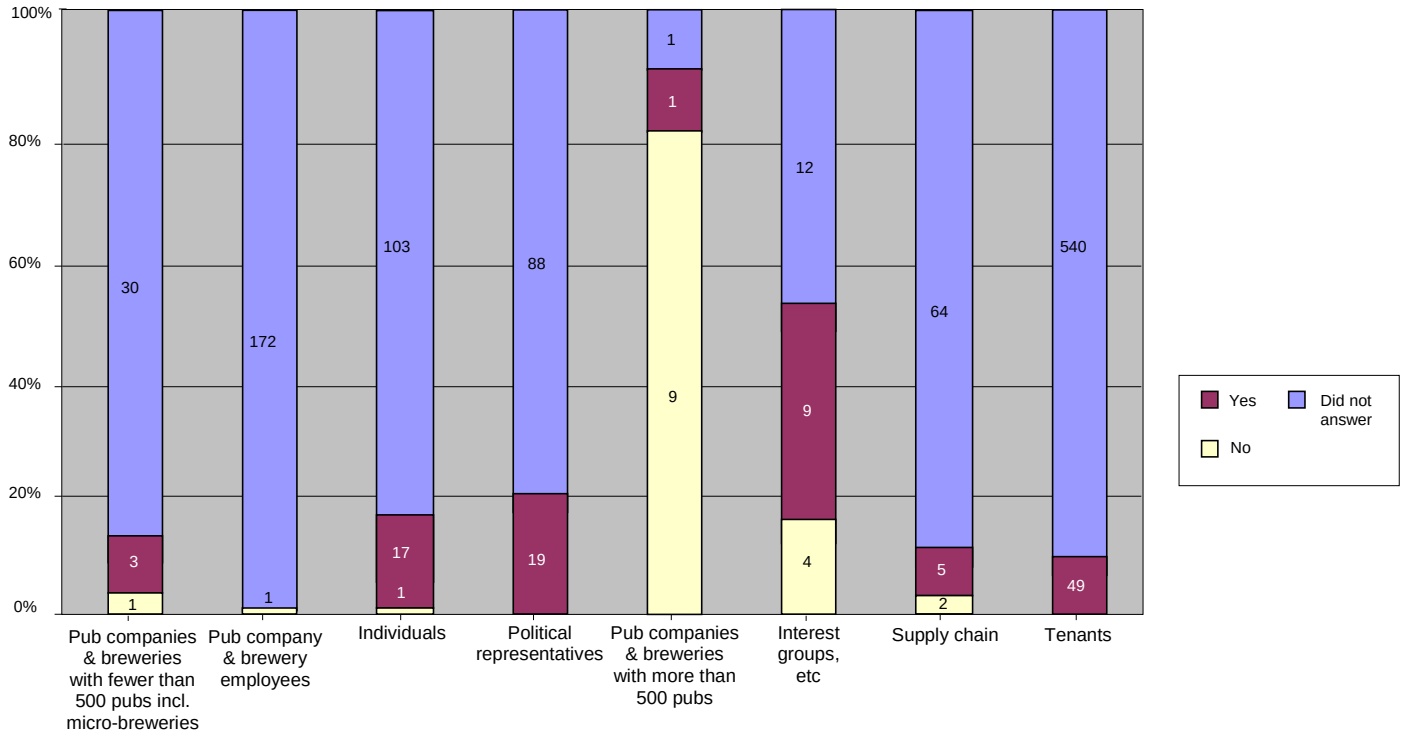
Q1. Should there be a Statutory Code?



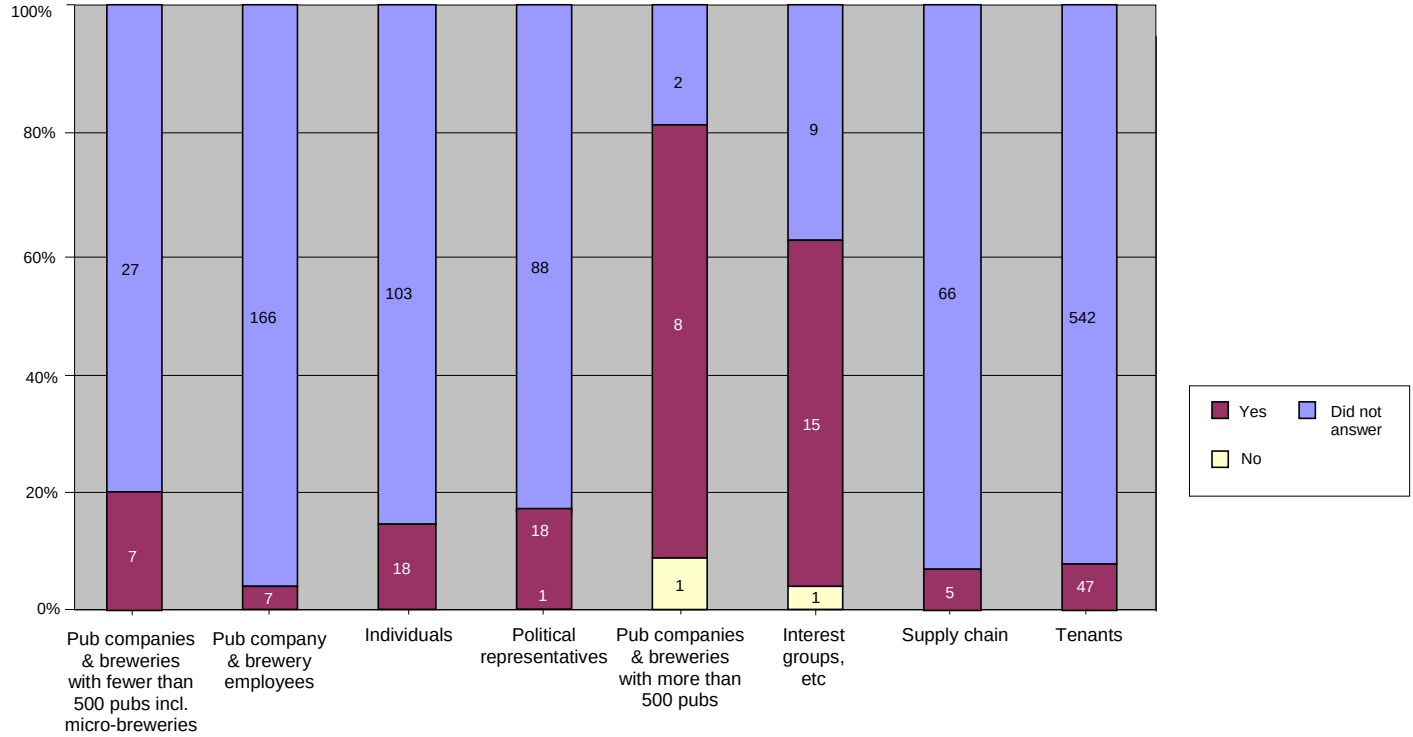
Q2. Do you agree that the Code should be binding on all companies that own more than 500 pubs?



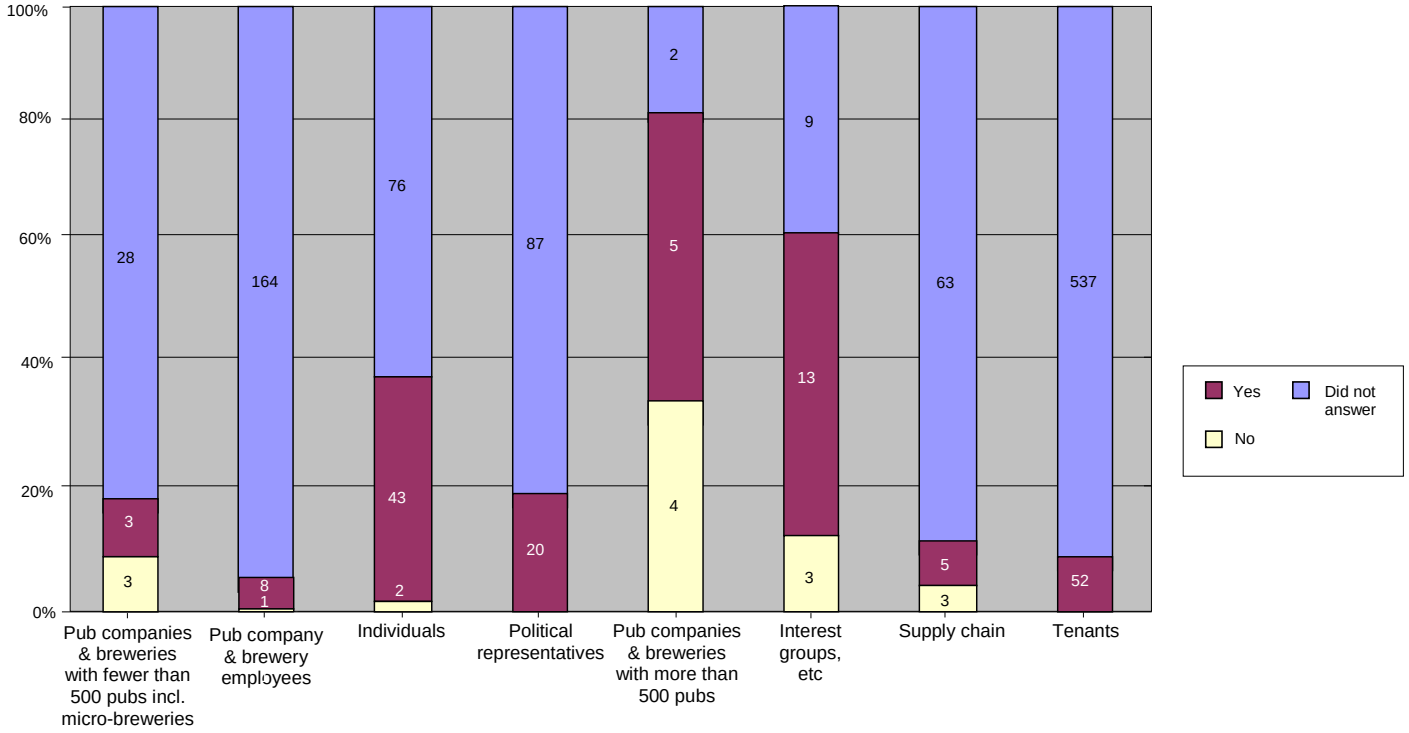
Q3. Do you agree that, for companies on which the Code is binding, all of that company's non-managed pubs should be covered by the Code?



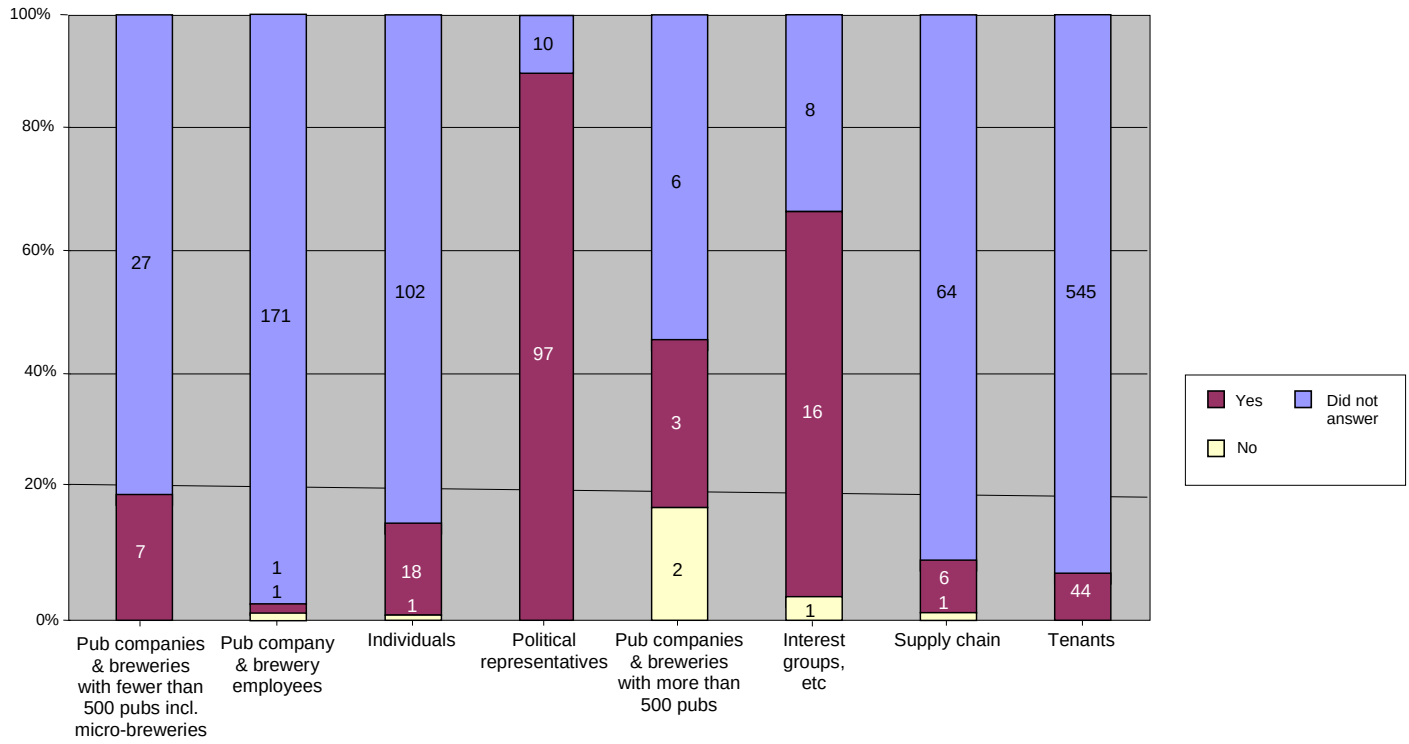
Q7 (i). Do you agree that the Code should be based on the principle of Fair and Lawful Dealing?



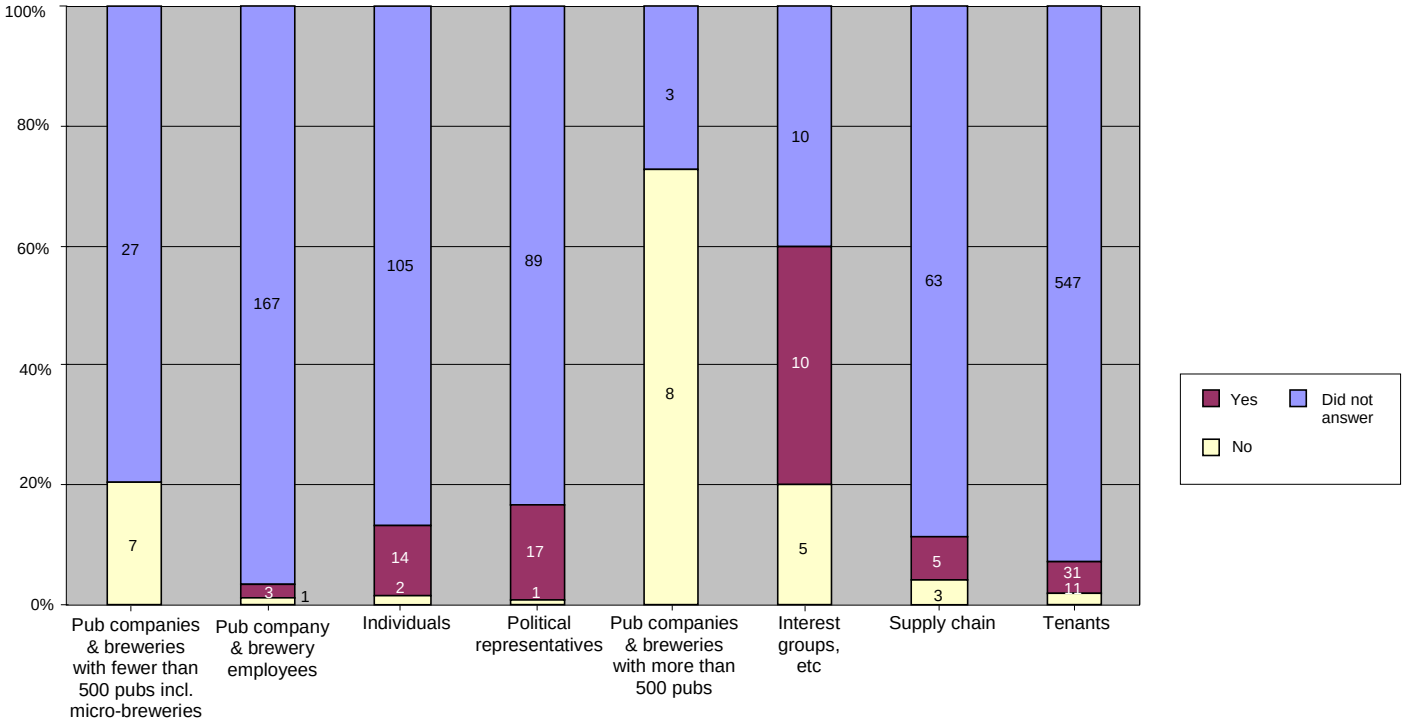
Q7(ii). Do you agree that the Code should be based on the principle that the tied tenant should be no worse off than the free-of-tie tenant?



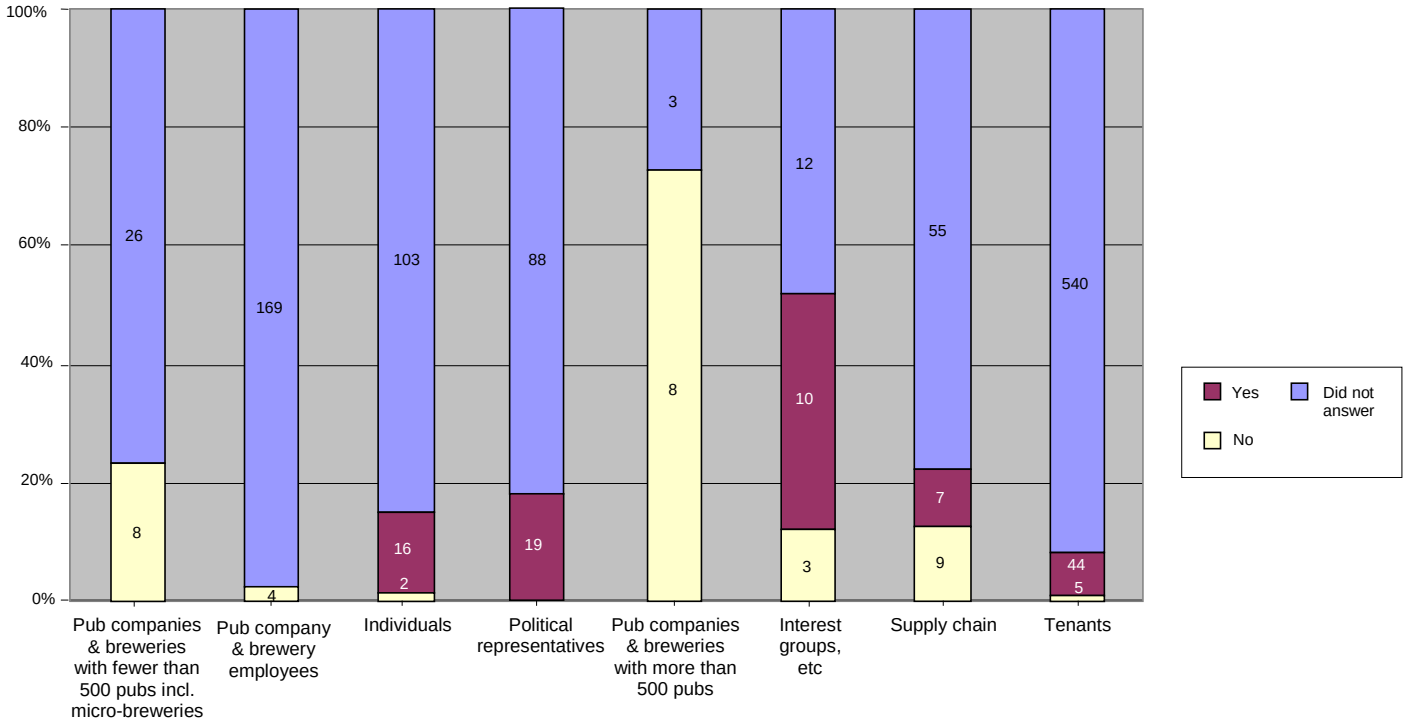
Q8(i) Do you agree that the Statutory Code should include a right for tenants to request an open market rent review if they have not had one in five years, if the pub company significantly increases drink prices or if an event occurs outside the tenant's control?



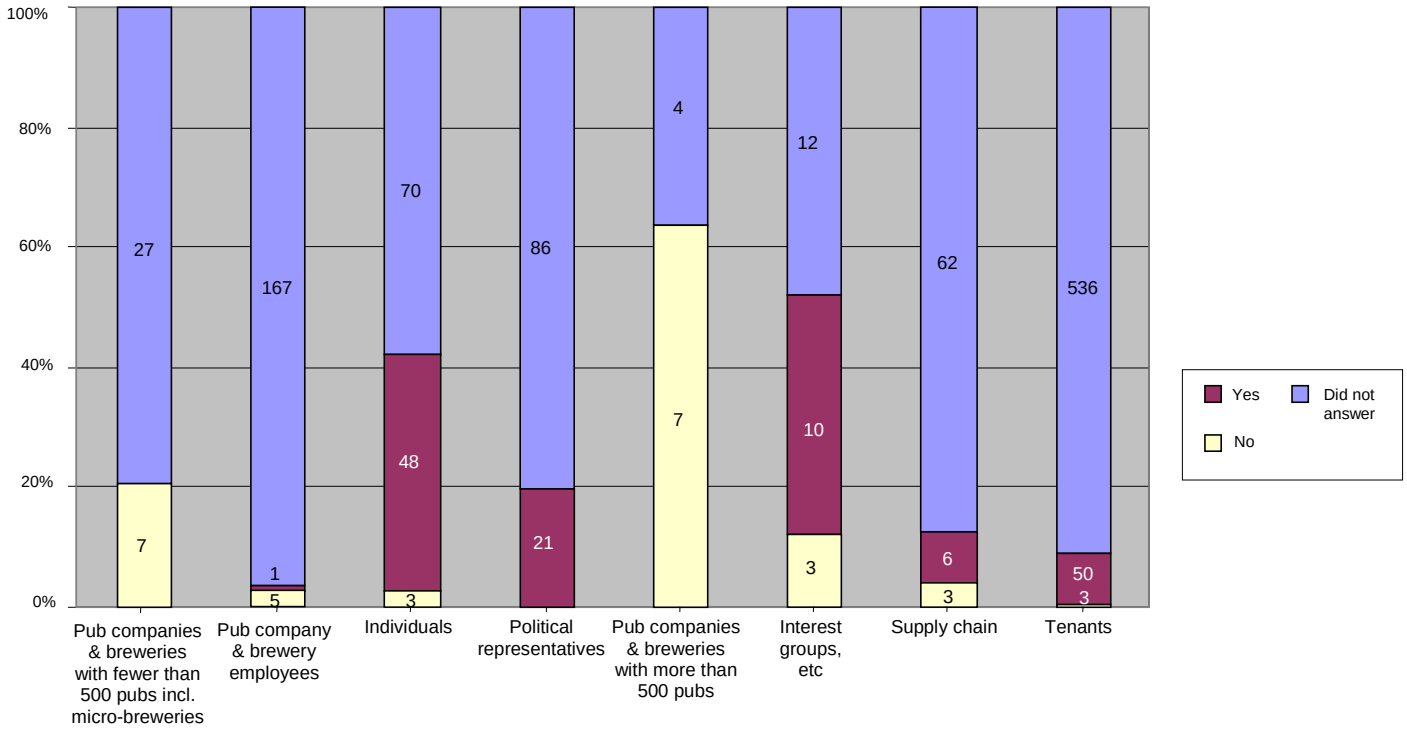
Q8(ii) Do you agree that the Statutory Code should include a provision to increase transparency, in particular by requiring the pub company to produce parallel tied and free-of-tie rent assessments?



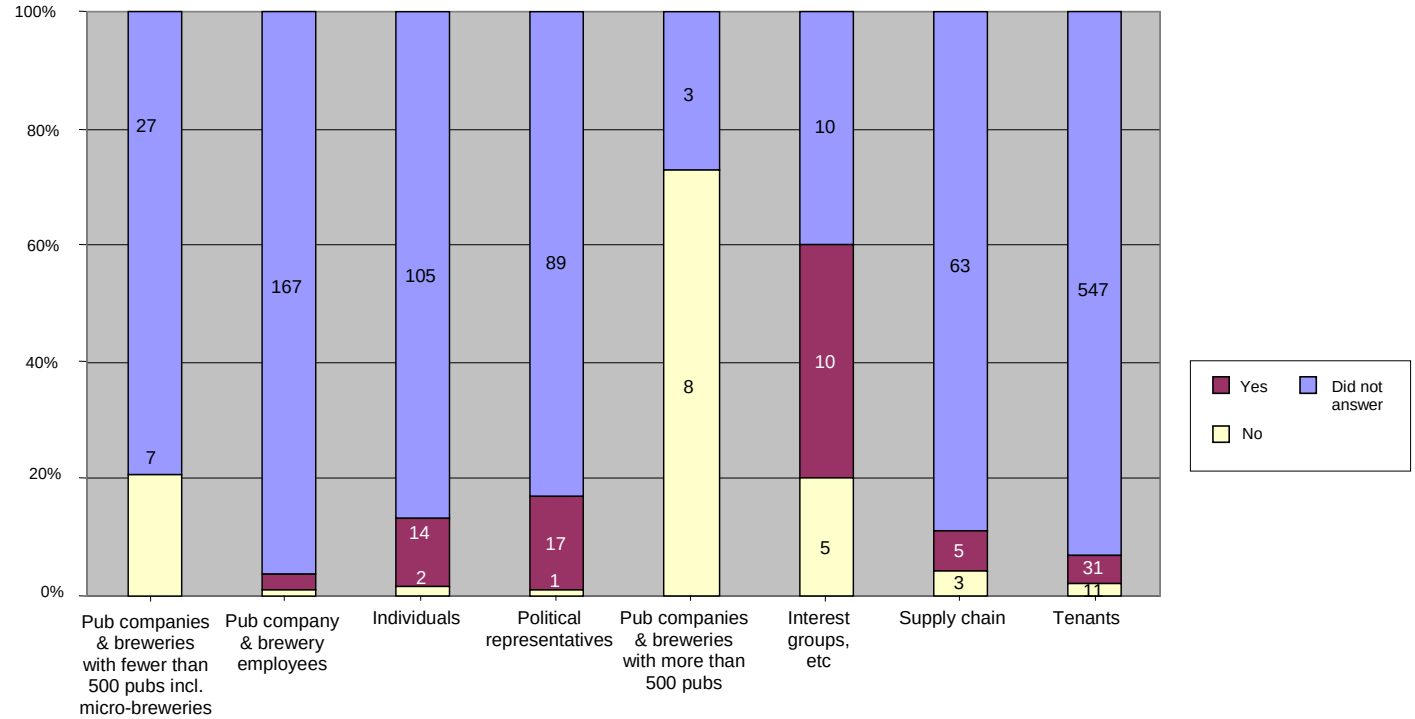
Q8(iii) Do you agree that the Statutory code should abolish the gaming machine tie and mandate that no products other than drinks may be tied?



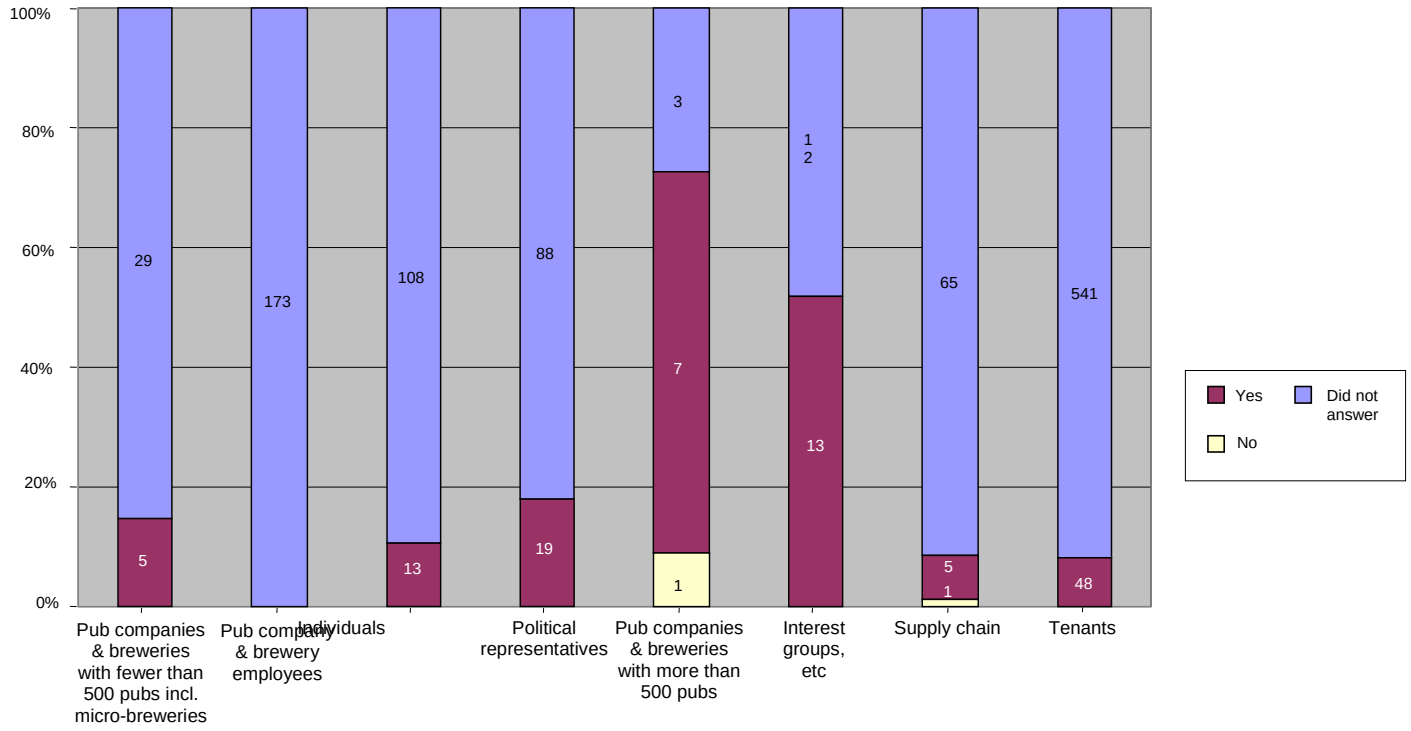
Q8(iv) Do you agree that the Statutory Code should provide for a "guest beer" option in all tied pubs?



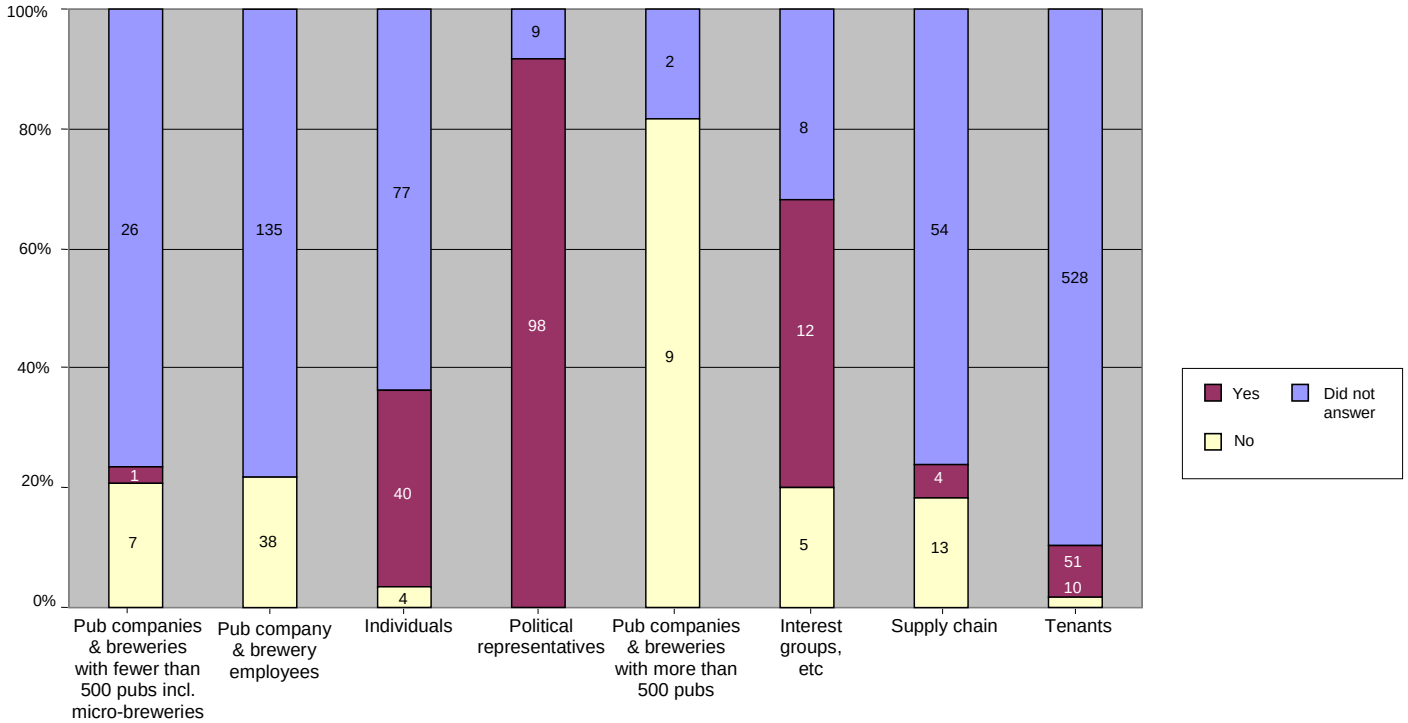
Q8(v) Do you agree that the Statutory Code should provide that flow monitoring equipment may not be used to determine whether a tenant is complying with purchasing obligations, or as evidence in enforcing such obligations?



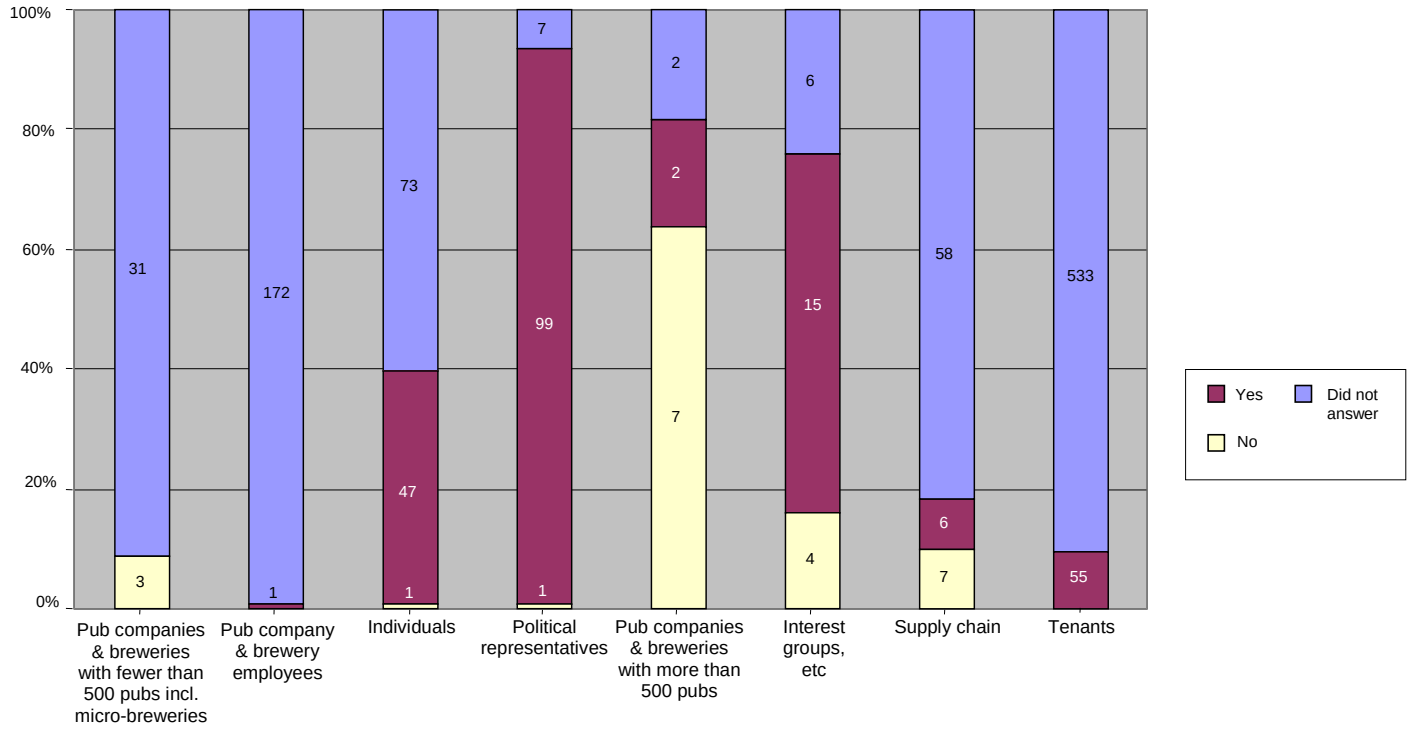
Q10. Do you agree that the Statutory Code should be periodically reviewed and, if appropriate, amended?



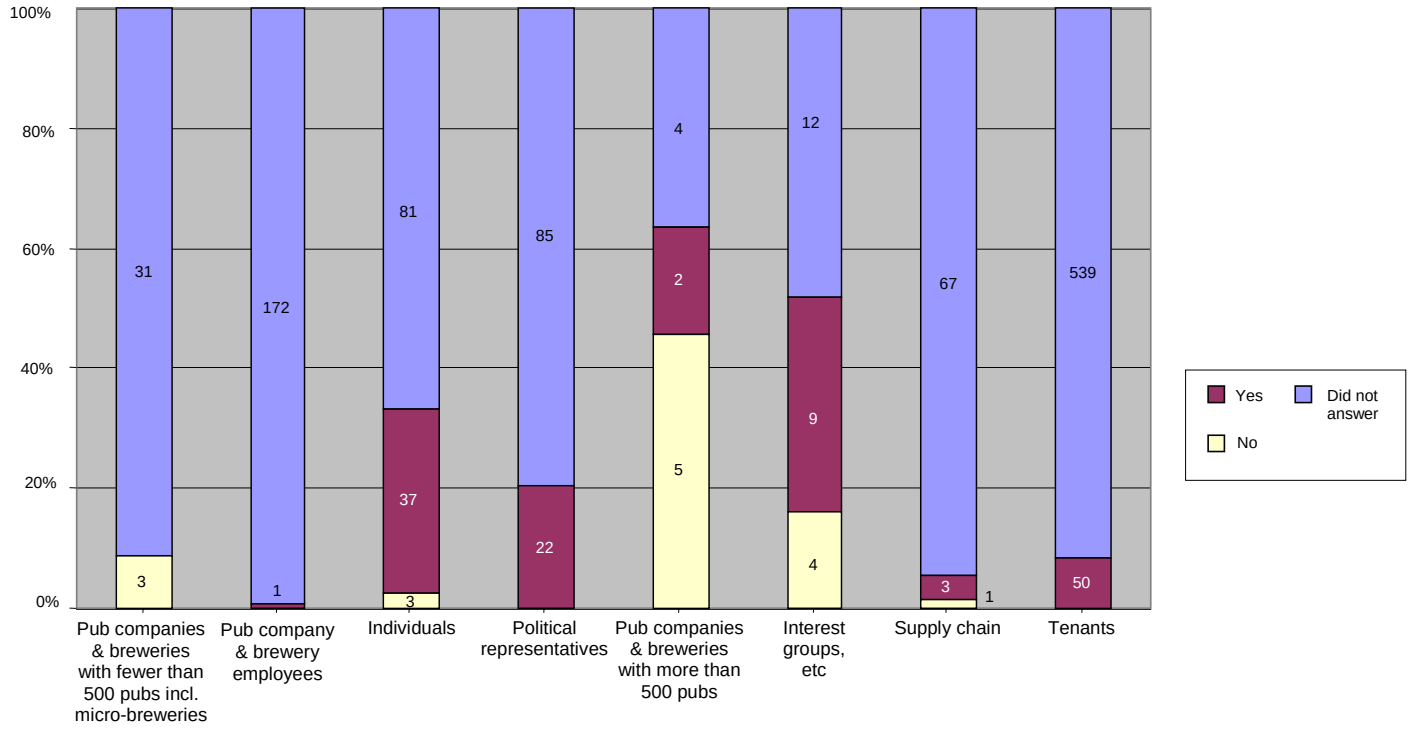
Q11. Should the Statutory Code include a mandatory free-of-tie option?



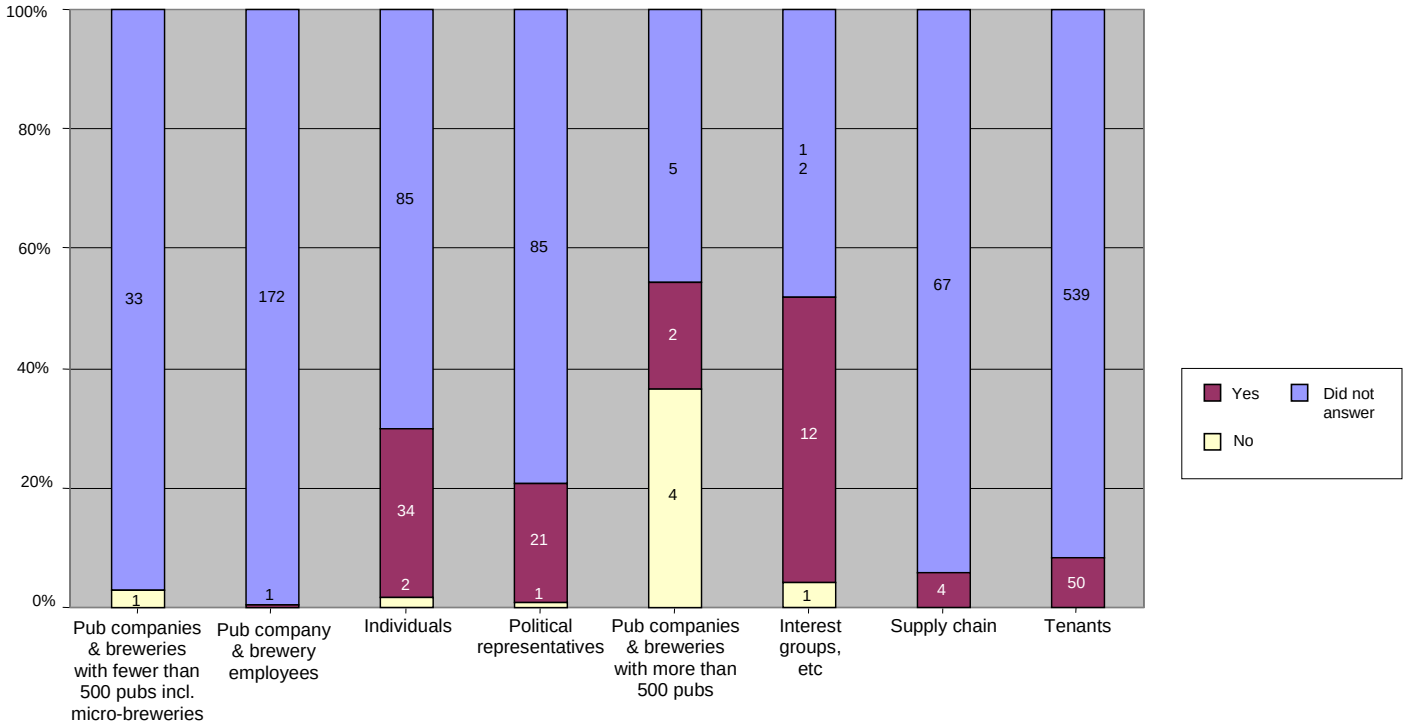
Q13. Should the Government appoint an independent Adjudicator to enforce the new Statutory Code?



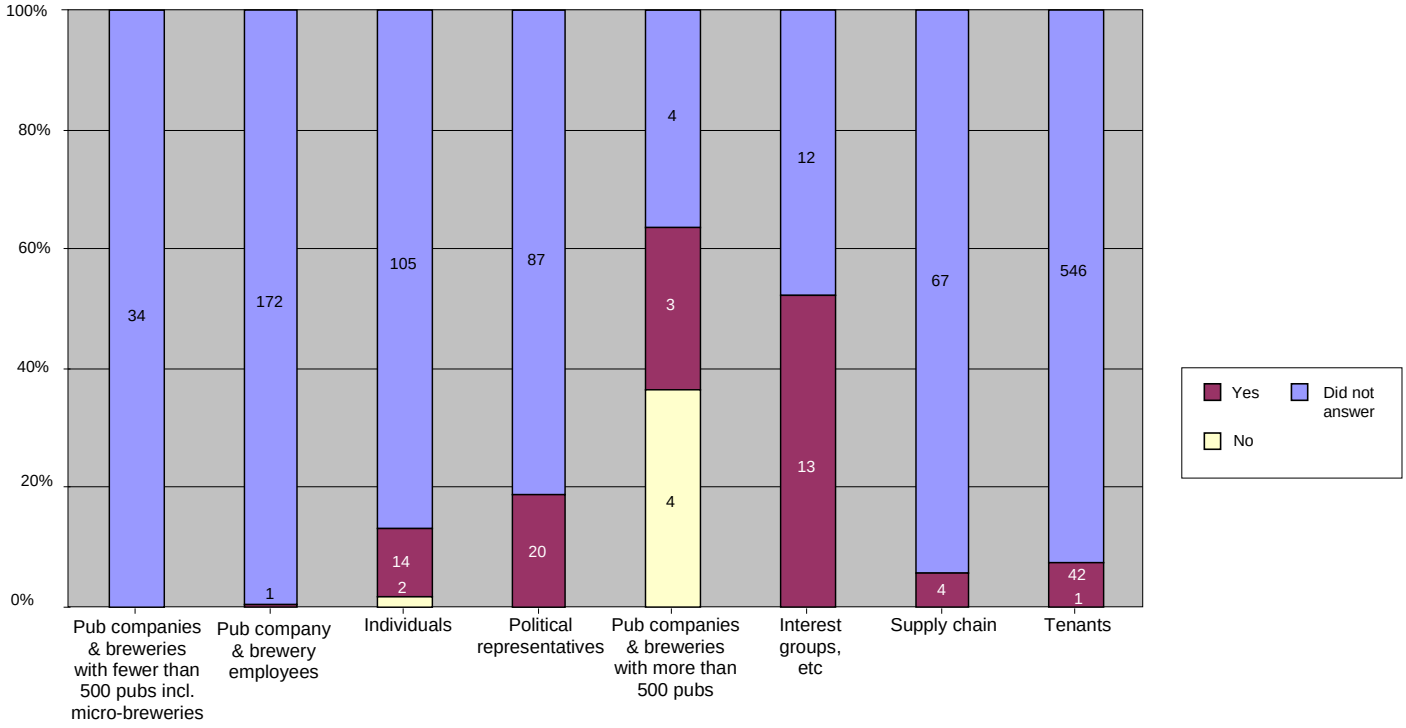
Q14(i). Do you agree that the Adjudicator should be able to arbitrate individual disputes?



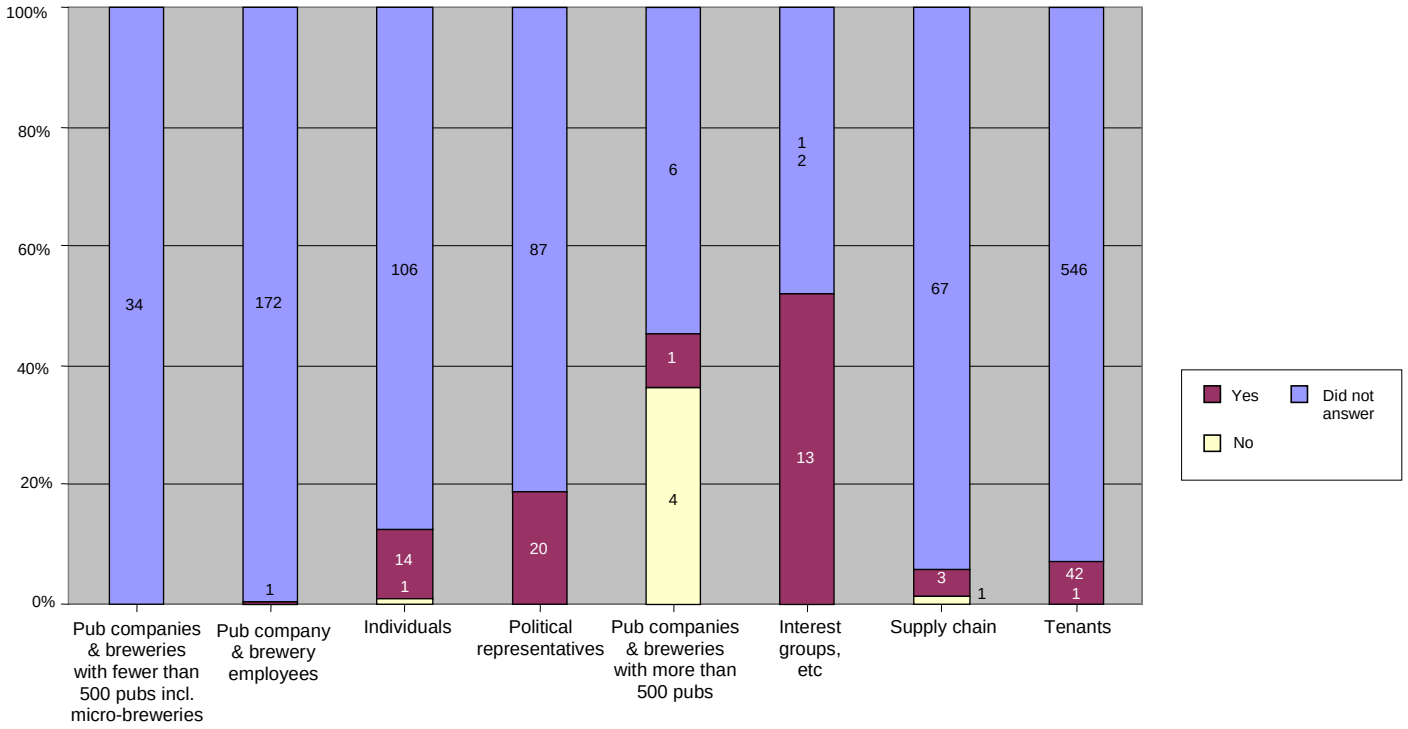
Q14(ii) Do you agree that the Adjudicator should be able to carry out investigations into widespread breaches of the Code?



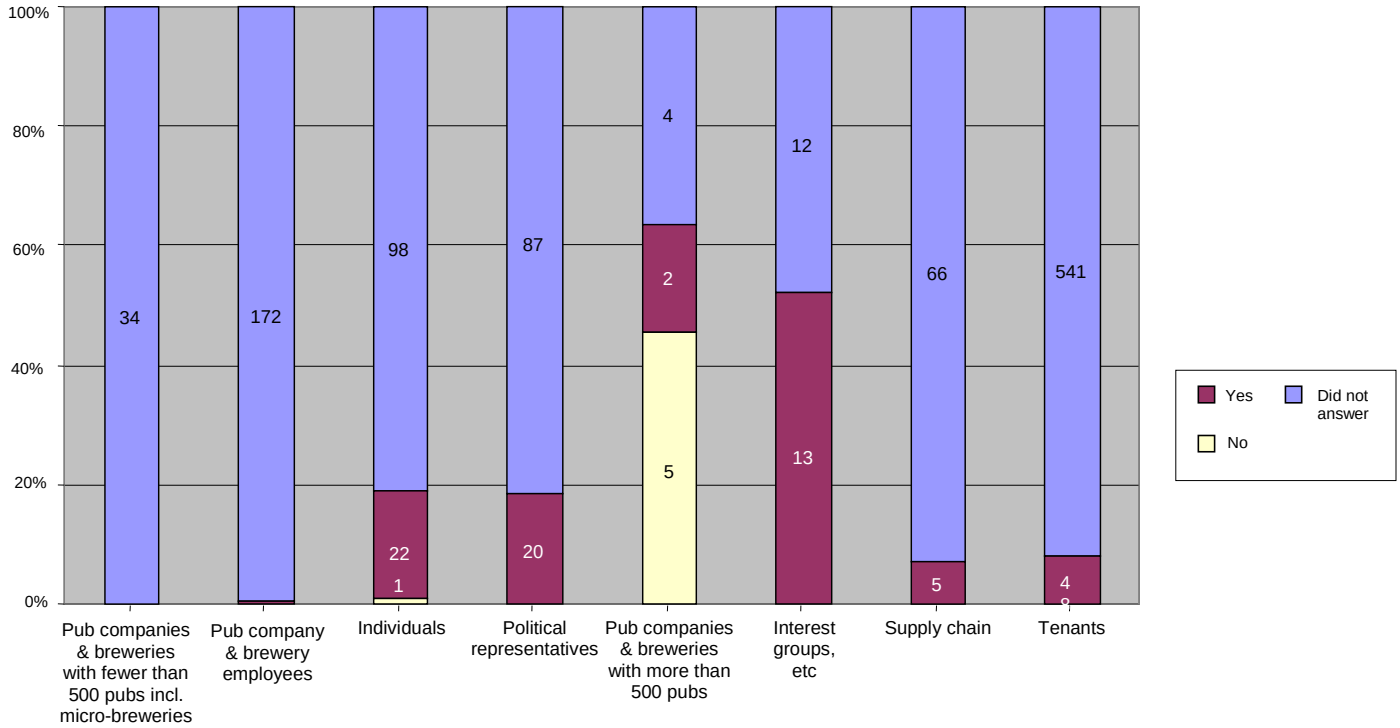
Q15(i) Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including recommendations?



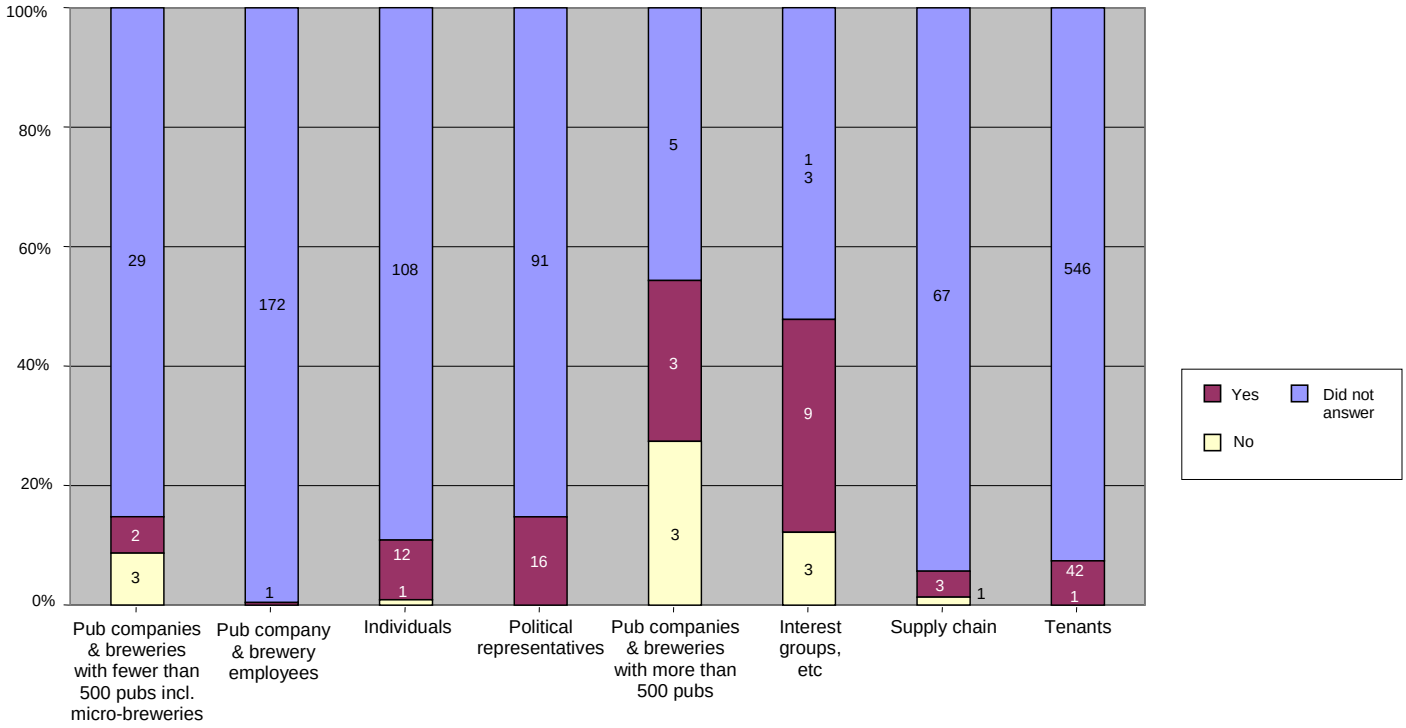
Q15(ii) Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the code, including requirements to publish information ("name and shame")?



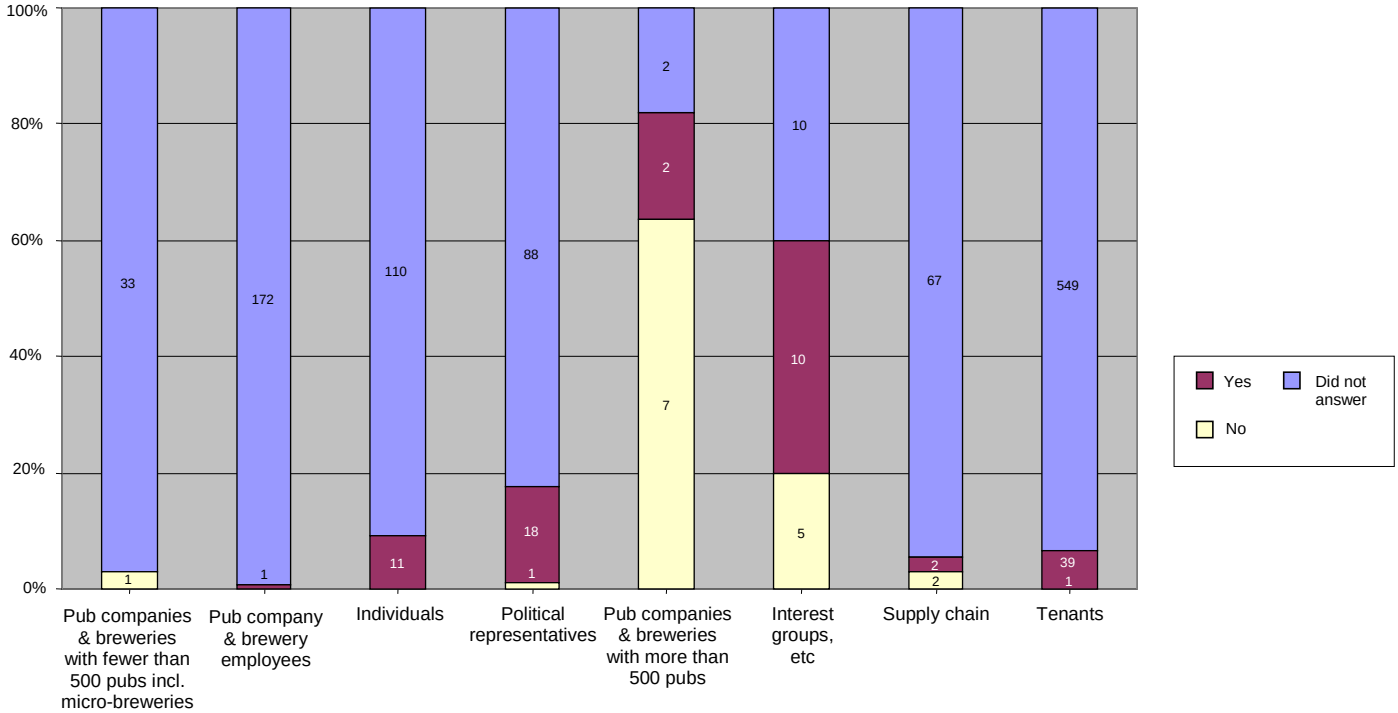
Q15 (iii) Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including financial penalties?



Q16. Do you consider the Government's proposals for reporting and review of the Adjudicator are satisfactory?



Q17. Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code more paying a proportionately greater share of the levy?



Annex D: Online Survey Responses

Pub companies and tenants - A government consultation

SurveyMonkey

1. Confidentiality & Data Protection Please read this question carefully before you start responding to this consultation. The information you provide in response to this consultation, including personal information, may be subject to publication or release to other parties. If you do not want your response published or released then make sure you tick the appropriate box.

	Response Percent	Response Count
Yes, I would like you to publish or release my response	55.9%	3,937
No, I don't want you to publish or release my response	44.1%	3,101
answered question		7,038
skipped question		0

2. Self regulation has been tried since 2004 but has not worked – too many tenants are still being badly treated and facing hardship. The Government therefore considers that it needs to introduce statutory legislation to regulate the relationship between pub companies and tenants. Do you agree that the Government should regulate the relationship between pub companies and tenants?

	Response Percent	Response Count
Yes	96.2%	6,729
No	3.8%	269
answered question		6,998
skipped question		40

3. The Government believes the best way of achieving this would be to introduce a Statutory Code, to set down the rules which pub companies would have to obey, and an independent Adjudicator to enforce and referee the Code. Do you agree that a statutory Code and independent Adjudicator would be an appropriate way of tackling this problem?

	Response Percent	Response Count
Yes	95.5%	6,674
No	4.5%	311
answered question		6,985
skipped question		53

4. The Government considers that the two most important principles that should be fundamental to the proposed Statutory Code should be that tenants must be treated fairly and lawfully and that tied tenants should be no worse off than free of tie tenants. Do you agree that these two principles should be at the heart of the Code? (Select each one that you agree with).

	Response Percent	Response Count
Tenants must be treated fairly and lawfully.	91.9%	6,425
Tied tenants should be no worse off than free of tie tenants.	90.0%	6,293
answered question		6,992
skipped question		46

5. The Government recognises that the tie can be used responsibly and that some pub companies treat their tenants fairly. On the other hand, some companies abuse the tie and it is the abuse of the tie that the Government wishes to stop. Some people have suggested that the simplest means of ensuring that tied tenants are no worse off than free of tie tenants would be if the Code forced pub companies to offer a free of tie option to tenants. By a free of tie option it is meant that the tenant could buy beer from whoever they wished and would only have to pay a fair market rent to the pub company. Others have suggested that this would be unfair to responsible companies who use the tie well, and that it would place less of a burden on responsible companies if the Code instead said that pub companies must compensate tied tenants by ensuring that the higher prices they pay for beer are matched by a lower rent. Which do you think would be the best way of ensuring that tied tenants are no worse off than a free of tie option?

	Response Percent	Response Count
A compulsory free of tie option.	**67.6%**	**4,718**
Ensuring that if a tenant pays more for drink prices than they could get on the open market, they must be charged a lower rent and vice versa.	29.9%	2,085
Another option that we have not considered (if so, please let us know via the main consultation – link at end).	2.5%	172
answered question		**6,975**
skipped question		**63**

6. It has been suggested that the Government also strengthen the proposed Statutory Code in other areas, to help ensure that tenants are treated fairly. Which of the below do you think should be addressed in the proposed Statutory Code (please tick all that apply):

		Response Percent	Response Count
An increased right to an open market rent assessment: This would allow a tenant to request a rent assessment if they have not had one for five years, if the pub company puts up their beer prices or if unexpected circumstances (flood, fire, recession etc) occur.		**92.5%**	**6,003**
Increased transparency: Assessing profitability can be difficult. This would require pub companies to publish parallel 'tied' and 'free of tie' rent assessments so tenants can check they are no worse off.		84.2%	5,465
Abolish the gaming machine tie. Under the gaming machine tie, pub companies take a share of the profits from gaming machines, which can reduce tenant profits. This would abolish that practice.		54.8%	3,557
A guest beer option. This would allow tenants to buy one beer of their choice from any source they chose, for example a popular brand or a beer from a local micro-brewery.		92.0%	5,971
Regulate flow monitoring equipment: Concerns have been raised that the equipment used is often unreliable. This would mean that a pub company could not use evidence from flow monitoring equipment to fine a tenant for breaking their contract.		61.4%	3,984
		answered question	**6,491**
		skipped question	**547**

7. The Government intends to establish an independent Adjudicator to enforce the Code. The Adjudicator would need to have a range of functions in order to ensure that all companies were complying with the Code. Which of the following powers do you think it would be helpful for the Adjudicator to have? (Please select all that apply).

	Response Percent	Response Count
Ability to arbitrate individual disputes about the Code, to ensure tenants could get compensation for any losses they had suffered.	93.6%	6,079
Ability to carry out investigations to discover widespread breaches of the Code by pub companies.	**94.0%**	**6,107**
Ability to impose fines on pub companies that breach the Code.	93.8%	6,092
Ability to give advice and guidance to pub companies on how to comply with the Code and to tenants on their rights under the Code.	92.2%	5,989
	answered question	**6,494**
	skipped question	**544**

8. In order to place the most proportionate burden on business, the Government proposes that the new policy should apply to all pub companies with more than 500 pubs. This is because the evidence suggests that smaller companies are generally behaving well and because this way the regulation would not cause a burden for smaller companies which might find it difficult to afford it. What do you think the threshold should be?

	Response Percent	Response Count
Companies with 500 or more pubs.	47.4%	3,078
All pub companies	**52.6%**	**3,415**
	answered question	**6,493**
	skipped question	**545**

9. Others have suggested there is a significant difference between leases and tenancies. The main difference is that leases tend to be for a longer period of time and place a greater burden on the tenants to repay the pub. The Government's view is that all tenants should be treated fairly, regardless of whether the pub is a lease or a tenancy. Do you think there should be a distinction between leased and tenanted pubs?

	Response Percent	Response Count
Yes	19.6%	1,269
No	80.4%	5,208
answered question		6,477
skipped question		561

10. Please confirm whether you are answering:

	Response Percent	Response Count
As an individual	97.5%	6,370
On behalf of an organisation that you are officially representing.	2.5%	164
answered question		6,534
skipped question		504

11. Are you (pick the single option that bests applies):

	Response Percent	Response Count
A tied tenant (includes lessees)	11.2%	714
A free of tie tenant (includes lessees)	0.8%	52
Someone who works or has worked in the pub industry who is not a tenant (includes pub managers, bar staff, surveyors, etc.)	11.4%	726
A consumer (i.e. someone who does not work in the pub industry).	76.5%	4,862
answered question		6,354
skipped question		684

12. If you were offered a free of tie option, would you take it, even if it meant paying a higher rent, (provided that rent was assessed fairly)?

	Response Percent	Response Count
Yes	92.8%	655
No	7.2%	51
answered question		706
skipped question		6,332

13. In your opinion, what are the three biggest challenges that you are facing as a tenant? (Please tick up to three boxes).

	Response Percent	Response Count
The beer tie	91.2%	660
Unfair treatment by your pub company	42.7%	309
Taxation (including beer duty)	59.5%	431
The recession	32.0%	232
The smoking ban	15.6%	113
Other Government regulation	6.4%	46
Supermarket pricing	60.6%	439
Cultural change	14.8%	107
Other	3.6%	26
answered question		724
skipped question		6,314

14. Which pub company or brewer are you a tenant of?

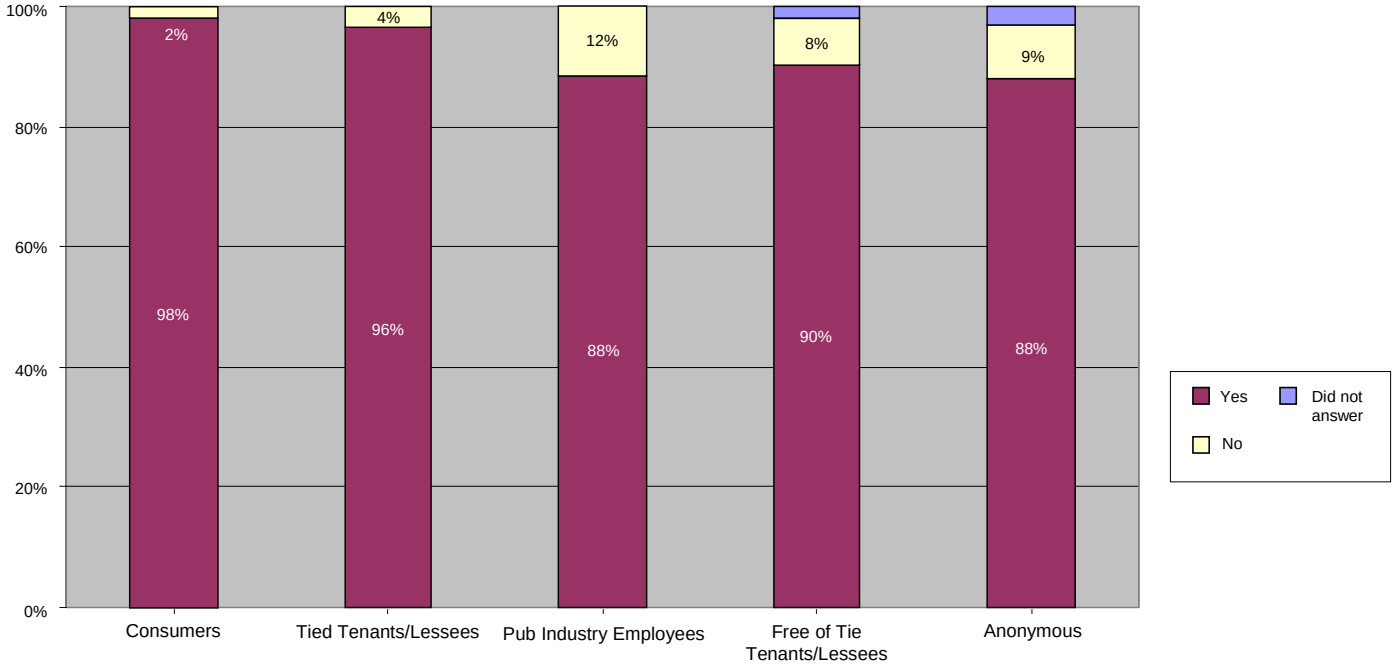
	Response Percent	Response Count
Punch Taverns	20.2%	145
Enterprise Inns	**48.4%**	**348**
Marston's	3.2%	23
Star Pubs	4.3%	31
Greene King	6.1%	44
Admiral	2.6%	19
Spirit	1.4%	10
Wellington	0.0%	0
Trust Inns	1.0%	7
A family brewer	7.2%	52
Other	5.6%	40
	answered question	**719**
	skipped question	**6,319**

15. How long have you been a tenant?

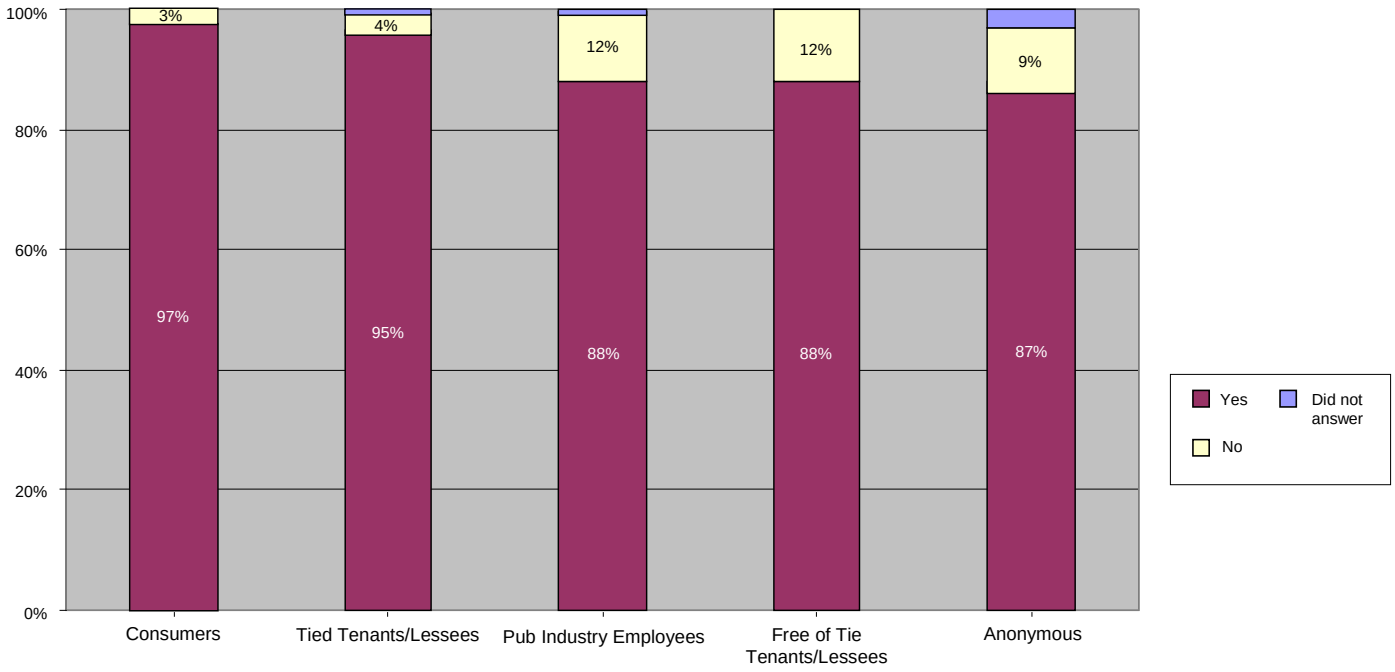
	Response Percent	Response Count
less than 1 year	12.1%	87
1-2 years	14.7%	106
3-4 years	13.8%	99
5+ years	**59.4%**	**427**
	answered question	**719**
	skipped question	**6,319**

Annex E: Analysis of Online Survey Responses

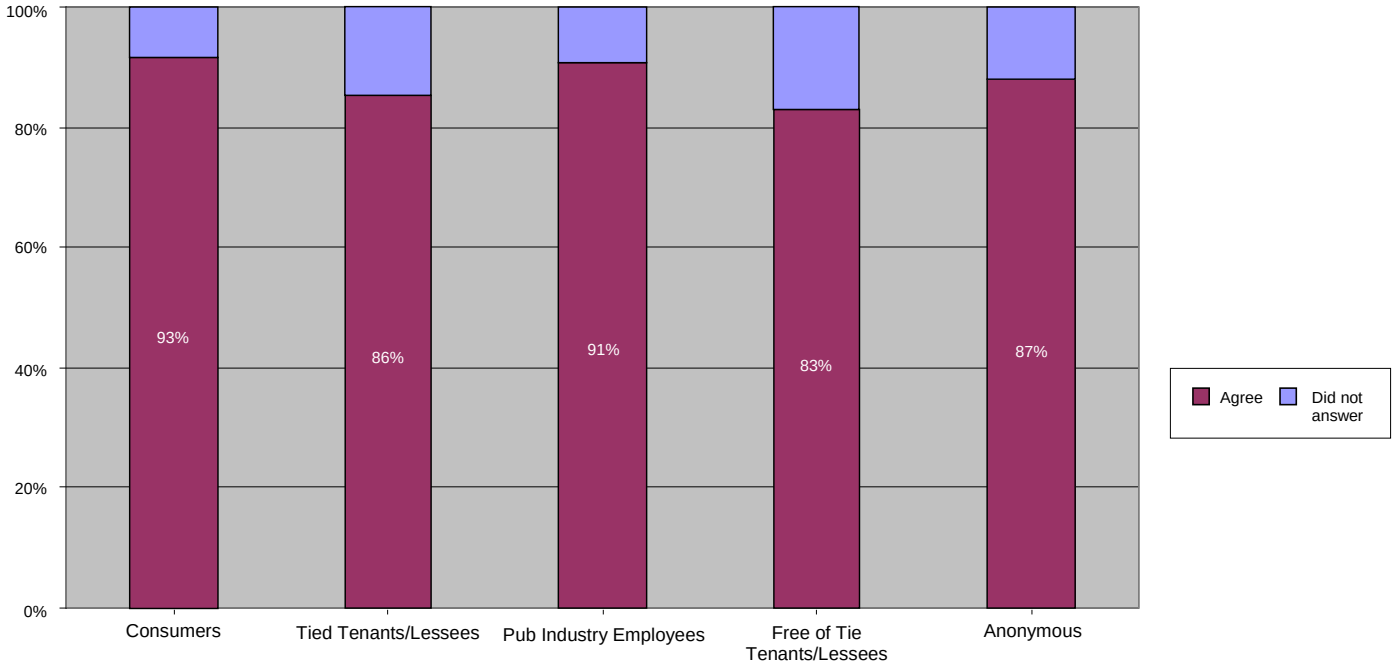
Q2. Do you agree that the Government should regulate the relationship between pub companies and tenants? *(Answered by 6,998)*



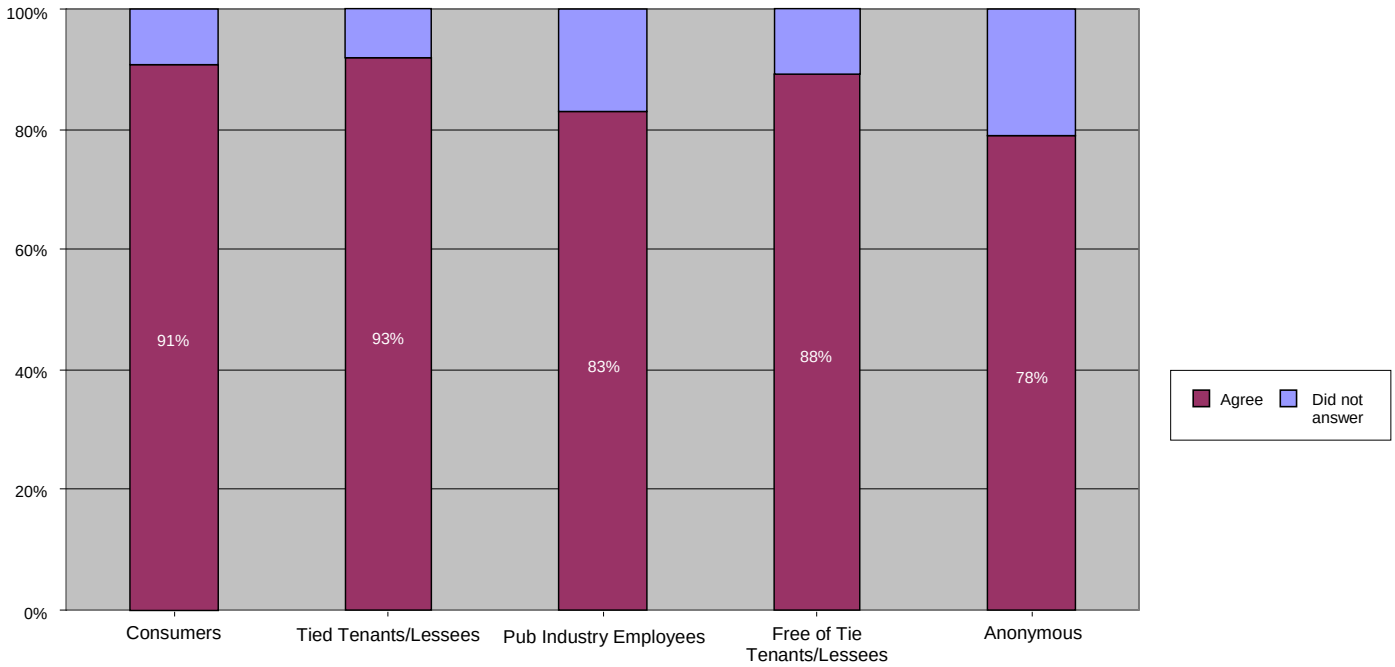
Q3. Do you agree that a Statutory Code and independent Adjudicator would be an appropriate way of tackling this problem? *(Answered by 6,985)*



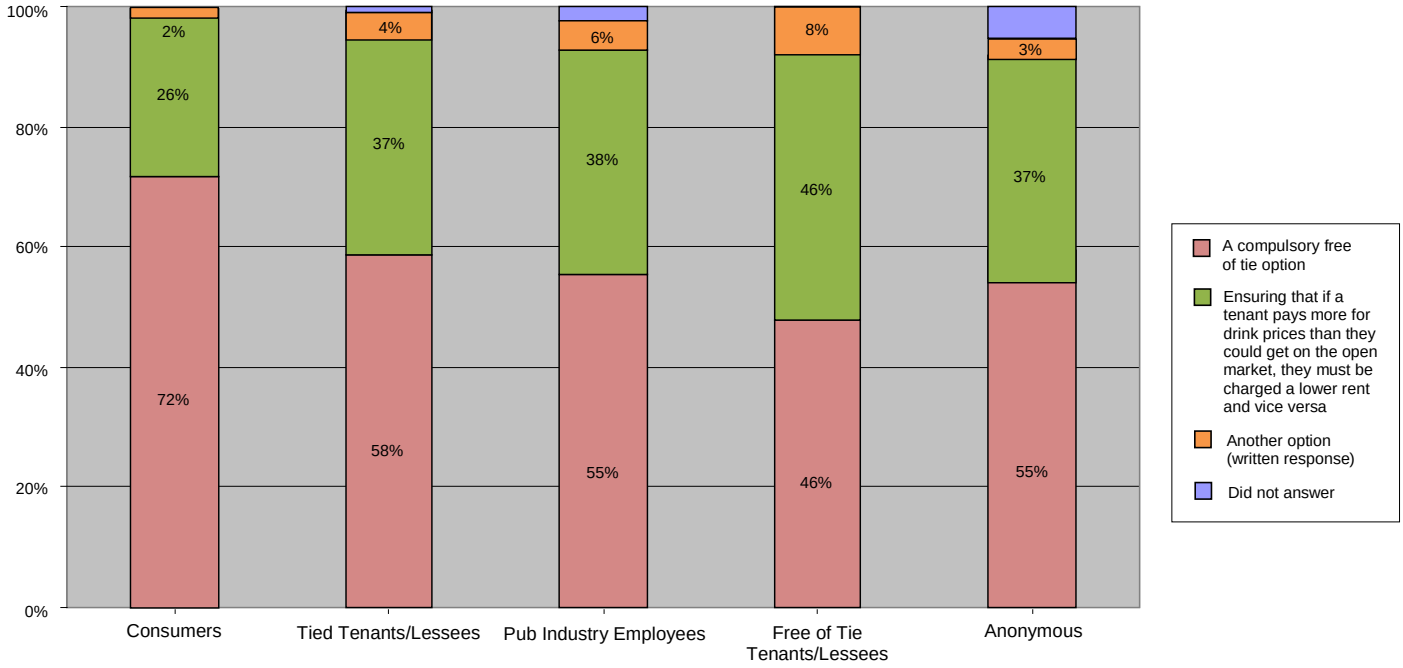
Q4 (i). Do you agree that the principle that tenants must be treated fairly and lawfully should be one of the two principles at the heart of the Code? *(Selected by 6,425)*



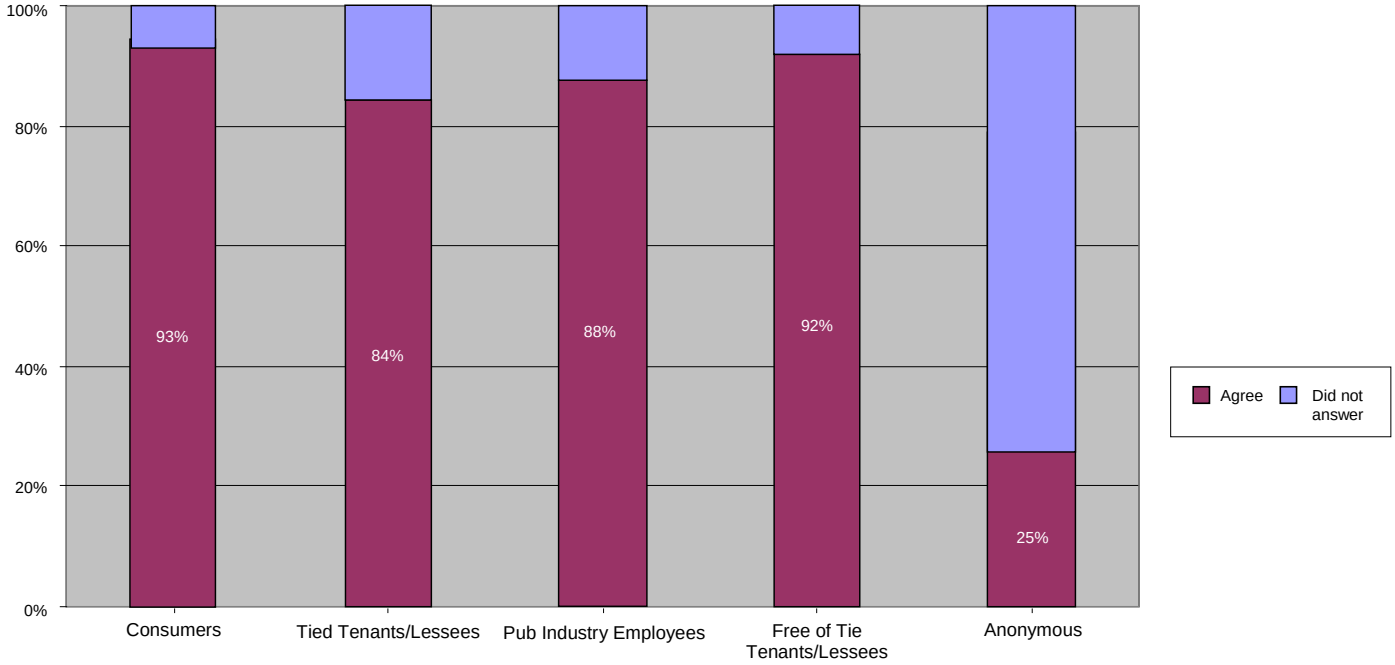
Q4 (ii). Do you agree that the principle that tied tenants should be no worse off than free of tie tenants should be one of the two principles at the heart of the Code? *(Selected by 6,293)*



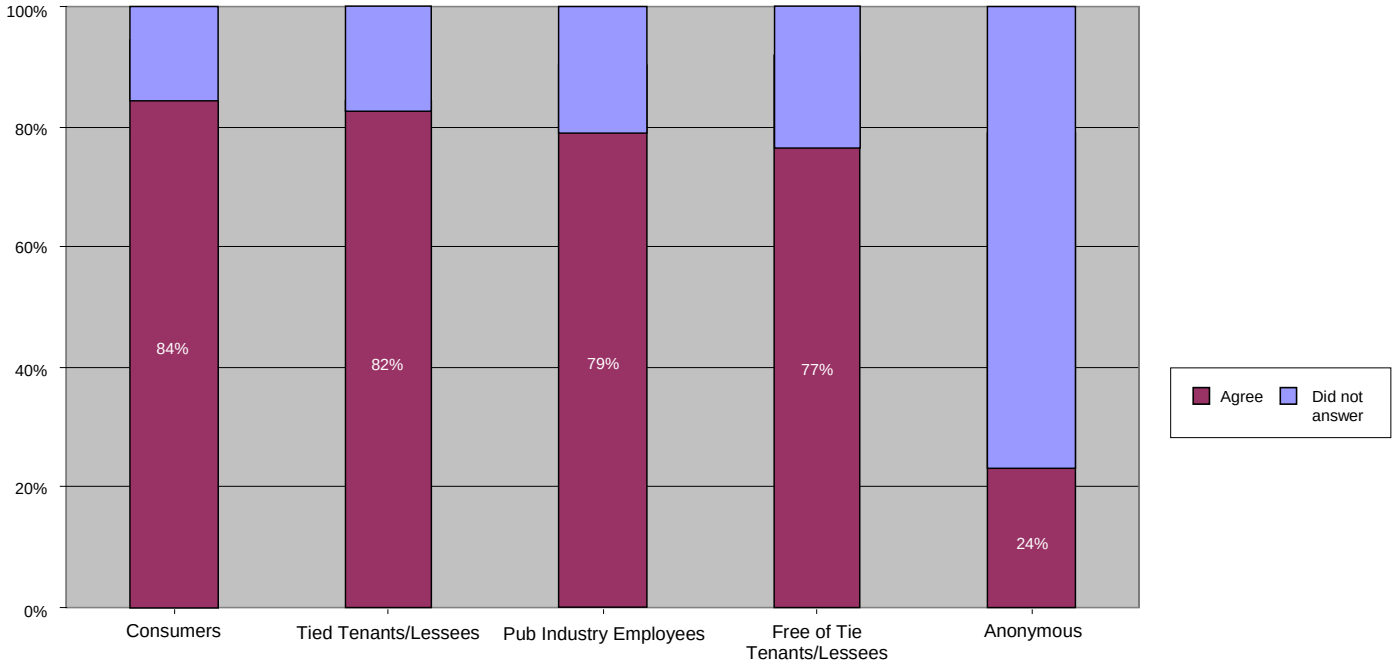
Q5. Which do you think would be the best way of ensuring that tied tenants are no worse off than a free of option? *(Answered by 6,975)*



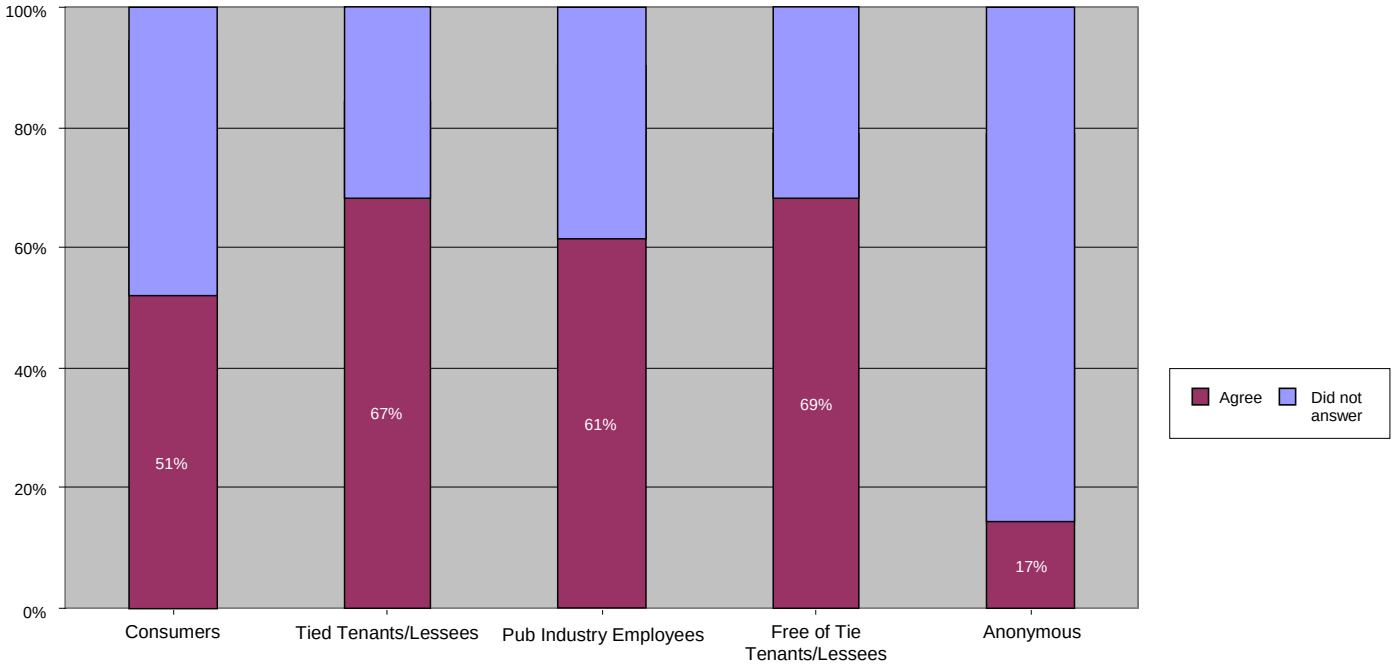
Q6 (i). Do you think that '<u>An increased right to an open market rent assessment: This would allow a tenant to request a rent assessment if they have not had one for five years, if the pub company puts up their beer prices or if unexpected circumstances (flood, fire, recession, etc) occur</u>' should be addressed in the proposed Statutory Code? *(Selected by 6,003)*



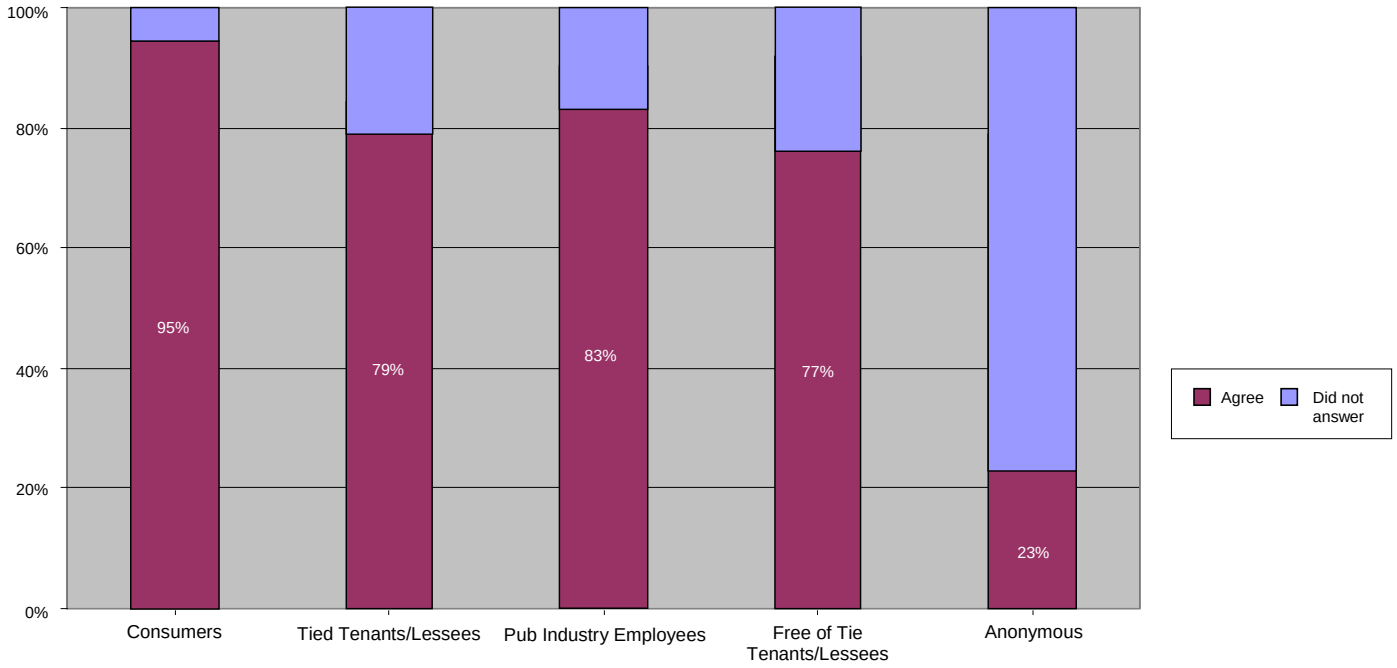
Q6 (ii). Do you think that '<u>Increased transparency: requiring pub companies to publish parallel "tied" and "free of tie" rent assessments so tenants can check they are no worse off</u>' should be addressed in the proposed Statutory Code? *(Selected by 5,465)*



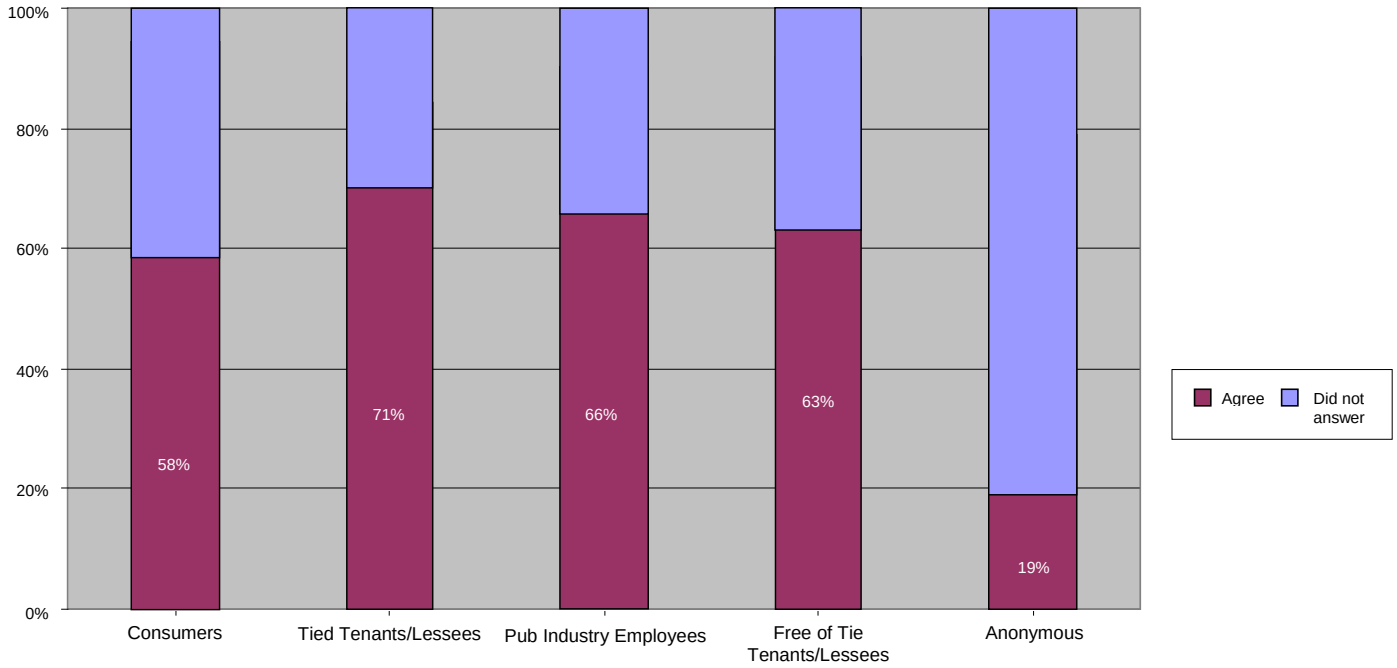
Q6 (iii). Do you think that '<u>Abolishing the gaming machine tie</u>' should be addressed in the proposed Statutory Code? *(Selected by 3,557)*



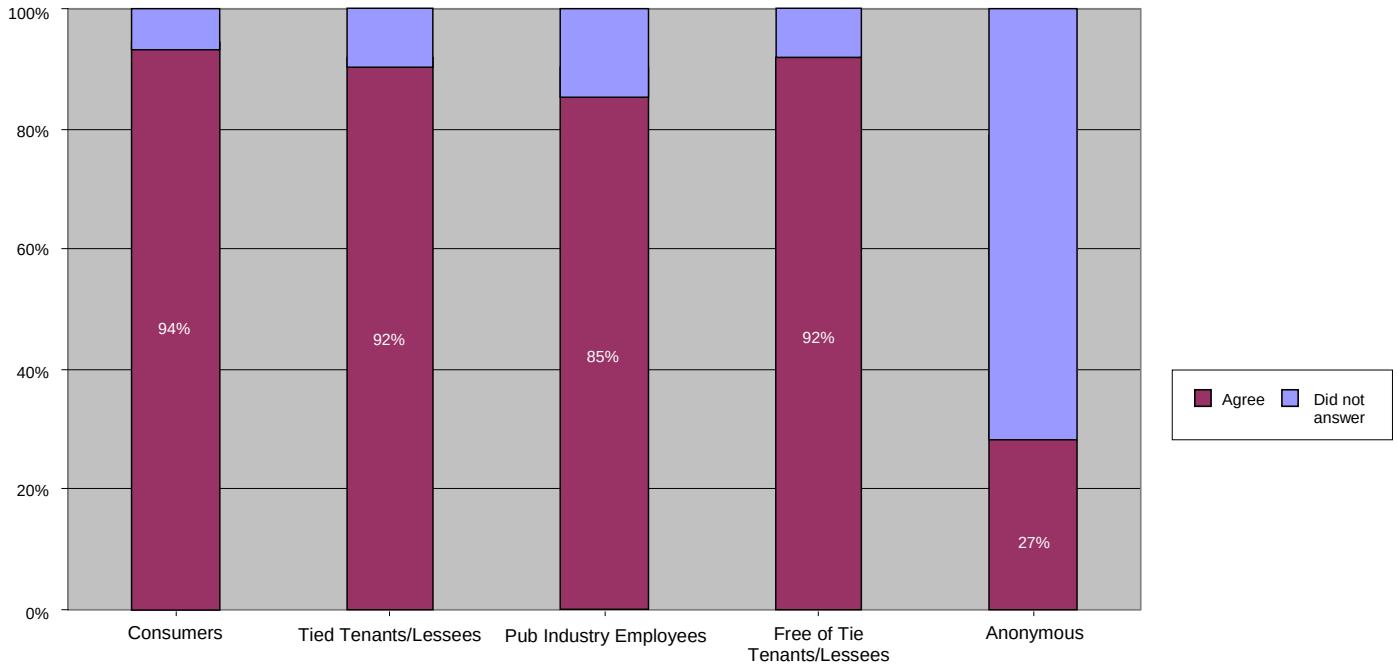
Q6 (iv). Do you think that '<u>A guest beer option. This would allow tenants to buy one beer of their choice from any source they chose, for example a popular brand or a beer from a local micro-brewery</u>' should be addressed in the proposed Statutory Code? *(Selected by 5,971)*



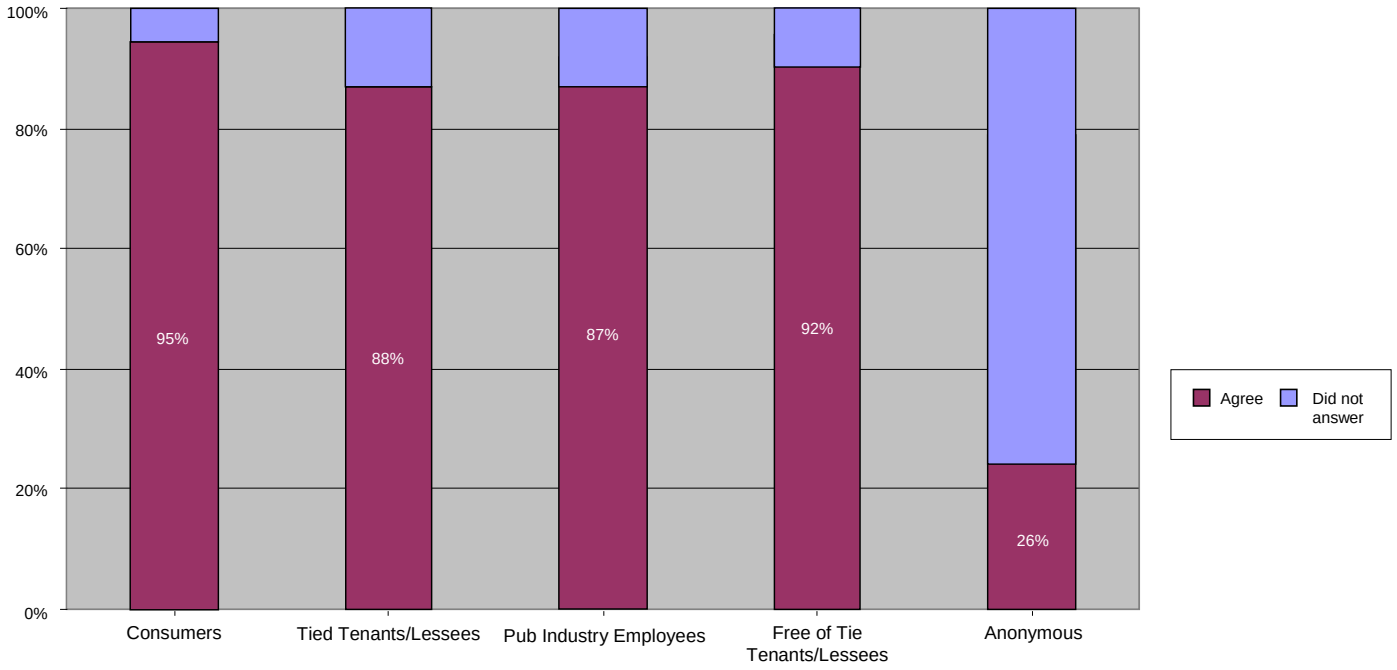
Q6 (v). Do you think that '<u>Regulate flow monitoring equipment: This would mean that a pub company could not use evidence from flow monitoring equipment to fine a tenant for breaking their contract</u>' should be addressed in the proposed Statutory Code? *(Selected by 3,984)*



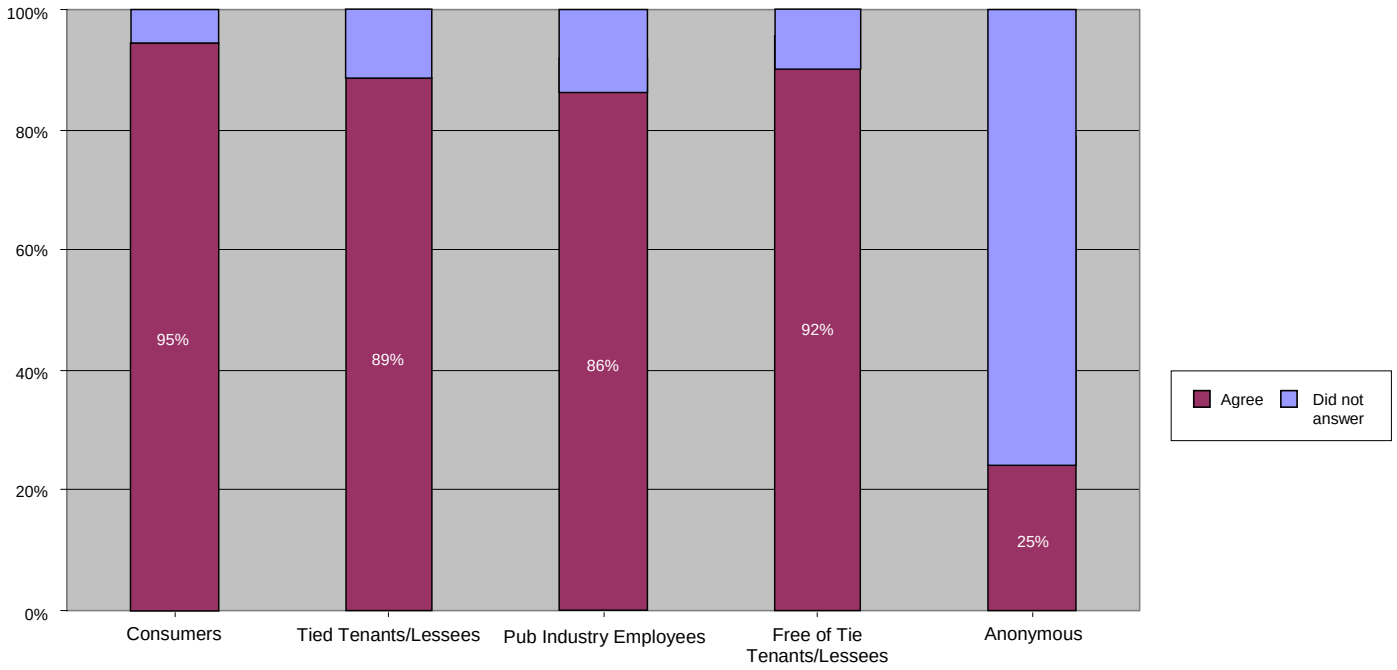
Q7 (i). The independent Adjudicator would need to have a range of functions in order to ensure that all companies were complying with the Code. Do you think it would be helpful for the Adjudicator to have the power 'to arbitrate individual disputes about the Code, to ensure tenants could get compensation for any losses they had suffered?' *(Selected by 6,079)*



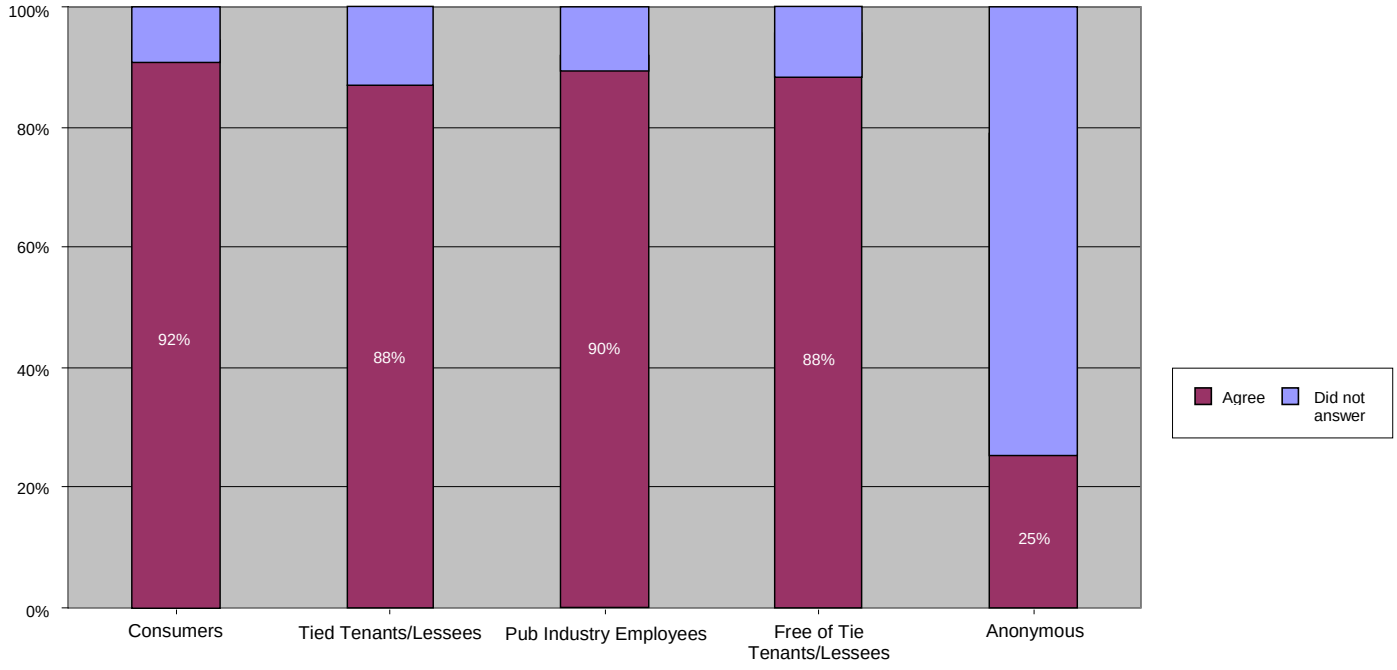
Q7 (ii). The independent Adjudicator would need to have a range of functions in order to ensure that all companies were compyling with the Code. Do you think it would be helpful for the Adjudicator to have the power 'to carry out investigations to discover widespread breaches of the Code by pub companies?' *(Selected by 6,107)*



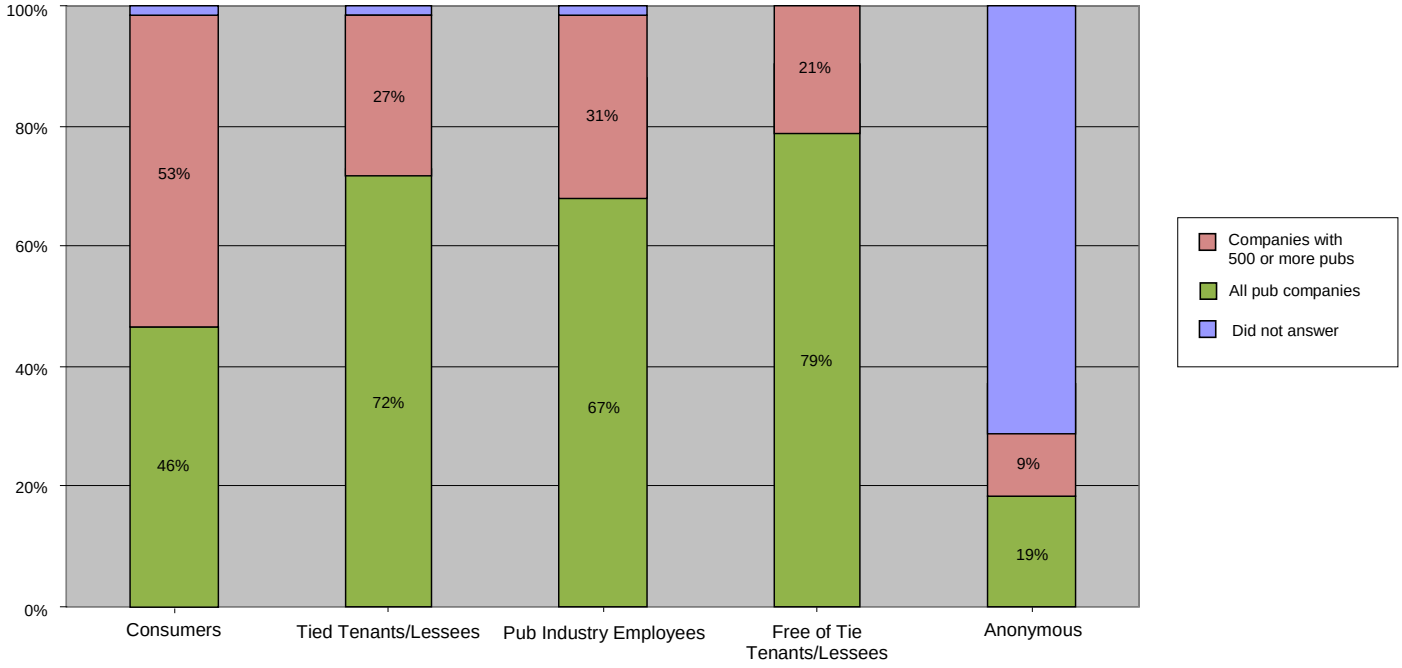
Q7 (iii). The independent Adjudicator would need to have a range of functions in order to ensure that all companies were complying with the Code. Do you think it would be helpful for the Adjudicator to have the power 'to impose fines on pub companies that breach the Code?' *(Selected by 6,092)*



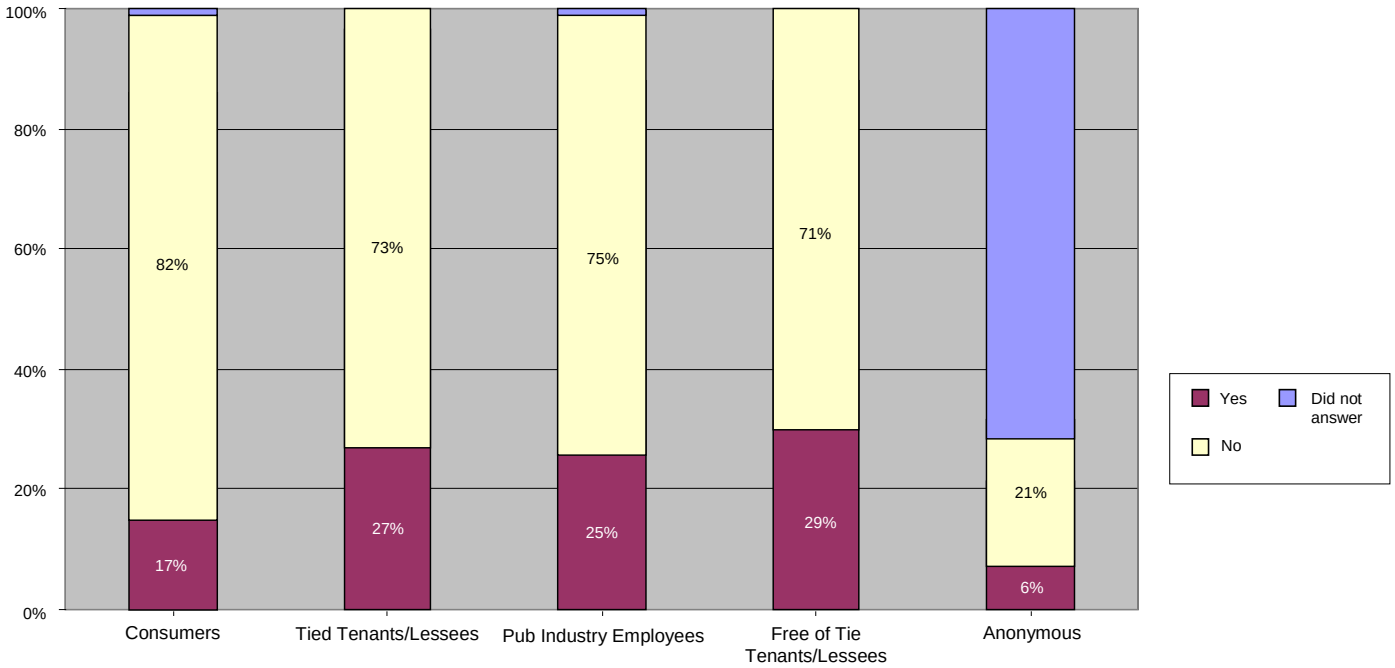
Q7 (iv). The independent Adjudicator would need to have a range of functions in order to ensure that all companies were complying with the Code. Do you think it would be helpful for the Adjudicator to have the power 'to give advice and guidance to pub companies on how to comply with the Code and to tenants on their rights under the Code?' *(Selected by 5,989)*



Q8. In order to place the most proportionate burden on business, the Government proposes that the new policy should apply to all pub companies with more than 500 pubs. This is because the evidence suggests that smaller companies are generally behaving well and because this way the regulation would not cause a burden for smaller companies which might find it difficult to afford it. What do you think the threshold should be? *(Answered by 6,493)*



Q9. The main difference between leases and tenancies is that leases tend to be for a longer period of time and place a greater burden on the tenants to repay the pub. The Government's view is that all tenants should be treated fairly, regardless of whether the pub is a lease or a tenancy. Do you think there should be a distinction between leased and tenanted pubs? *(Answered by 6,477)*



Annex F: Draft Statutory Code

DRAFT PUBS CODE

INTRODUCTION

In the Government Consultation on Pub Companies and Tenants we consulted on a proposed Pubs Code. Having considered the responses to the Consultation we have now amended this draft Code.

Legislation will establish a Pubs Adjudicator to enforce the Code and set out the powers it has to do so.

It is envisaged that on Royal Assent of the proposed legislation a draft version of this Code will be the subject of further consultation to ensure that the final drafting of the Code will deliver its objectives. Following this secondary legislation will be laid before Parliament to be approved by resolution of each House of Parliament before the Code is issued.

PART 1

DEFINITIONS

1. In this Code:

"The Adjudicator" means the Pubs Code Adjudicator**.**

"Business Development Manager" means those employees of a Pub Owning Business who are, from time to time, responsible for managing the relationship with, or are otherwise responsible for, the Pub Owning Business's interactions with the Tenant.

"Code Compliance Officer" – is an employee of a Pub Owning Business who keeps records of the Business's compliance with this code and provides such reports as necessary to the Audit Committee of the Pub Owning Business.

Gaming Machine" means a Category C or Category D Gaming Machine as defined by the Gambling Act 2005.

"**Large Pub Owning Business"** [to be defined in the Legislation]

"Landlord" [to be defined in the Legislation]

"Micro-Business" – these are businesses as defined in the Legislation.

"Pub Owning Business [to be defined in the Legislation]

"Premises" means the property and structures which are the subject of the Tenancy.

"RICS Guidance" shall be taken to refer to the Royal Institution of Chartered Surveyors' document "*The capital and rental valuation of public houses, bars, restaurants and nightclubs in England and Wales"* (GN 67/2010) published in December 2010 or any subsequent revisions of this guidance.

"Tenancy" [to be defined in the Legislation]

"Tied Pub" [to be defined in the Legislation]

"Tied Tenant" [to be defined in the Legislation]

PART 2

INTERPRETATION OF THE CODE

2. All provisions of the Code should be interpreted purposively in accordance with the principles set out in the Legislation, namely:

   (a) The principle of fair and lawful dealing;

   (b) The principle that a tied pub tenant of a ‘Large Pub-Owning Business’ should be no worse off than a free-of-tie pub tenant.

PART 3

GENERAL PROVISIONS

3. This code applies only in relation to the practices of pub-owning businesses in their dealings with their tied pub tenants.

4. Part 8 of this code applies only to large Pub Owning Businesses.

5. Pub Owning Businesses with more than 500 tied pubs must inform the Adjudicator of such and must also inform the Adjudicator if the number of tied pubs they own falls below 500.

6. Micro-businesses may opt in to this code by informing the Adjudicator.

7. An attempt by a Pub Owning Business to discriminate against a tenant as a result of a Tenant exercising or attempting to exercise its rights under this Code shall constitute a breach of the Code.

PART 4

QUALIFIED PERSON REQUIREMENTS

8. Before a Tenancy is agreed the Pub Owning Business must be satisfied that the Tenant is a suitable and properly qualified person.

9. In order to demonstrate that the requirement at paragraph 6 has been met the Pub Owning Business must ensure that the Tenant:

    (a) is aware of their obligations under the Licensing Act 2003; and

    (b) has completed accredited pre-entry training which meets the Qualification Curriculum Authority's standards.

10. The Pub Owning Business is not required to comply with the requirement at paragraph 6 if the Tenant agrees in writing that the obligations should be waived and the Tenant:

    (a) operates at least one other pub; or

    (b) can demonstrate at least three years relevant business management experience; or

    (c) has an existing Tenancy or has had a Tenancy with the Pub Owning Business.

PART 5

BUSINESS PLAN

11. Before a Tenancy is agreed or renewed the Pub Owning Business must be satisfied that the Tenant has a sustainable business plan.

12. In order to demonstrate that the requirement at paragraph 9 has been met the Pub Owning Business must:

    (a) ensure that the Tenant has:

        i. taken independent professional advice, including business, legal, property and rental valuation advice;

        ii. independently produced a business plan, having received professional advice. The business plan must provide financial forecasts for the duration of the Tenancy and it must include:

            - estimations of incomes and related costs;

            - a sensitivity analysis examining the business performance on an increase/decrease in business income and the effect of those increases/decreases on costs and profitability; and

            - the impact of indexation if appropriate.

    (b) advise the Tenant to consult RICS guidance and any relevant industry Benchmarking Reports which may assist with market comparisons for the preparation of the business plan.

PART 6

INFORMATION REQUIREMENTS

13. A Pub Owning Business must provide the information in paragraph 12 to its tied pub tenants:
    (a) Before the commencement of a tenancy
    (b) On any renewal of a tenancy

14. Information Requirements

i. the types of Tenancy offered by the POB;

ii. the period of tenure;

iii. details of any purchasing obligations (drink, food or services), including:

- the national prices charged for these products;
- qualifications for discount;
- whether the Tenant can purchase any drinks and/or food outside the tie and the process for agreeing these arrangements (if any);
- the current and relevant price list and notification about any imminent changes.

iv. the extent to which the Tenancy will place obligations on the Tenant in respect of the requirement to maintain and repair the premises and the condition in which the premises should be returned to the company at the end of the Tenancy;

v. the procedures which Tenants must follow to assign their Tenancy (if applicable);

vi. how the POB will deal with any requests for surrender of the Tenancy;

vii. the range of support programmes and advice which will be available during the operation of the Tenancy, on issues such as:

- the capabilities and training needs of the Tenant and the Tenant's employees;
- licences and any relevant training requirements;
- business management advice;

- brand promotion and merchandising;
- provision and maintenance of dispensing equipment;
- pub promotion and marketing;
- procurement benefits;
- rating advice;
- external decoration, signage, building repairs, car parks and gardens.

viii. their policy for dealing with requests for assistance from Tenants arising from circumstances where they experience business difficulties which are beyond their control;

ix. whether they would be willing to consider amendments to their standard terms;

x. whether the tenant is afforded protection under Part II of the Landlord and Tenant Act 1954;

xi. whether the tenant has a right to a parallel rent assessment under Part 8 of this Code;

xii. details about any rent deposit arrangements including:

- the amount of the deposit;
- the period the deposit will be kept;
- arrangements for paying or accruing interest;
- circumstances in which the deposit might be increased;
- when and how the deposit will be repaid to the Tenant;
- how the deposit is treated in the case of Pub Owning Company insolvency;

xiii. specify the following information where the Tenancy provides that the rent is to be varied by reference to an index:

- which index will be used;
- the date on which the rate will be assessed and applied;
- the frequency of any adjustment;
- that payments may be adjusted upwards or downwards, according to the movement of the index at the time; and
- an illustration of the impact of indexation based on the current indexation rate.

xiv. whether there is a superior landlord;

xv. whether the freehold owner (either Pub Owning Business or superior landlord) is actively seeking to sell the property;

xvi. the procedures to be followed in establishing whether the Tenant has breached the Tenancy, the process by which a Tenant will be informed that they are in breach and whether they will have opportunities to remedy the breach before legal action is taken.

xvii. information about the procedures to be adopted where the Tenant feels the provisions of this Code have not been followed.

15. In addition the Pub Owning Business must:

(a) provide the Tenant with a blank template profit and loss account for business planning purposes if requested;

(b) provide the Tenant with a full description of the premises, including where appropriate:

i. details of the premises licence and any licence conditions;

ii. any enforcement action taken during the previous two years, where known;

iii. information about any material changes of commercial conditions likely to appear in the pubs catchment area and how these might influence costs (e.g. service costs) and trading environment for the Tenant;

iv. details of any restrictions on the premises use, such as planning constraints on types of trading, access (including details of shared access), hours of trading and use classes; and

v. a schedule of condition identifying the state in which the premises are being provided, drawing attention to any specific problems or features and clarifying what, if any, remedial work is required and expected in accordance with the terms of the Tenancy and during the course of the Tenancy and when this work is required.

(d) encourage the Tenant to inspect the premises thoroughly and obtain a survey of the premises ideally carried out by a professional with experience of the pub market;

(e) advise whether fixtures and fittings will be purchased and, if so, provide information about the arrangements for payment;

(f) provide a protocol governing the treatment and procedures to be followed in dealing with dilapidations which will specify:

i. the timetable for the review and updating of the original schedule of condition (not less than six months before the end of the Tenancy);

ii. that any further dilapidations can be added to the schedule of condition at a later date in circumstances where there is clear evidence of new material consideration or developments which could not have been taken into account at an earlier date;

iii. the process for agreeing a schedule of wants and repairs in line with the schedule of condition;

iv. The period (not less than 12 months) before the end of the Tenancy when a survey will be conducted to determine the extent of dilapidations;

v. the process by which any dispute concerning the extent and amount of repairs and making good is resolved.

(g) clearly set out their policy regarding potential investment opportunities for improvements and refurbishments and any implications for rent;

(h) clarify whether they will maintain and meet the cost of insurances for the premises or whether the cost of such insurance is to be arranged by the pub owning company and re-charged to the Tenant.

(i) clearly set out their policy regarding rent suspensions and other support available when damage to the property impacts on its trading potential.

PART 7

RENT NEGOTIATIONS

14. All rent assessments for the negotiation of new tenancies, rent reviews and/or renewals must be produced, prepared and conducted in accordance with the RICS guidance prevailing at that time. Rent assessments must be signed by a qualified RICS valuer as being conducted in accordance with the RICS Guidance For example, relevant requirements for the rent assessment statement must include "the source and basis of the trading figures (actual and/or projected) and other trading information and assumptions made..."[41]

15. The assumptions included in the rental assessment model will be explained to the tenant and supporting evidence where available will be fully justified together with assessment procedures for rent reviews, including those matters that will be taken into account or disregarded by both parties.

16. Pub Owning Companies must provide a specific timetable for information to be provided in advance of rent negotiations, rent review and renewals.

17. Before a rent is agreed a Pub Owning Business must advise the Tenant to obtain independent professional advice, including rental valuation advice.

[41] RICS (2010) Capital and Rental Valuation of Pubs, Bars, Restaurants and Nightclubs in England and Wales. Paragraph 4.16

18. Upwards only Rent Review and/or renewals shall be considered invalid and unenforceable.

19. The Pub Owning Business must provide the Tenant with sufficient information to allow them to negotiate rent (whether on a new tenancy, a renewal and/or a rent review) on a level playing field with the Pub Owning Company.

20. In order to demonstrate that the requirement at paragraph 12 has been met, the Pub Owning Company must ensure that Rent Assessments are accompanied by a shadow profit and loss statement[42] and accompanying supporting information that:

    (a) makes reasonable allowances for costs and sustainable trade;

    (b) includes volumes purchased direct from the company over the past three years where available, including barrelage;

    (c) includes the projected sales and gross profit margins, with separate figures for: draught ales; lagers; ciders; wines; spirits; FABs and soft drinks;

    (d) includes a waste figure where it is not included in the gross profit margin;

    (e) include the estimated cost of a manager where the effect of such a cost will materially affect the earning potential of the Tenant, for example, where the Tenant is not intending to be the day to day manager;

    (f) explain how gaming machine income has been taken into account;

    (g) explains where specific costs are included as assumptions in other costs e.g. the cost of cellar gas;

    (h) must express information as a percentage relative to turnover;

    (i) is net of Value Added Tax and Machine Games Duty;

    (j) is accompanied by the relevant national tied price lists; and

    (k) references comparable Benchmarks and explains the variance between the benchmark and the Pub Owning Business costs estimate.

21. In addition the Pub Owning Business must:

[42] The rent assessment containing the shadow P&L account must include the specified minimum content shown in Annex A

(a) provide the information at Part 6 of the Code if the Tenant has not previously received this information or if the information has materially changed since it was provided to the Tenant; and

(b) seek to comply with any reasonable request for further information from the Tenant and/or their professional advisors relevant to the Rent Assessment.

22. If any information is not made available the Pub Owning Business must disclose the reason for this.

23. The Pub Owning Business must ensure that a responsible officer of the company or its agent involved in obtaining and/or evaluating the supporting material provided in preparing the Rent Assessment will have visited the premises in question within at least three months prior to the assessment being undertaken.

24. All relevant information including a rent assessment will be provided to existing lessees no less than six months before the rent review date

25. The Pub Owning Business must provide a Rent Review outside of the planned contractual rent review intervals if:

(a) a Rent Review has not been conducted within the previous five years or

(b) if requested to do so by the Tenant; and one of the following conditions is met:

i. the Pub Owning Business makes a significant alteration to the price at which it supplies tied products to the Tenant or

ii. there has been an event outside of the Tenant's control and unpredicted at the time of the previous Rent Review that impacts significantly on the Tenant's ability to trade.[43]

[43] For example, the closure of an adjoining workplace which removes a considerable source of trade.

PART 8

PARALLEL FREE OF TIE RENT ASSESSMENTS

26. A Tenant or a prospective Tenant of a large Pub Owning Business can lodge a request with the Pubs Code Adjudicator for a Parallel Rent Assessment within 21 days of the point at which negotiations have failed on the basis of the initial tied offer.

27. If the notification has been made within 21 days and the negotiations are deemed to have failed the Adjudicator will require the pub-owning business to provide (or arrange for the provision of) a parallel rent assessment by a date which the Adjudicator will specify.

28. Rent negotiations are taken to have failed on the day on which the tenant notifies the pub-owning business that the tenant does not accept the rent offer made by the business, giving reasons why the tenant does not accept that offer.

29. Notification under paragraph 28 may not be given until:

    (a) the pub-owning business has made an offer as to the rent payable under the tenancy, and

    (b) either condition A or condition B has been met.

30. Condition A is that the tenant has made a counter-offer which the pub-owning business has rejected.

31. Condition B is that the tenant has notified the pub-owning business that the tenant does not accept the offer, or (where the business has made one or more subsequent offers) does not accept the latest offer) and:

    (a) the business has failed to respond within the period of 5 weeks beginning with the date of the tenant's notification under Paragraph 26, or

    (b) the business has responded without making a further offer.

32. The Tenant will pay a fee to the Adjudicator of £200.A parallel free of tie rent assessment must be signed by a qualified RICS valuer as being conducted in accordance with the current RICS guidance.

33. As part of the Parallel Rent Assessment the free of tie rent assessment must be comparable to the tied rent assessment and include:

    (a) the projected trade;

    (b) the costs of trade;

    (c) costs of running the business e.g. staff, maintenance and other premises running costs; and

    (d) a free-of-tie rent figure.

34. The parallel rent assessment must set out the projected 'Post Rent Balance' of the tenant under a free of tie scenario alongside the projected 'Post Rent Balance' under the tied scenario. The Tenant's 'Post Rent Balance' i.e. retained profit under the tied scenario should be equal to or greater than the projected Post Rent Balance that that Tenant would receive under a Free-of-tie Tenancy or the Pub Owning Business must provide a justification as to why the Balance is lower.

35. An illustration of the minimum content required for the a profit and loss account has been provided at **Annex A**.

PART 9

BUSINESS DEVELOPMENT MANAGERS

36. The Pub Owning Business must:

    (a) provide Business Development Managers with a copy of this Code;

    (b) provide training on the requirements of this Code to all Business Development Managers at least once each calendar year;

    (c) publish their provisions and commitments regarding the competence and future progression of Business Development Managers, including qualifications and on-going training and their commitment to continuous professional development;

    (d) keep records of the training received by Business Development Managers for inclusion in their Annual Compliance Report; and

    (e) provide information to Tenants about the role of the Business Development Managers and the support and guidance they will provide.

37. The Pub Owning Business must ensure that Business Development Managers:

    (a) receive training before carrying out a rental negotiation; and

    (b) abide by the overarching principle of fair and lawful dealing of the Code.

38. Business Development Managers must record all business discussions and agreements with Tenants; and must provide the Tenant with a note of the issues discussed within seven days highlighting the need for the Tenant to respond within seven days of receipt of the note if they do not agree any aspect of it.

PART 10

MISCELLANEOUS PROVISIONS

Assignment of Tenancy

39. The Pub Owning Business must respond in a timely fashion to requests for assignment and explain the implications of disposal for the tenant.

40. Following a request for assignment from the Tenant the Pub Owning Business must provide the Tenant with information regarding:

    (a) professional support and advice that is available;

    (b) fees;

    (c) buy back arrangements (if any); and

    (d) any dilapidations.

41. The Pub Owning Business must provide the information at Part 6 of this Code to the Tenant within a reasonable period if requested by the Tenant to enable the Tenant to provide this to the prospective assignee.

42. If the Tenant can demonstrate that he has provided the prospective assignee with the information at Part 6 of this Code the Pub Owning Business must not unreasonably withhold consent to a request for assignment.

Insurance

43. Where the Pub Owning Business charges the Tenant for insurance the Pub Owning Business must:

    (a) provide the Tenant with full details of the insurance schedule (to include all aspects of cover provided), a summary of cover, the charges payable and any excess applicable;

    (b) provide the Tenant with any additional information to enable a comparable quotation to be sought;

    (c) price-match any like-for-like policies identified by the Tenant by recompensing the monetary difference or alternatively allow the Tenant to obtain their own insurance; and

    (d) include insurance charges clearly and separately in the shadow profit and loss account.

Premises

44. The schedule of condition should be referenced when preparing wants of repair and dilapidations and it will form the basis of agreement on the repair liabilities of the Tenancy offered.

Gaming Machines

45. The Pub Owning Business must offer the Tenant the option to be free of gaming machine purchasing obligations when agreeing or renewing a Tenancy or when carrying out a Rent Review.

Flow Monitoring Equipment

46. Information obtained from flow monitoring equipment may only be relied upon by a Pub Owning Business as evidence when taking enforcement action on purchasing obligations if there is other evidence corroborating the flow monitoring data.

PART 11

CODES OF PRACTICE

47. Where a Company Code of Practice is produced, nothing in the Company Code of Practice will exclude or otherwise affect the rights of a Tenant and duties of the Pub Companies set out in this Code.

48. If the Pub Owning Business produces a Company Code of Practice it must be provided to all Tenants.

PART 12

COMPLIANCE

49. The Pub Owning Business must appoint a suitably qualified employee as the Code Compliance Officer.

50. The Pub Owning Business must ensure that the Code Compliance Officer:

    (a) will be provided with all resources necessary for the fulfilment of their role, including access to all documentation relating to the Pub Owning Business's obligations under this Code;

    (b) has access to the Business Development Manager to discuss issues in connection with the Pub Owning Business's obligations under this Code;

    (c) will be available as a point of contact for Tenants and any authority or other body making enquiries in relation to this Code;

    (d) will be independent of, and must not be managed by, a Business Development Manager;

    (e) will be available to discuss with the Tenant the reasons for any decisions made by the Pub Owning Business in relation to this Code; and

    (f) will be available to discuss compliance with the Pubs Code Adjudicator.

51. Pub Owning Businesses with more than 100 tied pubs must ensure that, for each complete financial year in which this Code is in force, the Code Compliance Officer delivers an annual compliance report to the Pubs Code Adjudicator, within four months after the end of the financial year to which the annual compliance report relates.

52. The annual compliance report must have been submitted to, and approved by, the chair of the Pub Owning Business's audit committee if an audit committee exists, and must include a detailed and accurate account, for the financial year to which the annual compliance report relates, of:

    (a) the Pub Owning Business's compliance with the Code in the preceding year, including instances where a breach or alleged breach of the Code has been identified by a Tenant, and the steps taken to rectify it when the breach has been proven;

    (b) steps taken during the preceding year to ensure compliance with the Code, including details of employee training undertaken and guidance issued in relation to the Code; and

(c) disputes between the Pub Owning Business and its Tenants regarding the terms of the Tenancy including rental disputes, or the application of this Code, and the outcome of any such dispute including details of where the Pubs Code Adjudicator has found the company in breach of the Code.

53. The first annual compliance report required for the purposes of paragraph 51shall cover the period from the commencement of this Code until the end of the first full financial year in which this Code is in force.

54. The Pub Owning Business must ensure that:

(a) the Code Compliance Officer provides such other reports as are necessary to ensure that the Pub Owning Business's audit committee retains effective oversight over the Pub Owning Business's compliance with the Code; and

(b) if the Pub Owning Business does not have an audit committee, the Code Compliance Officer should report directly to the non-executive director of the Pub Owning Business who carries out the functions typically associated with an audit committee, or in the absence of such non-executive director, to the Pub Owning Business's Chief Executive Officer, Managing Director or equivalent.

55. A summary of the annual compliance report must be included in the Pub Owning Business's annual company report. If the Pub Owning Business does not produce an annual company report, the summary of the annual compliance report must be published clearly and prominently on the Pub Owning Business's website within four months after the end of the financial year to which the compliance report relates.

PART 13

DISPUTE RESOLUTION

56. The Pub Owning Business must take all reasonable steps to resolve any disputes that arise under this Code swiftly.

57. Exercising rights under the Code should be interpreted as including making use of any of the dispute resolution functions of the [Pubs Code Adjudicator , including making a complaint to the Pubs Code Adjudicator, referring a matter to the Pubs Code Adjudicator for information or providing information to the Pubs Code Adjudicator.

58. Information which may be used in any dispute resolution mechanisms should not be unreasonably withheld and should be shared on request, subject to appropriate confidentiality agreements.

Annex A – Content for Profit & Loss Account (FAIR MAINTAINABLE TRADE)

OUTLET NAME_____ Date created _____

Historic volumes purchased from the company shown in 36 gall brewers barrels

	2011	2010	2009
Beer			
Cider			
Flavoured Alcoholic Beverages			
Wines			
Spirits			
Minerals			

						Tied Model			FOT Model		
WET SALES	**% of WET TURNOVER**	**36 Gall Barrels**	**Average Sale £/Unit (inc VAT)**	**Turnover (ex VAT)**	**Wholesale Cost/Brl**	**Discount Brl**	**GP %**	**GP £**	**Discount Brl**	**GP %**	**GP £**
Bitter (Standard)											
Bitter (Premium)											
Guest Ale											
Lager (Standard)											
Lager (Premium)											
Stout											
Bottled Ales											
Premium Packaged Lager											
Other e.g. Mild											
Draught Cider											
Bottled Cider											
Premium Packaged Spirits											
Wastage (if not accounted for in GP margin)											
Wine											
Spirits											
Minerals											
TOTAL WET SALES		**0.0**		**£0**				**£0**			**£0**
DRY SALES											
Bar Meals											
Letting Income											
Room Hire/Entrance fee & Other											
Net Machine Income (where Free of Tie, otherwise NIL)											
TOTAL DRY SALES				**£0**				**£0**			**£0**
WET AND DRY TOTALS				**£0**				**£0**			**£0**

EXPENSES	% of Turnover	£		Benchmarking % of Turnover	Benchmarking £
Wages & Salaries					
Rates					
Water Rates					
Energy					
Premises Repairs, Maintenance & Renewals					
Equipment Repairs, Maintenance & Renewals					
Insurance, Buildings and Business					
Marketing & Promotion					
Satellite Sport					
Entertainment					
Telephone					
Cleaning/Waste Disposal					
Professional Fees/Accountancy/ Stocktaker					
Bank Charges/ Credit Card Charges					
Equipment Hire					
Other (inc Gas/Consumables/ Licensing/Compliance)					
SUB TOTAL					
OTHER EXPENSES					
Interest on Tenant's capital (F&F/Stock/Cash etc)					
TOTAL EXPENSES					

BENCHMARKING MODEL USED
Type of pub and drink/food ratio Turnover circa £Xk per week

	Tied Model	Free of Tie Model
DIVISIBLE BALANCE		
PERCENTAGE BID & OPEN MARKET RENTAL PROPOSAL	%	
Net Tied Machine Income (Share after income split & not already included in above calculation)		
Tenant's Fair Maintainable Operating Profit (FMOP) after rent and machine income	**£X**[1]	**£X**

[1] Or the 'post-rent balance'

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