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RB/SW

12th June 2013

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation and Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

Dear Sir

Attached is Daniel Thwaites PLC's response to the Government Consultation on Pub Companies and Tenants.

Daniel Thwaites is the North of England's major independent family brewer. Founded in 1807, Thwaites has a rich heritage providing welcoming hospitality and award-winning beers that are brewed with skill and care from the highest quality ingredients.

Based at The Star Brewery in Lancashire, Thwaites owns an estate over 320 pubs, a small but growing group of characterful coaching inns and six four-star full service regional hotels and spas, which trade under the Shire Hotels banner.

In addition, Thwaites supplies a full range of drinks to many independently owned pubs, clubs and restaurants in the North of England and beyond and a wide range of bottled beers to most major supermarkets.

Yours Faithfully

Richard Bailey
Chief Executive

Pub Companies and Tenants:
A Government Consultation by the Department for Business Innovation & Skills
June 2013

Daniel Thwaites PLC

Department for Business, Innovation & Skills

Pub companies and tenants - A government consultation

Response form

The consultation will begin on 22/04/2013 and will run for 8 weeks, closing on 14/06/2013

When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation response form and, where applicable, how the views of members were assembled.

This response form can be returned to:

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation and Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

Email: pubs.consultation@bis.gsi.gov.uk

Please tick one box from a list of options that best describes you as a respondent. This will enable views to be presented by group type.	
Representative Organisation	
Trade Union	
Interest Group	
Small to Medium Enterprise	✓
Large Enterprise	
Local Government	
Central Government	
Legal	
Academic	
Other (please describe):	

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses

Further contact details:
Richard Bailey – Chief Executive

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1. Introduction

Daniel Thwaites PLC (DT) is a family brewer founded in 1807. It is organised into 4 divisions, Thwaites Beer Co, Thwaites Pubs, Thwaites Inns of Character and Shire Hotels & Spas. We are members of the British Beer & Pubs Association (BBPA), The All Party Parliamentary Beer Group (APPB) and the Independent Family Brewers of Britain (IFBB.)

We own 320 pubs which stretch from Solihull in the south to Penrith in the north. Our brewery in Blackburn brews approximately 35 million pints/ 120 thousand barrels of beer per annum,

We support local suppliers through the use of locally sourced materials. On the back of our tied estate we have grown a successful free trade business which services in excess of accounts. Collectively the tied pub business, brewery and free trade business account for the direct employment of 250 people in Blackburn with Darwen, one of the most depressed boroughs in England. When taking direct employment in our locally served pubs into account the business accounts for the direct employment of up to 600-800 people within a 10 mile radius of Blackburn.

Our Inns of Character division is again based at the brewery in Blackburn and has 8 managed houses which are mainly pubs with rooms; they sell a range of Thwaites beers and employ 160 people. Shire Hotels & Spas are also run from Blackburn; this division consists of 6 full service 4 star hotels which employ 750 people.

In excess of % of our pubs are let on short term renewable tenancy agreements. This long established business model offers a partnership between the pub owning brewer, supplying beer and looking after the property and our customer, the licensee who manages the retail business. We maintain the properties at our own cost and carry out capital investments with the long term sustainability of the tenants business always at the heart of our decision. In 2012/13 we carried out 70 capital development projects in our pub estate spending in excess of £ m, a similar programme is planned for 2013/14. In undertaking these developments we use a range of local external suppliers, such as architects, quantity surveyors, builders, furniture suppliers, sign writers and painters.

We are concerned that the introduction of a Statutory Code risks further costs and regulatory burden to an industry already beset with heavy taxation and compliance costs.

We also believe that the Statutory Code will have material unintended consequences for those companies operating below any threshold since any code implemented as proposed will create a material structural change to the Industry.

We believe that rather create an additional regulatory framework and burden on our industry. The major progress and changes across the industry implemented since 2011 and contained in the Voluntary Code of Practice should be recognised and given time to demonstrate the effectiveness of this approach.

2. Executive Summary

2.1 Tenancies and Leases

There have recently been four separate Select Committee enquiries into our industry and the beer tie, in 2004, 2009, 2010 and 2011. All have been aimed at the 'power of the pub companies' and specifically the long Fully Repairing and Insuring leases (FRI), which have become common since the Beer Orders broke up the national brewers in 1991.

In response to the House of Commons Business, Innovation and Skills Committee's tenth report of session 2010-2011 into pub companies, the Government recognised (Nov 11) that, particularly in the case of the traditional tenancy model, the tie may play an important role in safeguarding the future of Britain's smaller breweries and jobs within their tied pubs.

In that report it was concluded that the traditional brewery tenancy is fundamentally different to the long FRI lease market and should be governed separately, with a strengthened code of conduct. There were then, and have been since, no reported issues with IFBB members and their tied tenants requiring mediation by the resolution service PICAS or being referred to PIRRS for rent review resolution. Indeed since implementing its own voluntary code Daniel Thwaites has never had a complaint taken to arbitration.

The report acknowledged that the traditional tenancy model not only provides a low cost entry for a licensee wishing to run a pub but also offers a low cost/low risk exit, as neither the freehold nor the lease need to be sold on. In addition, the fact that the costs of property; repair, insurance, maintenance and improvements are borne by the brewer significantly reduces the risk profile. Long term decisions about the property can be made without short term risk to the tenant, and this is what underpins Daniel Thwaites on-going investment in its pub estate.

Our tenancy agreements are fundamentally different from lease agreements with the latter carrying far greater risks and capital requirements; however our business model offers the opportunity of our customers enjoying a high rate of return on a limited amount of capital invested.

Daniel Thwaites does however, have a small number of full repairing leases which again have not been subject to any complaints or referrals to PICAS

or PIRRS. It is the closer working relationship with our tenants and lessees that set us apart and our determination as a Family Brewer to settle the few disputes we do have in house. Our success is totally governed by our tenants' success and it is in our interest to make sure we listen carefully when a problem arises. We therefore believe the 500 cut off figure proposed in the legislation to be paramount to us being able to continue running our businesses in the way we and our tenants have been accustomed to whether that be by way of the traditional tenancy or as stated in one of the fewer but equally well supported leasehold premises.

2.2 Special Commercial and Financial Advantages (SCORFA)

At the heart of a traditional tenancy is a unique interdependency, whereby both parties to the tied agreement rely on each other to ensure that the outcome of the agreement is profitable. The traditional tenancy differs from the more straightforward commercial lease, as the landlord of the premises has an active role in the successful outcome of the business. SCORFA (Special Conditions or Financial Advantage) illustrates the financial element of the landlord's input to the traditional tenanted partnership. SCORFA benefits can be grouped within 5 main categories as below:

1. **Rent:** Traditional tied tenanted rents are substantially lower than free of tie lease rent.

   Empirical analysis evidences that the tied tenant pays 70% of the rent payable by a free of tie lessee.

   As enshrined in Version 6 of the Statutory Code, traditional tenancies are not subject to UORR (upwards only rent review), which is a standard feature of a commercial lease.

   Version 6 of the Code also ensures that rent can be rebased in the event of a material change of circumstance adversely impacting on the Fair Maintainable Trade of a tenanted house. This safety mechanism is not found in commercial leases.

2. **Property Risk:** Typically, the landlord of a traditional tenant bears such costs as:

- Maintaining the structure of the premises.
- Maintaining the infrastructure of the premises including gas / water piping and electric wiring.
- Decorating the exterior of the premises including the supply of signage.

3. **Retail Involvement:** The landlord of a traditional tenant is actively involved in the success of the business. This will involve the provision of training, together with operational support, involving the main elements of the business:

4. **Capital Investment:** The landlord of a traditional tenant invests substantially in the development and maintenance of traditional tenanted premises, as opposed to the commercial landlord. This varies from building extensions to new kitchens and sewage treatment plants.

   The landlord funds these works, provides necessary architectural services and bears the cost of depreciation.

5. **Discounts:** The landlord of traditional tenant provides discounts on the cost of tied goods.

In April 2013, the IFBB commissioned a leading firm of international accountants (Ernst & Young) to independently validate the value of SCORFA provided to licensees by member companies. Member companies provide different levels of support, as would be expected in a highly competitive market. Nevertheless, there is sufficient compatibility between this Sub-Set of the larger market to generate robust indicative values under the headings above. These benefits can only be accurately measured over the

life of the tenancy, as on an individual basis they will vary from year to year depending on the timing of investment or major repair.

In addition to services which can be measured in financial terms, the traditional tied tenant enjoys further intangible benefits which are not available to commercial lessees:

- **Peace of mind:** The traditional tenant is not bound into a fixed term. If for whatever reason he wishes to give up the tenancy, he can do so upon his issue of notice, without financial penalty and with a guaranteed reimbursement of deposits, stock and inventory value.

- The traditional tenant will enjoy a personal relationship with his landlord.

The detailed breakdown of SCORFA benefits is shown in section 4.

2.3 The Industry Framework Code (IFC)

We believe that the IFC provides a strong platform for self-regulation in the industry, with common ground among pub owning companies and operators. Daniel Thwaites has complied with the requirement to have a code in place and has never experienced any issues which have required the services of the PICAS/PIRRS arbitration services.

The intention of the IFC was to provide a framework for open and transparent business transactions, specifically the agreement by both parties of rent. It has achieved this aim and DT's view is that we have a better system of regulation than previously. Rent setting systems, for example the shadow P&L, have been reviewed and improved.

Furthermore, the emphasis on the differences between FRI long leases and brewery tenancies has allowed us to highlight the long established benefits which we were not previously making the most of. Potential licensees and newcomers to the trade can now be made more aware of the extensive support offered by brewers to their tenants under shorter term tenancy agreements. Since we have introduced our Code applicant numbers to run our pubs have increased by ·% p.a.

Recent research by leading industry marketing and PR agency, Elliott Marketing & PR, has shown that 73% of IFBB member licensees are content with the support that their landlord provides, and that 83% would seek to renew their agreement. These results prove strong evidence of a successful business partnership. The research was carried out independently across over 1,800 tenants from 16 IFBB member companies, including Daniel Thwaites.

2.4 A Statutory Code

The Government says it is committed to a free market, and to reducing the amount of Red Tape. If that is the case why are the Government now considering yet more legislation without a detailed investigation into the allegations of unfairness, particularly since the voluntary code that was requested by the BIS Committee has now been put into place following a lot of hard work and cooperation within the industry?

The situation that the Government Consultation is seeking to change was caused by the Government's last major interference into our industry with the Beer Orders of 1989. The law of unforeseen and poorly thought through consequences is in all likelihood to be repeated.

In the past ten years we have been further subjected to five enquiries and two OFT reports. In each and every case the fundamental principle of the tied business model for public houses has been supported both in the UK and in Europe through the 'Block Exemption'.

Daniel Thwaites would currently be below the threshold proposed of 500 pubs. However it is proposed that the Secretary of State be allowed to amend that level and that is a serious concern to us. We firmly believe that any alteration to the threshold should only ever be carried out through a Parliamentary Bill or equivalent and not on the whim of the Secretary of State.

If any terms of a new statutory code, for example a free of tie option or a guest beer provision, were suddenly to become a right for tenants at a lower threshold, say 200 pubs, it would have devastating consequences for our business. The main areas of concern are:

1. Lower beer volumes in our brewery.
2. Loss of business support and training for free of tie customers.

3. Lower levels of on-going investment in our pubs.

There seems little to be said for increasing regulation, with more legislation, at a time when the Government is committed to reducing 'red tape'. As recently as November 2011 the Government's own report to DBIS said that there were no competition issues with the market (two OFT enquiries) and that the debate over 'free of tie' or 'tie' was 'a distraction'.

It would be better to place the existing code on a legal footing, which the industry believes has already been achieved, and strengthen the options for appeal for long FRI leases.

For many licensees, sadly, the years of recession between 2007 and 2010 were too much for their businesses. High taxation, loss leading beer pricing in supermarkets, behavioural change by both supermarkets and consumers and simply escalating costs of doing business all played a part (e.g. rates and utilities rises). A statutory regulator would not have had any impact on the factors that have affected those businesses, nor would it have made them more profitable or saved those which have failed over the past few years.

3. Responses to Questions

3.1 Introduction

Our responses are predicated on the basis that we do not believe that the evidence supports the needs for a Statutory Code and adjudicator and are answered on the basis that if a Statutory Code is implemented it should be light-touch, cost effective and not materially distort competition.

2.5 Question responses

Q.1 Should there be a Statutory Code?

Daniel Thwaites (DT) does not accept there is a need for a Statutory Code.

DT firmly believes that self-regulation is working and should be given more time. The structure of PIRRS (rent) and PICA-Service (breaches of the IFC) is in place to ensure any claims relating to abuse of the tied model are properly and swiftly dealt with, at least cost to all parties. What other industry offers such a service at so low a cost; £200? Self-regulation also now ensures that potential licensees have to undertake suitable pre-entry training (Daniel Thwaites runs a 3 day in house course), financial and legal advice before taking on a pub. Many of the current problems for licensees are historic with long leases taken on at a time of economic prosperity which are now, as in many other sectors suffering as a consequence of the downturn, and historic assignment of leases by licensees at a premium, to which the pub company has little control over who buys the lease but still provides assistance and SCORFA benefits.

No other industry to our knowledge provides such a comprehensive low cost mechanism for complaints. Longer established has been the PIRRS scheme for disputes surrounding rent reviews where a panel of independent assessors consider rent adjustment proposals and are empowered to set rent as a result. The more recent PICA-Service scheme allows lessees and tenants to complain against anything else in individual company codes. Three or four cases have been heard, many more have been resolved before they reach the PICA-Service panel. The low level of cases taken forward demonstrates the significant strides made by the industry in fair and transparent dealings between parties.

Version 6 of the Industry Framework Code is now in place. BBPA spent almost a year in discussion with representatives of multiple lessees agreeing commercially sensitive changes to the Code. Version 6 will be implemented into Daniel Thwaites' Company Code by the end of this year. Further evolvement of the Code will be taken forward by the new regulatory board where both landlord and tenant interests are fully represented (with the majority of Board places going to tenants) and behaviours judged by a voluntary system already in place which tied pub companies (large and small) have funded at a cost of £4 million since 2010, and £1 million per annum on-going.

A Statutory Code would also result in a two-tier resolution system with significant cost implications for all companies. This would put an inevitable strain on the voluntary system.

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.

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?

We support a 500 leased/tenanted pub threshold, but only on the basis that this does not lead to a material distortion in competition above and below this threshold.

We welcome the fact that smaller operators such as family brewers will not be affected in the event that a 500 pub threshold was implemented. This of course is subject to the cost of self-regulation not being disproportionately high as a consequence.

The current proposals which abolish the machine tie and demand a guest beer be offered could materially distort competition between large and smaller companies with less than 500 houses. We would also point out that as drafted the guest beer could be nominated as a lager which we believe is not the intention.

In addition, as drafted, the number of pubs would also mean that managed house numbers are included in the 500 proposal and we strongly argue that managed house numbers should not be part of the equation.

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

We believe if operated under the British Franchise Association regulations, franchises should not be included under the proposed 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.

We do not agree with the costs and benefits stated in the consultation document regarding the impact the proposals will have on the pub sector. As outlined in the introduction to this consultation response, we have a number of concerns with the evidence base for the proposals, and the assumptions made by the Government in the Impact Assessment.

The primary 'benefit' to the pub sector of the proposals is the transfer of (best estimate) £102 million from the pub owning companies covered by a Code to their licensees, working out at around £4,000 per pub. This is not justifiable or realistic in any way. This transfer value is based on the difference between an estimate of wet rents, the value of SCORFA benefits and the number of tied pubs covered by the adjudicator (24,000). The impact assessment recognises this as being very much a 'finger-in-the-air' exercise.

The number of tied pubs quoted to be covered by the Code – 24,000 – seems to us to be a high estimate. We would estimate that the figure would be nearer 18,000, which would in turn lower the estimate of the transfer of value from companies to pubs (by 25%).

In reality there may be little, if any transfer of value if SCORFA benefits are greater than the difference in wet rent and indeed other considerations are properly taken into account. In which case there would be absolutely no justification at all for these proposals. There are other important factors to consider such as risk to pub viability, consideration of value over the lifetime of agreements, risk to investment, balance of risk/reward, the reality of the rent assessment process at individual pub level, and unquantifiable benefits such as ease of surrender. There is also no such thing as a free-of-tie traditional brewery tenancy and indeed only c.1, 500 free-of-tie leased pubs exist in the UK to compare with.

Therefore we do not believe the proposed calculation of "no worse off" under a Statutory Code and consequent transfer of value is an acceptable or indeed practicable proposition. We believe that it is misleading as it does not take account of the other benefits that would be foregone

The other suggested benefit of the proposals set out in the impact assessment include increasing the incentive for licensees to invest in their pub, while decreasing the incentive for the pub operating company to invest. The Government concedes that this benefit is not likely to be large. Our view is that in reality, licensees would not be able to invest in their pubs to a comparable level with the significant amount of investment by pub companies in their estate each year. Investment averages over £240 million a year. The Government has acknowledged in other sectors that bank lending is hugely difficult to obtain. Bank lending to pubs is almost non-existent. It is difficult to understand how the Government thinks pub company investment is to be replaced by individuals on an industry wide basis.

The cost of the adjudicator is estimated at £900,000 per year (best estimate). The current assumption made in the document that the code will cover seven companies is incorrect, and will impact on the calculations regarding the cost to each company, currently estimated at £168,000 per Pub Company. We would also point out that as currently proposed, managed and free-of-tie companies would be liable for adjudicator costs (such as compliance officers etc.) despite not having any pubs that would actually be covered by the Code itself. This will therefore increase the costs to pub operating companies.

There will be costs to those companies under 500 pubs operating under the self-regulatory system, as the larger companies will no longer be part of this system. Therefore, the cost of self-regulation (PIRRS/PICA-Service etc.) will go up for the smaller companies such as Daniel Thwaites, as our share of the costs will increase with the removal of the larger players into a Statutory Framework.

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

Daniel Thwaites fully supports self-regulation within the industry, and believes great progress has been made in recent years with strong evidence that the system is working well.

Inaccuracies regarding self-regulation in the Government proposals

To clarify the current extensive self-regulation already in place within the industry, we would like to point out that the impact assessment (section 33) contains out-of-date information. The pub sector published in February 2013 Version 6 of the Industry Framework Code (IFC) - not Version 5 as stated in the IA. Version 6 of the Code is a major step forward from Version 5 as it provides greater transparency for tenants and lessees and seeks to tackle a range of more commercially sensitive issues. In summary, the new reforms include

1. Companies which operate more than 100 leases will be required to publish an annual statement of Code compliance which will be externally audited
2. Greater clarity is provided around insurance and a commitment to price-match on like-for-like policies
3. A clear commitment that income from AWP machines can only be shared once and will not also be included in the rent assessment
4. A schedule of conditions which clarifies obligations on any remedial work required
5. Common formats for shadow profit & loss accounts and rent assessments
6. An improved protocol on flow monitoring equipment

The Code also reflects a commitment to establish a new Regulatory Board to oversee the corporate governance of BIIBAS, which accredits all company codes, and the PIRRS and PICA-Service panels, which have already been successfully established and provide independent, low-cost arbitration services for rent and other disputes. This commitment has been advanced recently, with the Regulatory Board set to be in place by the end of May with both tenant and landlord representation.

There are a number of unfounded assertions regarding the self-regulatory system within the impact assessment and consultation document which we

would question, particularly as the view that self-regulation has 'failed' is part of the Government's rationale for proposing such a Statutory Code. The assertions include:

- 'Some in the industry are not convinced the code is legally binding' – it is not clear as to who this refers to, nor is there any evidence that this is the case. The legal status of the IFC is made clear in version 6 and has been tested by the Government's own lawyers before the Government's response to the last Select Committee was published.

- 'Even positive developments like PICAS are divisive with its independence being questioned' – this again is an assertion, with subjective evidence being presented to back this statement up. There is a large amount of support for PICA-Service within the industry and recognition of its fair and positive operation for both companies and tenant (liaise with BIIBAS re data). The Panel for PICA-Services comprises experts who are tenants and lessees and represent these organisations.

The Government states that self-regulation is 'likely to continue to deliver small improvements in the treatment of licensees, however continued widespread complaints of abuse...mean improvements will be limited'. We disagree with this view, and see self-regulation as delivering important and far-reaching changes in terms of improvements made in landlord-tenant relations and transparency around lease and tenancy agreements.

BBPA The Future of Self-Regulation

We have set out our views above on the real progress made with regard to self-regulation in the pub sector in recent years. However, Daniel Thwaites as a member of the BBPA is prepared to do more to ensure that self-regulation is as effective and transparent as possible and is delivering measurable results. This has already begun with the establishment of the Regulatory Board, with tenant representation, to oversee all of the self-regulatory structures in place and ensure they are operating effectively. In addition to this, we propose:

- To review the self-regulatory system regularly – a suggested timeframe is every three years – by an independent body or person;

- Ensure data relating to complaints received, and their resolution and resultant action, is easily available;
- Be fully transparent around all the benefits offered by SCORFA

Daniel Thwaites is committed to the Industry Framework Code and self-regulation, and will aim to improve where possible.

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

Daniel Thwaites is totally committed to fair, transparent and lawful dealing with tenants and lessees and all other business partners and to stamping out any abuse of the tied pub model, as has been proved by take-up of the self-regulatory system.

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

It should be noted that we do not believe that there is such a thing as a 'Free of Tie' tenant whose landlord bears the property risk without recharge to the tenant, having said that, Daniel Thwaites fully supports the principal.

Although every house is different and a one rule fits all scenario is impossible, we have laid out in Section 4, the SCORFA benefits enjoyed by a typical/ average tied tenant partnered with an IFBB member such as Daniel Thwaites.

SCORFA benefits should be considered over the lifetime of a tenancy or lease agreement one point that is almost impossible to quantify is the balance between risk and reward of the different business models and this is reflected by very few pubs operating on a free-of-tie lease basis.

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.

Agree. A number of pub operating companies already have this provision in place within their own company codes.

We consider that in the context of this sector, where an individual pub company generally faces significant competition from other pub operators in the downstream retail market and where the characteristics of the market do not offer conditions in which coordination between the large pub companies is likely to be sustainable, pub companies will not be in a position to sustainably inflate prices charged to lessees above a competitive level.

'If pub companies do not ensure that their lessees are well placed to provide a competitive offer to customers, those pubs risk losing custom to other tied, free house and managed pubs in their locality. For these reasons, we do not consider that it would be sustainable for pub companies to set prices and rents at a level that would compromise the competitive position of pubs within their estate...to that extent, pub companies' commercial interests would appear to be aligned with the interests of their lessees', and it would not appear to be profitable for pub companies to inflate the beer prices and rents charged to their lessees to a level that would undermine their lessees' ability to compete effectively'[1]

We would welcome further definition around what constitutes an event outside of 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.

We support greater transparency of SCORFA benefits which would highlight the key benefits of the tied model to prospective tenants and lessees at rent assessment time. However we do not believe it is practicable or possible to lock these into rent assessments on an individual pub basis where every pub is unique and rent is part of a commercial negotiation. This would have to be illustrative over the life of the agreement, and over the entire company estate. There is also the issue that in relation to 'traditional' brewery tenancies in particular, there is no equivalent free of tie model to compare rent assessments with.

[1] CAMRA Super-Complaint –OFT Final Decision (October 2010) p.125-126

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

Do not agree. By restricting what may and may not be tied in this way for companies over 500 pubs first and foremost, leads to a market distortion between these operators and smaller companies.

There is a real concern that removing the tie would encourage the spread of criminal behaviour by unscrupulous suppliers of gaming machines and potentially a lack of understanding of the regulations regarding the control and taxation of Category C gaming machines in pubs.

Benefits of the machine tie

Operational benefits

IFBB / BBPA Members report that the average age of an AWP in free trade houses is 2.5 years, whilst in tied estates this is nearer 1 year – the pub company is able to source good quality new machines for their estate which in turn means higher net cashbox as players prefer these machines.
Supplier accounts are vetted to ensure that they have adequate funds for capital investment.
Suppliers can be denominated, or be penalised through loss of business for poor standards or performance.
Pub companies set income target objectives for suppliers and monitor performance.
Licensees are advised of the best performing Suppliers should they wish to change.
Pub companies monitor fraud on note and coin acceptors.
Pub companies monitor machine break-in and robbery patterns.
Pub companies recommend the removal of equipment in loss making sites.

Contracts

Tied licensees do not have to enter into supply agreement with a Supplier for a given term.
They have the freedom to select a Supplier from a professionally vetted nominated list.

Some free trade machine supply contracts are onerous either due to the length of term or the fixed rental cost.
In free trade older machines can be supplied on rents which are commercially unreasonable due to the lack of licensee's specialist knowledge.

Legal compliance

Suppliers approved by the pub company will ensure that machines aren't installed without the correct licenses and permits - this is not always the case with all machine suppliers.
No illegal machines will be supplied by approved suppliers, again this is not always the case with other suppliers and there are regular instances of illegal machines being offered to tie pubs. This risk can only be policed by approved suppliers and the pub companies because the licensees don't have the expert knowledge to be aware of current machine legislation.
Tied Suppliers will apply for the necessary permits on behalf of licensees if requested.
Tied collection service removes an accounting burden for licensees ensuring that MGD and VAT is calculated and declared accurately.

Maintenance of product quality

Companies ensure by contacted arrangements that a minimum number of new machines are purchased for tied estates each month.
Product test data is gathered from a range of sources weekly and consolidated to ensure that the best machines are purchased for use in tied estates.
All machines supplied into tied estates comply with Gambling Commission regulations for both AWP and Skill with Prize.
Legislative Machine changes are monitored and flagged to suppliers to maintain licensee income.
Rent/net income ratios are managed to ensure that over-renting doesn't happen.

Managing the supply chain

The UKs only remaining volume AWP manufacturer was purchased by an Austrian company who then tried to increase the price of machines by 60%. This would have been a substantial additional cost to publicans, but the buying power of the pub companies resisted this and encouraged and

supported new entrants to the market thus ensuring a competitive market and suppressing price increases for licensees.
The constant demand for new products driven by pub companies stimulates manufacturing and supports jobs.

The above benefits would be lost if the proposals went ahead as drafted. A further point to note is that if the tenant went free of tie on machines then the income from the machine would be included as part of the divisible balance and therefore taken into account when the rent levels were assessed – whereas under the current tied model income from machines (IFC v.6) cannot be included in the divisible balance. This could result in licensees being no better off under free of tie proposals as the cashbox would be rentalised.

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

We do not agree. The 'guest beer' option is defined as 'the tenant should be allowed to purchase and sell one draught beer from any source'. The consultation document justifies the inclusion of such an option by claiming 'it may be of benefit to both the tenant, consumer and independent breweries'. There is no evidence to support this assumption and it would lead to competition issues, we brew own beer. We already offer a wide variety of choice for tenants within their existing supply agreements. Which includes a choice of lagers and ales brewed by third parties other than our selves.

Daniel Thwaites would also point out that although we are not within the number of 500 outlets as proposed, if enacted we believe the guest ale rule will distort the market place.

In addition we believe the intention of the guest beer option being made available was actually to allow guest ale. If that is the case the drafting is poor as a licensee could nominate a lager as currently worded.

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**

Do not agree. There is no evidence presented in the consultation as to why flow monitoring equipment should not be used as part of the process to determine if a tenant is not complying with purchasing obligations.

The argument made in the consultation document that the 'model of the tied public house has been part of the British pub industry since at least the 18th century...it is therefore completely possible to operate a tied estate and to enforce the tie without the use of flow monitoring equipment' is flawed, in that it is disingenuous to compare the technology available in the 21st century with that available 300 years ago as a reason why not to use flow monitoring equipment as a tool in determining whether purchasing obligations are being breached.

The current Industry Framework Code has a flow monitoring protocol which has been included in Daniel Thwaites company code stating that flow monitoring equipment cannot solely be used as evidence that a breach of contract has occurred. We would support this as a fair and reasonable position to take in any Statutory Code.

Flow monitoring equipment is a benefit to both the pub company and tenant as a management tool. It allows for example off-site management of sales which is very useful to a tenant or lessee away on holiday.

Q.9 Are there any areas where you consider the draft Statutory Code (at Annex A) should be altered?

We have dealt with a number of the issues raised by the proposed Code in answer to the questions above. Looking at the draft Code itself at Annex A of the consultation, we would make the following observations in comparison to the current IFC:

- In general there is no definition made between leases and tenancies in the Statutory Code as compared to the IFC version 6. Tenants covered by the Statutory Code will be subject to the same obligations as lessees which is currently not the case;

- Definitions in the introduction to the Code:

    - 'Tenant' – explained here as meaning the person to whom the pub is assigned as either a lease or a tenancy (irrespective of which type of agreement) yet the Code itself (notably Part

6 – Miscellaneous Provisions) does refer to separate 'lease' and 'tenancy' agreements which is inconsistent and confusing;

- 'Pub' – attempting to define a 'pub' is always a difficult task, and defining it within legislation such as this could lead to unintended consequences. The definition set out in the Code could exempt food-led non-managed pubs, or indeed include premises which otherwise could be classed as 'restaurants' if they have a high level of food turnover and have no specific licensing conditions relating to consuming food at the premises;

- The majority of Part 2 of the Code 'Pre-contractual Negotiations' is taken from the current IFC. However, as noted above is taken primarily from the leased section of the IFC and as such will introduce onerous obligations on tenants and tenanted operators;

- Part 2 also simplifies a number of the obligations set out in the IFC, potentially making it less onerous on pub companies subject to the Code compared to companies subject to the voluntary IFC;

- Section 9 (c) refers to companies providing a blank template P&L account to tenants – this is a departure from the IFC as it was removed from IFC after objections from other companies;

- Part 3 – rent assessment statements: It is not clear throughout this section as to the difference between an initial rent assessment provided to a tenant going into a new pub and existing tenant rent reviews which will lead to confusion;

- Section 20 makes it illegal to enforce an UORR clause – already in IFC but will apply to companies currently outside this scope; commercial free of tie agreements generally retain UORR clauses.

- Part 4 of the Code contains the majority of the new obligations on companies, we comment on these in answer to question 8 above:

  - Sections 22 – 24 regarding calculation of rent in relation to FOT leases and SCORFA;
  - Section 27 – guest beer option;

- Section 20 – no other products other than drinks may be tied;
- Section 30 – flow monitoring: this is a significant departure from the IFC as it does not allow flow monitoring evidence to be used in any way to determine whether a tenant is complying with purchasing obligations, whereas in the IFC it could be used in conjunction with other evidence.

- Part 5 – BDMs contains a number of obligations not included in the IFC regarding BDM training etc.

- Part 6 – Miscellaneous provisions

  - Section 33: New obligations here include incorporation of Code into by next rent review (inconsistency here again regarding the definition of 'rent assessment' to cover both reviews and initial assessments for new tenants), as discussed could lead to companies carrying out rent reviews just prior to Code adoption in order to delay changes as long as possible;

  - Section 37: More onerous obligations for tenants/tenanted companies regarding 'keeping' or 'putting' the pub in good order as these are different requirements for leases and tenancies and will cause problems if have to be adopted by traditional tenancies.

- Part 7 Pub company codes of practice: does not require those subject to the Code to produce a separate IFC compliant code

- Parts 8 and 9 deal with the statutory adjudicator and related dispute resolution and so are above and beyond anything within IFC v6.

- Annex A – rent assessment statements – this differs from that within the IFC as includes hypothetical FOT option as comparator.

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?

Yes. As the BBPA have committed to reviewing the self-regulatory system regularly (suggested every three years) and we would expect the Statutory

Code to be reviewed (transparently and independently) on the same timescale.

However on page 28 of the consultation document it states that the Secretary of State in reviewing the Statutory Code would have the power to alter the minimum threshold above which the Code would apply. We strongly disagree with this proposal and would recommend that any alteration to the minimum threshold should only ever be carried out through the introduction of a full Parliamentary Bill or equivalent measure and should not just be a decision made by the Secretary of State.

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

No. The imposition of a mandatory Free-Of-Tie (FOT) option would destroy the basis of the traditional tenancies that we operate and that have served the industry so well over a period of many decades by sharing risk with our customers.

A mandatory FOT option would also have serious unintended consequences for Daniel Thwaites and other IFBB members' entire pub estates as identified in the consultation.

For example one of these consequences could be that the IFBB members became nervous about the future market and curtail future investments in their estate with the consequent negative impact on jobs. Daniel Thwaites has planned capital expenditure of £ m across 70 projects. To potentially jeopardise such a considerable and important investment in local economies would be a huge risk to all concerned including the Government.

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?

No.

Daniel Thwaites believes that the self-regulatory system and SCORFA already delivers this.

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

Under the IFC, PICA-Service already provides an independent conciliation and arbitration service for complaints around company conduct, and PIRRS for rent reviews.

Any Adjudication system should be as cost effective as possible and impose the minimum of red tape on the industry. We believe the cost estimates for the Adjudicator as stated in the Impact Assessment are low, and are likely to be higher – especially taking into account the arbitration function outlined at Question 14.

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

(i) Arbitrate individual disputes?

We would point out that there are already a number of services that are available to tenants to arbitrate disputes:
PICA-Service (disputes relating to breaches of the IFC)
PIRRS (disputes relating to rent reviews)
Via the court system over contractual disputes
Other established arbitration bodies (ACAS)
RICS also operate a dispute resolution service.

(ii) Carry out investigations into widespread breaches of the code?

Investigations into breaches of the Code would have to be based on sound evidence, and specify where exactly the Code has been breached. Systems should be in place to prevent vexatious and speculative complaints being escalated, with the resultant time and financial cost of unnecessary investigations.

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) Requirement to publish information ('name and shame')
(iii) Financial penalties

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.

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

Yes.

Q. 17 Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code paying a proportionally 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 impact on the industry and consumers of setting up such an Adjudicator should be as limited as possible. As stated above, we believe the cost estimates of such a regulator are too low. There is the danger of regulatory creep by such a body, and suggest a cap of the budget of the Adjudicator to minimise the impact on the pub sector.

The Levy as proposed will be paid by pub companies covered by the Code, in proportion to number of pubs owned. In second and subsequent years of the levy, it is suggested that those who breach the Code pay more. However, this still does not address managed companies and FOT companies having, as proposed, to pay into the Adjudicator system despite having no pubs that are actually covered by the provisions.

4. SCORFA Benefits

The IFBB instructed Ernst & Young to validate the value of SCORFA provided by member companies including Daniel Thwaites. The breakdown is as follows;

A)

(1)

(2)

(3)

(4)

(5)

(6) Total SCORFA (Excluding lower Rent)

Total **£**

B) SCORFA Comparison – Landlords and Tenants Relationship Tied Tenancy v FOT FRI Lease

		Traditional Brewery Tied Tenancy	Free of Tie FRI 10 Year Commercial Lease
Property SCORFA	**(2) + (3)**	Bears property risk	Passes property risk to lessee
		Pays for building insurance with no insurance rent	Does not share insurance discount
		Revenue Property Repairs/Building Insurance	
Retail Support SCORFA	**(1)**	Actively involved in supporting/building retail trade	Has no interest in development of trade
		Retail Trade Support (Marketing/Training/Consultancy, etc)	
Capital Investment SCORFA	**(4)**	Provides maintenance Capex	Provides no capital support
		Provides development Capex	
		Provides architect/surveyor services	
		Capital Investment Support – interest not charged	
Rent	**(5)**	Provides premises	Provides premises
		Provides subsidised rent	Charges full market rack rent
		Rent can reduce on review	UORR
		Interim downwards review if MCC	
		Rental Subsidy	
Intangibles		Partnership approach to maximising retail turnover	Essence of relationship
			Submission of quarterly rent demand
		Peace of Mind **Low Risk/Easy Exit** **Family Brewer Experience** **Bulk Purchasing Schemes, egg food and utilities**	

C) SCORFA Comparison – Funding Requirements (4)

		Traditional Brewery Tied Tenancy	Free of Tie FRI 10 Year Commercial Lease
Initial Investment Premium/Development	Inventory	£	£
Interest at 15%		£ per annum	£ per annum
Depreciate to 50%		£ annual equivalent	£ annual equivalent
On Going Maintenance Capex		Nil	£ per annum
Depreciate to nil			£ annual equivalent
Interest at 15%			£)
			£ annual equivalent
Total Capital Investment		£	£
		Landlord £	
Total Funding Cost		£ per annum	£ per annum

This does not reflect:

- Availability of finance
- Cost of arranging finance
- Peace of mind as lessee is likely to offer collateral to obtain funding

5. Conclusion

Following consideration of the above Daniel Thwaites would request that the following points are taken into account:

- Much of the consultation is flawed, misrepresentative and at times misleading. For example it claims that there have been over 400 complaints to the BII when in fact there have been 400 enquiries.

- The impact assessment includes a number of inaccuracies as outlined above.

- There is no evidence to show that self-regulation is not working nor indeed that a Statutory Code would work and therefore we believe that a Statutory Code should not be introduced and the Voluntary Code should be given longer to prove its effectiveness.

- Daniel Thwaites and other members of the IFBB have never been to arbitration and already treat our customers/tenants fairly. Traditional brewery tenancies are a proven and successful business model that have survived the test of time evidenced over decades and even centuries.

- We support a 500 tenanted/leased pub threshold on the strict condition that it does not lead to a material distortion in competition above and below this threshold. The current proposals to abolish the machine tie and offer a guest beer (which could be a pub's best-selling lager) would materially distort competition.

- The current proposals to abolish the machine tie and offer a guest beer (which could be a pub's best-selling lager) would materially distort competition.

- Any future alteration of the minimum threshold above which the Code would apply should only be introduced through a full parliamentary Bill or equivalent and not just by the Secretary of State.

- 3.11 states "The Government's aim is to regulate proportionately". We would argue that this is a contradiction in terms and history

suggests that it is a very difficult balance for Government to strike when introducing new regulations.

- Any intervention in the industry at the end of the day is likely to be paid for by the consumer. Is that really fair or a desired outcome?

- The questionnaire that accompanies the Consultation Document is in our opinion very biased and the fact that a Government Minister interviewed on video is featured on the Consultation web page using emotive language and inaccurate data leads us to believe that the outcome of the review has already been pre-judged by those most closely involved with this important issue. We believe that the Ministerial interview, as well as parts of the Consultation Document and the questionnaire are in clear breach of the Market Research Society Code of Practice designed to ensure fair and open consultations.

- The introduction of a Statutory Code:

    - risks further costs and regulatory burden to an industry already beset with heavy taxation and compliance costs. We do not want or need any more regulation and must be better off without it.

    - which includes a mandatory free of tie option will unquestionably distort the market leading to uncertainty, brewery closures and further job losses. It will also lead to reduced investment in pubs and consumer choice. Daniel Thwaites is planning to invest £ m in our tenanted pub estate in 2014 helping to secure 150 jobs. The proposal risks jeopardising this sort of annual investment as well as additional investment across the industry.

    - will lead to damaging, unintended consequences such as higher costs for those companies using the current Voluntary Code. We want to continue with a cheaper, more efficient Voluntary Code which is already working well.

In conclusion Daniel Thwaites thoroughly rejects the proposal that a Statutory Code underpinned by a newly-formed regulator is a necessary or appropriate way forward. Indeed it would lead to many damaging, unintended

consequences and the existing Voluntary Code should be given longer to work.