

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: <input checked="" type="checkbox"/> Spirit Pub Company PLC |
| 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

Response by Spirit Pub Company PLC (“Spirit”) to Consultation by the Department for Business Innovation and Skills in relation to Pub Companies and Tenants June 2013

Key messages

- **At Spirit we fully support and participate in the current arrangements which govern the sector and enjoy a very good relationship with our licensees**
- **The Industry Framework Code has not been given adequate time in which to prove itself across the sector**
- **Government proposals require more thought as to their detail and impact to determine effective implementation of a workable solution**
- **There is a significant chance that the cure envisaged by the current proposals will be worse than the supposed illness, and may have serious unintended consequences for economic value, jobs and growth.**

Executive Summary

Spirit Leased is a division of Spirit Pub Company PLC and operates 463 leased, tenanted and franchised pubs across England, Scotland and Wales. We believe that a well regulated pub sector plays an important part in delivering sustainable profit growth for us and our licensees. In this response we refer to tenants and lessees as licensees, since both take a tied agreement irrespective of its type.

We are only successful if our licensees are successful and this goes to the heart of our business model and how we work in partnership with our licensees. We own (most of) our pubs and in looking to derive a return on each of these outlets we share a common agenda with our licensees and the Government – jobs, growth and wealth creation. The commercial success of our pubs is therefore a shared vision in which strong, transparent and fair relationships with our licensees are critical.

We fully endorse the impact of recent Government inquiries to the extent that they are reflected in the latest version of the Industry Framework Code (IFC) Version 6 (Jan 2013). In our view, self regulation within the guidance of the IFC is working and we are currently seeking accreditation of the latest version of our company Code of Practice (COP) to meet the requirements of Version 6.

We believe there is no real need to introduce a new Statutory Code of Practice especially if it is to take the form of that proposed in the Consultation document. A Statutory Code would only be tenable if it were along the lines of IFC version 6 and was binding for both tied tenancies and tied leased agreements. Any Statutory Code should not be binding on any pubs that are free of tie (FOT), nor those that are subject to temporary or franchise agreements or managed pubs.

We feel that a Statutory Code that goes far beyond IFC version 6 and is along the lines of that proposed in the Consultation document is neither appropriate nor proportionate.

We would, in any event, suggest that if a threshold has to apply, and if it has to be a figure of 500, then it should be based on a minimum of 500 tied tenancy and tied leased agreements (that is to say excluding pubs that are not tied leases or tied tenancies) and not be based on a threshold that includes managed houses owned by the same company.

In our view, the issue of a Statutory Code and a Statutory Adjudicator do not need to go hand in hand. There is sufficient recourse currently for issues of a breach of the code or poor behaviour to be progressed through the Pub Independent Conciliation and Arbitration Service (PICA-Service). As per the Government's Impact Assessment, the costs associated with an Adjudicator are relatively unknown but may be potentially excessive, unnecessary and it is not clear by whom such costs would be borne or on what basis they would be allocated and this is not something we support. It is also a concern that the proposed use of an Adjudicator appears to be based on the application of the as yet untested equivalent applying in the grocery sector. It follows that for this reason alone, the case for rolling out the Adjudicator model (and the costs it will entail) to other sectors is questionable at this stage.

We appreciate why the Government is proposing that pub companies produce parallel tied and FOT rent assessments so that a licensee can ensure that they are no worse off. We believe this ignores many important factors which would not be considered as part of that comparison. These include the cost and possible unavailability of capital as a challenge, and the provision of a home to the licensee at no additional cost as a benefit.

There are significant benefits provided to our tied licensees under the Special Commercial or Financial Advantage (SCORFA) arrangement which enable us to help our licensees operate successful businesses themselves. In our experience, successful tied licensees employ teams of people locally to work in their businesses and build great local community assets. It is the very fact of being tied to purchase drinks from a business like Spirit that means a tied licensee has a significantly greater chance of business success; a fact acknowledged in the Consultation document.¹

With access to significant retail experience, investment capability and scale, an entrepreneur working within a tied arrangement can enjoy so much more support than they may be able to realise at the same cost or value without the tie. For example a typical investment at one of our pubs incorporates the expertise of an architect, project manager and interior designer with the added benefits of in pub training for both the licensee and their staff by our training team. In addition we provide a formatted menu delivered in their pub including reduced cost food, menus and dish specifications, external and internal point of sale material. The provision of these services saves significant time and money for the licensee, but also enables them to take advantage of the expertise and proven training and concepts which we provide.

Further, the idea that the tie is responsible for the economic challenges facing a certain group of licensees is deeply misleading. All pubs, whether tied or not, have been adversely affected by events unrelated to any tie, for example, by the recession, supermarket prices, duty, regulatory factors such as the smoking ban, and employment and social trends. As highlighted in our opening paragraph, pub companies have absolutely no incentive to force onerous terms onto their own outlets (tied or otherwise), the effect of which is to place such businesses at risk. It does not make economic sense that well-established companies - whose portfolios comprise long term capital investments (such as pubs) - should base their revenue model on uncertain and short-term profits. In any event, on the basis that a person is free to

¹ See appendix 3

enter into an agreement, this comes with the responsibility to take advice, consider its terms and accept some level of responsibility for one's own performance.

Were a FOT option to become mandatory in a Statutory Code, we are concerned about the impact that this would have on our business, our licensees and on the economy. A licensee's pub business is able to thrive best when it can call upon the resources and skills of a pub company and a portfolio of tied pubs is critical to give us the scale to invest in an appropriate support infrastructure for the licensee. A more effective and efficient relationship arises where the pub company is closer to its licensees and therefore able to identify the need for, and provide, real and tangible support to make sure they succeed. This is what we are doing with our tied pubs.

A mandatory FOT option may well force us to move more towards a property based approach with a FOT licensee and operate a more arms length relationship with them. The initial reduction in prices by major suppliers could remove smaller brewers from the sector giving such suppliers greater market share. In the longer term licensees and consumers might have less choice. This could ultimately result in prices rising amplified by licensees negotiating prices without the scale of a pub company or brewery.

Another significant benefit of the tied business model in addition to retail support is the sharing of risk and reward and the low cost of entry that an entrepreneur incurs when taking on their own pub business. The pub company owns, funds and secures the asset; for a licensee to do the same would mean they would have to provide a minimum of 20% of the value as a deposit and take a business loan or mortgage against the remaining value plus insure the property on the open market. This route also takes no account of the fact that borrowing is difficult to obtain and that a commercial finance provider may not be so flexible when there is a downturn in sales. Conversely the tie allows a licensee much greater protection from a downturn in sales as they are not burdened in times of difficulty with the significantly greater fixed cost of higher rent that would accompany a free of tie arrangement.

If a FOT option was to be made a mandatory condition of a Statutory Code our concern is that this takes no account of the economics of the business model in that the pub company owns the asset in the first place. The assumption that licensees will choose to invest at the same rate to pub companies in a FOT scenario seems flawed. The FOT scenario also poses some challenge around investment for companies; the higher the rent as a starting point the less headroom there is to set rents to support investment decisions.

Certain assumptions in the Consultation document suggest that, in revenue terms, the proposals outlined will be neutral because any loss of income to the pub company is offset by the additional profitability transferred to the licensee. There is no evidence provided in the Consultation document for this assumption; moreover, it ignores other potential issues, for example, the risk of a decline in revenue because of the greater opportunity to evade payment by under-declaring revenue. By allowing, for example, gaming machines to be sourced, and the income from those machines to be collected, in an unmonitored way this may increase the risk of under-declaration. A non drinks tie relating to gaming machines has a real and tangible benefit to Government but also importantly to a licensee's business in terms of optimising the profit of machines through the management support afforded by companies such as ours. Similarly, we are also able to significantly support the development of a strong food offer in a tied pub with our scale and retail experience. For these reasons we see value in maintaining ties on other products other than drinks as well.

The concept of a tie, subject to the satisfaction of certain market share conditions, is entirely lawful and consistent with UK and EU competition law and acknowledged as giving rise to a variety of positive economic effects.² If a national statutory code sought to regulate the issue of ties in a more restrictive manner than that envisaged under applicable EU competition law. It is open to question whether such a measure would be enforceable under European law.

Our business and that of our licensees could be materially impacted by unnecessary intervention and red tape. We are firmly of the view that with IFC version 6 only just now going through the accreditation process by individual pub companies, self regulation should be given a proper and meaningful opportunity to continue to demonstrate its value before any decisions are made to effect further change which may not be beneficial.

We believe that some of the consequences of the proposals put forward are far reaching, would drive structural change with unpredictable consequences, and could potentially drive the closure of pubs and cause economic damage to communities across the UK. There is a clear conflict where we have a Government which is committed to reducing bureaucracy and yet appears to be attempting to impose costly burdens on a sector which provides high employment but in which all participants are under cost and profit pressure.

Q1. Should there be a Statutory Code?

We believe there is no real need to introduce a Statutory Code of Practice especially if it is to take the form of that proposed in the Consultation document. In our view self regulation of our current code of practice (COP) is working; we are complying with all elements of our COP, have no recorded breaches and no cases at either PICA-Service or Pub Independent Rent Review Scheme (PIRRS). We operate positively and professionally with our licensees as business partners and our teams are fully trained on all aspects of our COP. New systems have been developed and implemented to enable us to manage and control our compliance.

We are currently seeking accreditation from the British Institute of Innkeeping Benchmarking and Accreditation Services (BIIBAS) to include the provisions of IFC version 6 within our existing Spirit COP. If however a Statutory Code were to take the form of IFC version 6, we see this as the only tenable solution.

Importantly, we don't believe that a Statutory Code and Independent Adjudicator have to go hand in hand. We believe that significant progress has been made in the sector following the recommendations by the various Government inquiries with regard to developing transparent relationships with our licensees. The costs associated with an independent Adjudicator are unknown but may be potentially excessive and are unnecessary; we believe that the role of PICA-Service and PIRRS provides sufficient escalation for a licensee in the event that we were to default on any element of our COP.

² See appendix 3

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 any supporting evidence.

The Consultation appears to have a level of confusion as to who should and should not be included. In Part 4.22 of the Consultation the Government proposes that the Code should apply to all companies which own more than 500 pubs: "It is clear that this definition should apply at the level of the top company within a group, to avoid pub companies seeking to evade the provisions of the Code by creating a number of smaller companies within a group structure, each containing for example, 450 pubs". Whereas in the associated impact assessment it states in Option 2 that "the Statutory Code would apply to all pub companies with more than 500 non-managed pubs".

We would seek clarification as the above cannot both apply at the same time.

The logic seems disproportionate and we would say that if a threshold of 500 pubs were to be applied it should relate to 500 or more tied tenancy and tied leased pubs only and exclude the ownership of any other pubs e.g. managed, FOT, Tenancy at Will (TAW) and franchise pubs within the threshold calculation.

We reiterate that we would only see a Statutory Code along the lines of IFC version 6 as tenable and this should be binding for both tied tenancy or tied leased agreements. It should not be binding on any pubs that are FOT; temporary agreements (TAW or 1 year agreements), franchised or managed pubs.

We should stress that on a 500 pub threshold as set out above; our business would fall below the threshold. Our position is that whatever the size of the threshold it should be comprised as in the paragraph above.

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?

We believe that focus here has to be just on tied leased and tied tenanted pubs only, not managed pubs or FOT, temporary agreement sites or franchised pubs.

By default, a FOT pub should not be included in a code as the FOT agreement implies more of a commercial property agreement with the pub company. In this instance we would reserve the right to amend our business model and seek a full market rent based on the best price for which the prospective licensee is prepared to pay in the market in the same way as any other property investment company can do. We might also choose not to provide the extent of countervailing benefits that a tied licensee would receive such as our accountancy package (which is delivered at a considerably lower cost than its open market equivalent).

Temporary agreements and one year agreements should also not be bound by a Statutory Code because they involve less investment on both sides and therefore significantly lower levels of risk for the licensee.

True franchise agreements should also not be included in the self regulated or proposed Statutory Code but rather should fall under the guidance and criteria laid down by the British Franchise Association.

Spirit believes that the inclusion of all non-managed pubs in the Statutory Code would be damaging to commercial property markets. It would mean that pub companies would be regulated while other commercial landlords letting properties on a similar basis would be exempt from legislation. Our belief is that all non-managed

pubs should not be included in the Statutory Code, but if they were the consequence of not extending similar regulation to all commercial property (such as High Street shops, restaurants etc) could be a damaging market distortion.

Q4. How do you consider that franchises should be treated under the Code?

We see true franchise agreements as being outside of any Statutory Code and the IFC. The mechanics of the Spirit franchise agreement in our Leased estate differ significantly from a standard tied tenancy, tied lease or “managed tenancy”. The Spirit franchise agreement uses the established John Barras brand combining it with the company’s scale and retail knowledge of how to operate a business successfully having done so in over 100 managed houses of the same brand. The Spirit franchise agreement provides the franchisee with all of the associated intellectual property rights under that brand.

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.

The Spirit franchise agreement also offers a profit share upside for franchisees and Spirit as the business grows and operates without many of the traditional elements of a tied lease or tenancy agreement (such as rent reviews).

In our view therefore true franchises should not be included in any COP other than the guidelines prescribed by the British Franchise Association. We would also ask for further investigation by Government as to whether it is right to include franchising in one sector alone in a statutory COP; where would this leave for example other hospitality retailers such as Subway, Dominos and McDonalds and their associated food / drink supply arrangements?

The franchise model represents a small, but growing, portion of the pubs sector. We believe that it represents a major driver of innovation within the sector. We see franchise as another way of further developing high quality community assets and creating associated economic benefits; for example a typical John Barras franchise investment creates an additional 14 jobs.

We believe that extending regulation to the franchised market segment, while it is growing and represents a new alternative for many pubs, could smother growth in what is an exciting and innovative part of the pub company sector.

Q5. What is your assessment of the likely costs and benefits of these proposals on pubs and the pubs sector? Please include supporting evidence.

We fully endorse the improvements made through the introduction of the IFC and the legal framework that already surrounds this and we have adapted our business model significantly to facilitate this self regulation. On an ongoing basis we are already incurring annualised costs of £200,000 to facilitate appropriate self regulation. These costs include:

- Employment of a Compliance Manager
- Employment of a RICS qualified in-house Surveyor

- IT Software Development for completing RICS guidance Rent Assessments
- A new automated Applicant Management System linked to a new corporate website to ensure we can track new licensee applications at every stage of their pre-entry compliance requirements
- Administration / tracking systems to ensure overall COP compliance at every stage of our business processes
- Business Development Manager (BDM - Area Managers) training in COP and rent assessment
- Weekly Rent Panel chaired by our managing director to sign off all new rents, rent reviews and renewals under RICS guidelines.

The potential introduction of a Statutory Code as described in the Consultation documents alongside a Statutory Adjudicator and industry levy would significantly impact on these costs further estimated by Government as £168,000 but realistically unknown.

We remain very concerned about this additional potential liability and particularly about the potential impact of a Statutory Code on pub companies, licensees and UK economy as a whole. The suggestion/assumption in the Consultation document is that in revenue terms the proposals will be neutral because any loss of income to the pub company is offset by the additional profitability transferred to the licensee. We believe that this assumption is flawed and open to challenge and is highlighted in detail below.

Spirit's concerns are as follows:

In a FOT model, licensees would have to go out to the market place and purchase the services covered by Special Commercial or Financial Advantage (SCORFA).

- Where pub companies own a larger number of pubs the scale by which SCORFA can be provided is often cheaper than that which can be obtained by a sole operator who would have to pay for these on an individual pub basis and at a proportionally higher cost. Our SCORFA value is currently being independently analysed by PWC to establish this point.
 - As part of any balanced assessment, it is important that the countervailing benefits, such as SCORFA, are not disregarded or undervalued when considering the policy objective.
- **The assumption that licensees will choose to invest (when pub companies would not) is also flawed** given that:
 - (a) many pub tenants across the sector are on short leases which may well be non-assignable and which provide little incentive for investment
 - (b) the ability of licensees to invest is severely constrained by the availability of bank finance

(c) traditionally licensees have chosen to mortgage/remortgage their homes to raise money to buy leases but this has been adversely affected by a largely sluggish house market.

- **By contrast it is the pub company which has the longer term interest in improving the quality of the pub and has the access to capital for investment.**³ If a Statutory Code is enacted, this may well have a negative impact on investment because:
 - A Statutory Code will constrain the ability of pub companies to set rents to justify investment decisions. If a licensee is on a FOT arrangement then there is little incentive to provide financial support for minor investment and other contributions which fall short of a major refurbishment where usually the only return on capital will be the rent and this is fixed and cannot be increased (particularly beyond RICS guidelines).
 - There is a false assumption that requiring a pub company to offer a FOT lease will encourage licensees to invest. The terms of the FOT lease will probably make investment unattractive since the only source of income to the pub company is rent; the pub company might well wish to grant a shorter lease or one with a break clause and contracted out of the security provisions of the Landlord and Tenant Act 1954 to be able to recover possession and convert the pub into a managed house for example.
 - In such circumstances the licensee would not be entitled to statutory compensation for disturbance and be unlikely to be entitled to compensation for improvements or for the goodwill of the business.
- **The Consultation takes no account of the fact that pub companies, such as Spirit are the existing freehold owners.**
 - The tied model enables a licensee to set up their own business at a lower cost of entry than would ordinarily be the case.
 - Were pub companies forced to adopt relationships in line with general commercial property practices, in absence of the tie, it would be necessary to adapt our business model, with, increased costs at entry and much higher rent.
 - The alternative would be for pub companies, pursuing value for shareholders, to explore other alternatives for the use of our property portfolio in order to maximise yield.
- **The interests of consumers do not appear to feature heavily in the Consultation document but they should be addressed.**
 - The assumption is that consumer choice will be improved if the tie is relaxed (with a guest ale provision) or if the licensee goes free of tie. This is not supported by evidence.

³ See Appendix 1

- Spirit, in line with other pub companies, offers a range of 150 cask ales and also provides access for our licensees to an extensive portfolio of ales supplied by the Society of Independent Brewers Association (SIBA).
 - The Department for Business, Innovation and Skills (in its response to the Business, Innovation and Skills Committee's most recent report on pub companies) has acknowledged independent data that shows that tied pubs are less likely to close than FOT pubs.
 - It is a business reality that the higher the fixed costs in any business (which a FOT arrangement would have with rent), puts additional strain on cash flow. Higher fixed rents have historically meant higher levels of business failure particularly in times when sales fall.⁴
 - The benefit of a tied arrangement is that the total cost of goods bought from the pub company (wet rent in effect) falls when sales fall. With a FOT arrangement, when sales fall the higher fixed rent still remains payable.
 - Business failure is not in any pub companies interests as each time a pub fails it costs our business an estimated £25,000.
 - The impact failure can have on a licensee, their staff and the local community can be devastating. This is likely to mean than many, smaller community pubs will become unviable for both pub company and licensee as any economic value will in effect be passed to third parties. We therefore have a shared agenda with our licensees to ensure their business succeeds. It is in no-one's interest to have communities with even larger numbers of boarded up premises.
- Given the large numbers of FOT pubs in the market place choice is available to a prospective licensee who wishes to acquire a lease of a pub FOT.
 - It should not be compulsory for a pub company, which does not consider that the FOT pub model is appropriate for a particular pub to be forced to offer it nonetheless.
 - A consequence of the proposed Statutory Code is that licensees will likely purchase freeholds through a brewery loan rather than a bank and ultimately be tied much more strongly with less choice in any event.

Q6. What are your views on the future of self-regulation within the industry?

We fully endorse self regulation and we take our responsibilities under self regulation extremely seriously. We acknowledge the changes in the ways of working between pub companies and their licensees that the various Government inquiries have influenced and the improvements that are continuing to be made.

We are proud to have placed our current COP on a legal footing with our licensees and believe there is a sufficient escalation process in place already via the PICA-

⁴ See appendix 2

Service and PIRRS in the event of a breach of our code; or if a licensee believes we have not acted within the spirit of our code.

PICA-Service and PIRRS are established and working and the new PICA-Service regulatory board will provide further improvements and greater accountability. We would ask the Government to recognise these bodies formally and were this to be the case then we would suggest that a Statutory Code along the lines of IFC version 6 plus PICA-Service and PIRRS could be appropriate.

Our experience in our business is that we are able to resolve and manage issues effectively because of our COP and self regulation. Self regulation provides clarity and professional ways of working for both parties in what is entirely a voluntary business partnership.

We believe there is evidence to show that self regulation is working and in an environment where there is a will to reduce red tape for small businesses the irony is that a Statutory Code would only serve to defeat this aspiration. Accreditation of a revised Spirit Leased COP is currently underway in line with IFC Version 6. In our view the changes in this COP go sufficiently far enough to further improve self regulation and it would make sense therefore to allow more time for these to become embedded.

Q7. Do you agree that the Code should be based on the following two core and overarching principles?

- ***Principle of Fair and Lawful Dealing***

We absolutely agree that our licensees should be treated lawfully. The principle of fair and lawful dealing, however, as described in the Consultation is unclear. There is no clear definition of "fair"; as a term it is akin to "reasonable" which has defied definition. Guidance ought to be given as to the full meaning of "fair and lawful dealing" rather than leaving it to the court to decide in the event an issue arises.

Our agreements are also legally binding and preserved in the law of contract and Landlord & Tenant Act 1954. The Spirit Leased COP is also legally binding and our ways of working are administered within this framework. In addition to this, we believe we are also currently governed by sufficient existing law including the Misrepresentation Act 1967 (which affords a licensee rights if they wish to allege that false statements have been made to induce them to enter into an agreement) and the Unfair Contract Terms Act 1977 (which goes some way in a consumer context to identify situations where a term may be unfair and uses the concept of reasonableness).

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

We understand and agree with this principle. As a pub operator we want our tied licensees to make a success of their business. Our success relies on our licensees' success and our investors rely on us to protect that success for the long term.

The assessment and application of FOT principles is complex and needs to be comprehensive if it is to be equitable and equivalent. The current principle appears to take no account of:

- The ownership status and the cost of the financing of the pub asset

- The absolute true value of SCORFA (tangible and intangible benefits) provided
- The fact that a tied pub's dry rent is significantly lower than a commercial property rent (not one restricted by a 65% Divisible Balance rate)
- The fundamental basis of risk and reward in a tied licensee relationship.

It follows that the challenge of establishing a clear and predictable basis of measurement that will minimise the risk of disputes arising may be considerable. We would ask Government to weight the importance of these factors when considering this principle accurately.

Q8. 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 licensee's control.*

Our common agenda with the Government is to support jobs, growth and wealth generation for all and it is very important that through our tied relationship we can share risk and reward with our licensees. Under our current ways of working we allow our licensees the right to request an open market rent review and see this again as being adequately covered through self regulation and IFC Version 6.

- 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.*

In principle we can fully appreciate why the Government is proposing this. We would refer to our views outlined to Question 7 and would like to emphasise the benefits of the tied agreement to ensure this issue is fully understood. What we share with our tied licensees comes partly from the value derived from our scale, leveraging this through a central procurement function and the fact that we own the asset in the first place. The proposal in the Consultation takes no account of this and we believe it could fail. We do believe that how we derive our rents currently is transparent because of our compliance with RICS guidance and the IFC requirements (V5 and V6).

We would advise that the philosophy of using this method of rent assessment in parallel is questionable. To give the right balance we suggest this principle should recognise and address the following:

- The value of the ownership of the asset included in SCORFA.
- The difficulties in assessing an industry standard acceptable SCORFA.
- The true value of SCORFA and how difficult it is to quantify; this takes no account of the cost of the pub asset or many intangible benefits provided e.g. accommodation.
- The benefits we provide under SCORFA can only be secured if they are procured through our economies of scale and should not be open to debate

and dispute. Because of these benefits, the chances of a licensee operating a business more successfully than a FOT business are greater. We do not believe that a licensee should therefore be able to pick and choose elements of SCORFA as we see that this could lead to uncertainty, difficulties with business planning, free-riding (where one licensee unfairly benefits from the wider investments or commitments of others) and further failure. It may also impact on our ability to provide these scale benefits to other licensees.

- The basis that SCORFA is a source of commercial advantage and will have a greater value in terms of tangible benefits from larger pub companies.
- SCORFA is assessed by each pub company using commercially sensitive information and would therefore not be fully available to analyse as it is a source of competitive advantage.
- On the open market the equivalent of SCORFA benefits may not be realisable by many FOT licensees. Understanding the cost through a parallel assessment would be apparent but realising the value that benefit brings might not. This would mean some FOT licensees might not access (through their own cost or cash flow) business benefits that are intrinsic to the wet rent and the associated business support and benefits provided by a tied agreement.

As a true comparison an amount must be included to reflect the value of the free accommodation provided to a tied licensee and or the cost of a brewery loan or a bank loan/mortgage for the same property the licensee would have to access (to own that same asset).

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

We believe that a gaming machine tie provides a licensee with real benefits and that abolishing this tie would have a detrimental impact on their profitability (see below). We can very easily offer a licensee the option of being free of tie on gaming machines and this option exists at the moment with little take up. We would question therefore the reasoning why there is a need to abolish a gaming tie, or the validity of such a step from a wider competition law perspective.

In addition to this we would also seek to clarify why one sector should have to exclude other ties in their business models e.g. food where this is providing a clear advantage to the licensee (scale, expertise, menu creation and training) and another sector i.e. fast food franchises, where no such requirement is proposed. This proposal seems to be a disproportionate measure and we cannot find any foundation for it. Further, in our view, it represents entirely unjustifiable and unnecessary regulation and conflicts with the Government's commitment to reduce red-tape.

We would emphasise to Government the benefits of the current ties:

Machine Tie:

- A well managed machine portfolio can derive greater levels of benefits to the licensee and we would ask the Government to seek detail on the additional profit to the licensee derived from the machine tie from major machine suppliers.

- With our current tie on machines we are able to ensure that the high quality of machines in our pubs is maintained and that the presence of unregulated machines is limited. The consequences of unregulated machines include reduced tax revenue and we believe the machine tie is in the public interest and mitigates this risk.
- Spirit Leased machine managers ensure that all licensees are registered for Machine Gaming Duty and help with this registration process. If the machine tie were abolished this service could be withdrawn with the likely result being a reduction in MGD revenue and compliance.
- Our service level agreements with our machine suppliers ensure that our licensees' machines are rotated regularly to optimise the profit of these machines and the associated benefits this brings.

Other Ties:

- The proposed removal of other ties would impede innovation and restrict investment. For example a number of our licensees are choosing to buy their food from us which includes some significant benefits:
 - Certainty and integrity of supply
 - Lower cost of food goods by leveraging our scale
 - Training of the licensee's kitchen team and front of house team to ensure the quality delivery of a strong food offer and Health & Safety obligations are met.
 - All marketing and communications material internal and external relating to the food offer
 - Ongoing menu development and menu change
 - Reverse logistics on waste management enabling licensees to save money on their waste recycling costs.

This is part of a packaged approach of business support using our scale and expertise and provides the licensee with a much more compelling food proposition, better food margins and a stronger business. It therefore leads to the retention and creation of jobs and successful pubs as community assets. Removing the opportunity to include further non wet ties would remove the ability to improve the consumer offer for our licensees and the benefits described.

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

We appreciate the logic behind the proposal that "a guest beer option will provide a greater degree of consumer choice and strengthen community links", however we would seek clarity on two points:

- We currently offer a range of 150 cask ales from 59 British Breweries and access to a further 3,000 locally brewed ales available through SIBA. On that basis we are unsure as to the benefit a guest beer would bring. We could understand that there may be benefit in having a guest beer defined as "a locally brewed cask ale" thereby supporting the Government

position on strengthening community links. That aside, we already provide significant choice for the consumer, alongside the guarantee of a route to market for British breweries (some of whose products would already fall within the definition of guest beer referred to above) of circa 15,000 barrels of cask ale per month.

- If a mandatory guest ale option comes in, British brewers who currently have a wide distribution of their cask ales brands may find they lose the volume of guaranteed route to market that they have established in the sector.

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 tie is an intrinsic part of our tied agreements and we need to be able to utilise technology to help us understand a licensee's compliance with purchasing obligations. Like any other person, we have a legitimate expectation to be able to monitor and enforce our legal rights where those rights are entirely consistent with applicable laws. Flow monitoring investment also provides significant benefits to licensees; we estimate that each licensee currently sees a minimum of £1,312 per year additional net profit through the use of the information obtained from the system.

Our use of flow monitoring equipment is consistent with the IFC; we do not use evidence from flow monitoring equipment in isolation. If this proposal has been made because it challenges the quality of the evidence that may be provided by flow monitoring equipment we would like to suggest that a judge would determine whether the evidence was satisfactory. We believe that current law provides adequately in this area for relevant challenge and therefore that this proposal is unnecessary.

We would also like to stress that flow monitoring equipment provides real value to our licensees in a number of areas (see below) and we believe that the introduction of the above would impact on any further investment by Spirit Leased in terms of flow monitoring equipment and there would be associated consequences.

- We have invested £2.3m this year in new i-Draught flow monitoring equipment for our pubs and believe the benefits to the licensee of this system are significant. The i-Draught package is a substantial management tool for our licensees to use, measuring throughput of products, yield and quality metrics of temperature, line cleaning and low throughput lines. It provides important management information in real time and controls which ensure the licensee has the right products on the bar for their consumer and to maximise their profitability. There is no charge for the use of this equipment to our licensees.
- The investment in tie compliance technology is also in the public interest as it supports the protection of VAT revenue for the Government. Therefore we do not believe that proposing that flow monitoring equipment cannot be used is in the public interest.

Q9. Are there any areas where you consider the draft Statutory Code (at Annex A) should be altered?

We believe that a Statutory Code should mirror that of the IFC Version 6 and the proposed enhancements within the Statutory Code are unnecessary. A Statutory Code should in our view introduce the rent setting methodology as outlined in IFC Version 6 only, therefore not include a SCORFA value and parallel rent assessment

of tied vs FOT (Please see more detail in our response to questions 5, 7 and 8 ii). If SCORFA is to be included in a Statutory Code rent assessment we believe it would need to address our recommendations in question 8 ii.

We summarise below where we believe there should be adjustments to Annex A.

- **Part 1 – Objective of the Code**

2. a and b. Please see our response to Q7.

- **Part 2 – Pre-Contractual Negotiations**

6. a. ii *“Has completed accredited pre-entry training which meets the Qualification Curriculum Authority’s standards”* – Clarity is sought over what the standards are in this context before any response can be made to this.

6. b.ii. *“A sensitivity analysis examining the business performance on an increase/decrease in business income”* – this needs to specify the sensitivity required e.g. 10% movement up or down in sales; without this it will be open to dispute and debate going forward.

9. a. vii. *“The capabilities and training needs of the Tenant and the Tenant’s staff”* – We are more than happy to provide training to our licensee’s team at the licensee’s request. However the capabilities of the staff who work in the pub will be the responsibility of the licensee who employs them. It is important to make this distinction; when a new licensee takes occupation TUPE regulations apply and the pub company is not accountable for the capability of the staff. We have no contractual relationship with the staff in a tied leased or tenanted pub.

9. c.v. *“A Schedule of Condition identifying the state in which the premises are being provided etc”*. We do not agree with this proposal given that our tied tenancy and lease agreements have obligations on the licensee to put the property in good order and keep the property in good order (known as a put and keep agreement). We do provide a Schedule of Dilapidations for both the outgoing licensee and the ingoing licensee to be explicit about the repairing obligations on their agreement that are outstanding at that time. The key distinction here for our agreements therefore is the requirement for a licensee to return a property to us in good condition and not necessarily the same condition that it was in when they took occupation.

9. h.iii *“The process for agreeing a schedule of wants and repairs in line with the schedule of condition”*. See as per above.

- **Part 3 – Rent Assessments**

10. a *“The rent assessment statement must include the minimum content set out in Annex A to this code”* – Please see our response to question 8 Part ii which outlines our concerns about including SCORFA assessments and parallel tied/FOT rent assessments. We believe that how we derive our rents using current RICS guidance and the rent assessment in IFC Version 6 provides for a realistic rent assessment.

16. b *“The pub company makes a significant alteration to the price at which it supplies Tied products to the tenant”* - We currently review rents when a request is made and in line with the terms of an agreement. However we believe there is

more clarity required here over what a significant alteration in price means. This current proposal is vague and may be open to abuse.

17 and 18 – We agree with these improvements

20 *“Upwards only rent assessments shall be considered invalid and unenforceable”* – We have voluntarily withdrawn UORR clauses in tied tenancy and lease agreements under self regulation and we would continue to agree to this for tied tenancy and lease agreements only. If a mandatory FOT option is included in a Statutory Code then the resulting lease is no different to a commercial lease for any business and we may require the right to implement UORR in accordance with the Code for Leasing Business Premises in England and Wales. Please see our response to question 11.

22, 23, 24. Tied vs FOT Rent Assessment - Please see our response to Questions 7, 8 ii, and 11. We believe this approach in the Annex A is simplistic and fails to address the fundamental understanding and benefits that the tied model provides the licensee. It also does not consider the fact that the pub company owns the asset in the first place.

27. *“Where drinks are supplied under a tied agreement, the pub company must provide the tenant with a ‘guest beer’ option”* - Please see our response to Question 8 iv.

29. *“No products other than drinks may be tied”* - Please see our response in Question 8 iii. We disagree with this proposal.

30. *“Information obtained from flow monitoring equipment may not be used for the purpose of determining whether a Tenant is complying with purchasing obligations, nor may it be used or considered as evidence when taking enforcement action on purchasing obligations”*. Please see our response in Question 8 v. We believe this proposal lacks understanding about the information that can be used to fully understand the circumstances upon which the tie has potentially been breached and the added value benefits this equipment can provide to a licensee. We describe in Question 8 v how we do not use flow monitoring evidence in isolation.

- **Part 6 – Miscellaneous Provisions:**

37 and 38 *“Keep or maintain the building... Schedule of Condition should be referenced”* – Please see our comments above in Annex A 9.c.v.

- **Part 7 – Pub Company Codes of Practice**

42. *“If the Pub Company produces a Company Code of Practice it must be provided to all Tenants”* – We do not agree with this proposal and outlined in Questions 3 and 4 we do not believe that our COP should include TAW, 1 Year, FOT or Franchise.

- **Part 8 - Compliance**

46 – *“Annual Compliance Report”* – In principle we have no issue with this proposal, however we would seek confirmation as to the exact requirements of this report and clarification on any data protection impact. We believe that PICA-Service and PIRRS provide appropriate regulation in this area now.

- **Part 9 – Dispute Resolution**

50 to 53 – Dispute Resolution – We agree that we must take all reasonable steps to resolve any disputes that arise under our COP swiftly. We do not agree with the need for a Statutory Adjudicator and believe that IFC Version 6 sufficiently addresses this area.

Q10. 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 three overarching principles?

We do not believe that a Statutory Code should be introduced. If, however, a Statutory Code is to be introduced it should mirror IFC Version 6 and be reviewed every 3 years. Depending upon the impact of the threshold, it may be the case that a voluntary code will in any event operate alongside a Statutory Code, and the potential for confusion and unfairness should not be underestimated.

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

We understand why this question is raised but do not agree that a FOT option should be mandatory. To answer this question fully we would highlight the benefits of a tied agreement and the consequences of a mandatory FOT option if this were to be introduced.

In summary a tied agreement is valuable and offers the following benefits to a licensee:

- Low fixed rents - the proposal takes no account of the fact that the pub company owns the asset compared to the initial financial outlay and ongoing borrowing commitment required by a licensee to purchase a freehold property.
- Sharing of risk and reward. A licensee pays a lower fixed rent than they would otherwise taking a commercial lease. They may pay higher prices for the drinks they purchase because of the tie. When demand fluctuates the downside is shared with the pub company when sales fall in terms of less wet rent paid.
- There are SCORFA benefits because there is a tie. A licensee would, we believe, pay a higher cost on the open market if they were to try and source these benefits themselves. Many would not access these benefits (due to inertia, market unavailability or cashflow constraints) and in our view this would have significant consequences for the success/failure of their business.
- Capital made available by the pub company for investment.⁵
- The protection against high Head Rents. Head Rents are the pure costs paid on the same pub property by the pub company. At Spirit Leased we currently have 100 pubs in our estate with head rents which are circa 60% higher than the rent for the same property charged to our licensees. We would have to consider reviewing our model to cover our costs of renting the property in the first place if a FOT option were to be made mandatory.

⁵ See appendix 1

The consequences we believe of introducing a mandatory FOT option would be far reaching and ultimately would affect the small business and the licensee as detailed below. We reiterate that we have a common agenda with Government and it is in our interests for our pubs and licensees to be successful. We highlight below the potential negative consequences of a mandatory FOT agreement by building on our answers in question 5:

- Fixed rents would need to increase to at the very minimum 65% of divisible balance and would very likely result in a review on how we model our business. We do not wish to become a pure property company which this proposal would infer; the scaling back of SCORFA may occur putting more strain on the costs to the licensees and their potential for success. In our experience the higher the fixed costs in any business the more strain you put on cash flow.⁶
- Upward only rent reviews (UORR) may have to be re-introduced to make up the loss of margin to a pub company to secure a sufficient return for its business owners and therefore in our view there should be no restriction on UORR if a FOT option be made mandatory.
- We should be able to seek a full market rent based on the maximum rent achievable and there would have to be no restrictions on the terms on which a lease or tenancy was granted if it was FOT.
- There should be no requirement that the commercial terms offered on a FOT basis should match those of a tied tenancy or tied lease.
- Business support would be significantly reduced; the tied arrangement allows the flexibility to support a licensee in distress, for example through rent concessions, rent reviews, retail advice and investment.
- Prices would rise. Basic economics shows that discounts from suppliers through the purchasing power of the pub companies would no longer be available. Licensees purchasing on their own would have less purchasing power and prices would increase. On the flip side larger suppliers may reduce their prices in the short term by significant amounts to price smaller suppliers and British breweries out of the market.

Q12. 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?

In our view self regulation and the benefits we provide to our tied licensees achieve this already.

Commercial property on the High Street provides a relevant comparison showing significant stress (according to Price Waterhouse Coopers (PWC) 20 stores closing a day in 2012) because of the fixed costs of a commercial rent. The absence of a tie would suggest that pub rents will increase to commercial rents.

⁶ See appendix 2

Spirit encourages the Government to allow the sector to continue with self regulation and a tied business model and trust in our responses above as to the benefits the tied model provides the licensee.

We would also ask that there is a review of Business Rates. Tackling the setting of business rates and the appeal process would provide a lifeline to many licensees and High Street retailers. The appeal process for a review of business rates is laborious; a business rate appeal could take up to 12 months based on now unrealistic property values set in 2008 which will now extend to 2017.

Duty continues to be one of the biggest burdens to our pubs and we would stress that Government freezes the escalator on all alcoholic products, not just beer going forward.

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

We do not believe an independent Adjudicator should be appointed to enforce any new statutory code and summarise our reasons below:

- Self regulation is working and the principles of PIRRS and PICA-service are now established. They already offer an effective, low cost dispute resolution service for licensees. We would urge the Government to encourage the use of these services instead.
- A Statutory Adjudicator is also unnecessary on the ground of cost, additional red tape and the number of actual complaints made to the BII.
- The Consultation states that "even accounting for some overlap, overstatement and mis-categorisation, there are hundreds of complaints per year and these are just those where mistreatment is actually reported". However this is anecdotal evidence and no further clarification is provided to support this statement.
- BIIBAS has provided further clarity on their "complaints" statistics. They state that they received a total number of 600 calls (not necessarily complaints) over the last three years to their helpline. This could equate to an average of 200 calls (not necessarily complaints) a year to a Statutory Adjudicator which at an annual cost of £900,000 (Impact Assessment) would mean that £4,500 per call would seem unjustifiable.

Q14 Do you agree that the Adjudicator should be able to:

i. Arbitrate individual disputes?

A distinction should be drawn between disputes over rent (whether at rent review or on the renewal of a lease) under the Landlord and Tenant Act 1954 and complaints concerning breaches of the COP. To address this we need to ensure that the existing self regulation framework (PIRRS and PICA-Service) and laws are given the appropriate support to continue to operate as efficiently as possible.

Clarity is required as to what an individual dispute means. If it relates only to issues regarding the COP, in our view a Statutory Adjudicator and the associated costs are

excessive. There is already a low cost alternative available for dispute escalation which is working.

If disputes are related to rent then again there are already clear processes available to determine these under existing laws including arbitration, independent expert determination or PIRRS. The proposal therefore that the Adjudicator should decide rent disputes is unrealistic and unnecessary.

We also would like to highlight that a two tier system i.e. some disputes being assessed by an Adjudicator and some continuing under the established regime may result in very different decisions, costs and disparities across the sector and with licensees.

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

We do not believe an Adjudicator should be able to carry out investigations into widespread breaches of the Code. Version 6 of the IFC is explicit around our obligations in all areas. We are also very clear about our obligations under competition law and responsible pub retailing. Our current COP is legally binding and therefore we would expect potential breaches of code to be based on sound evidence and if the escalation options available do not effectively remedy any widespread breach we understand that the court can currently decide.

Q15. 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?***

We believe that all three areas here are adequately provided for under current self regulation and therefore there is no need for an Adjudicator.

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

The self regulatory requirements are extremely thorough and if a Statutory Code were to be introduced we would recommend that the reporting remains the same if the annual reporting requirement mirrors that of the IFC Version 6.

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? What, in your view, would be the impact of the levy on pub companies, pub tenants, consumers and the overall industry?

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.

The impact of introducing the proposed levy could be significant in terms of increased costs to the licensees and pub companies. We acknowledge that a welcome consequence of self regulation has meant significantly more transparent relationships with our licensees and as a result far fewer complaints. We do not therefore believe that an industry levy is appropriate as it also adds additional red tape and bureaucracy.

The impact at an industry level might mean us passing on additional costs to our licensees and ultimately the consumer.

Appendix 1 - The Contribution to the Economy – Spirit Pub Company and the Pub Sector

Spirit Leased is a division of Spirit Pub Company PLC and operates 463 leased, tenancy and franchised pubs across England, Scotland and Wales. Of those 463 pubs, 3 are FOT.

Given that our estate comprises predominantly former managed pubs that have transferred to a lease or a tenancy, we have some of the best and largest pubs in the sector, providing compelling business opportunities for entrepreneurs.

Key Statistics:

- 65% of our tied licensees are operating their pubs on long term tied leases.
- We currently work in partnership with 83 multiple operators who are choosing to operate either a tied tenancy or tied lease with us in a total of 133 of our pubs. Those multiple operators may also be tenants or lessees of other pub companies in other premises.
- Due to the larger than average size of our pubs, our licensees employ in the region of 7,000 people, making a valuable contribution to the wider economy and the sustainability of pubs as community assets.
- We have invested £12 million in our estate in the last 12 months. A combination of investment and job creation has increased revenue to the Government in terms of VAT, National Insurance and tax contributions.
- On average every time we make a significant capital investment in one of our Spirit Leased pubs we create up to an additional 14 jobs.
- Building upon the experience of the very successful Apprenticeship programme in our managed pubs we are rolling out a similar programme to our leased and tenanted pubs.
- We see an investment in training our licensees as critical to their business success. We have now trained 20% of our licensees and their teams within the Spirit Leased business in a mixture of areas including customer focus, sport, upselling, delivering great cask ale and food and investment launch training.

Economic Overview of the Benefits of the Pub Sector

The pub sector provides a valuable contribution to the overall economy:

- The sector contributes £19 billion to the UK GDP and generates £10 billion in tax revenue (British Beer & Pub Association BBPA).
- For every pint sold in a UK pub 98p is paid in duty to the Government (BBPA 2012).
- The pub sector alone pays close to £13 billion in wages (BBPA).

- In the UK alone 949,000 jobs are supported by the pub sector (BBPA 2013) with 46% of those being young people aged between 16-24 (BBPA).
- The industry generated 1 in 8 new jobs (Association of Licensed Multiple Retailers - ALMR) and the average pub employs 21 people compared to 7 in 1998 (ALMR).
- The average pub generates £160,000 GVA for its local community (BBPA).
- The pub sector contributes significantly in direct taxes (BBPA and Oxford Economics 2011):

| | |
|-----------------|----------------|
| Corporation tax | £822 million |
| Income tax/NI | £2,143 million |
| Excess Duty | £678 million |
| VAT | £4,922 million |
| Business Rates | £848 million |

- The pub sector served 20 million meals and 3.6 million coffees last year ensuring a valuable VAT contribution to the economy (ALMR).
- The pub sector comprises 50,395 pubs (BBPA). Of that total, around 27,000 pubs are operated under the tied lease and tied tenancy model. These pubs are independent, bespoke and unique, playing a major role in their communities or the UK tourism market.

Appendix 2 - What happens to profit when sales decline when comparing tied with FOT

Based on a typical 395 barrel pub with average operating costs

This is a simplistic example that shows tied versus FOT and what happens to profit at different levels of sales.

When sales fall the higher fixed rent under a FOT arrangement becomes a significantly higher proportion of a lower turnover figure than in a tied model.

It can be seen that the licensee's net profit becomes more at risk with a FOT agreement and hence there is even greater likelihood of business failure in this scenario.

Original Tied Model Scenario

Average discount per barrel Licensee receives = £127.

Discount applies to all beer and cider products

| | |
|--------------------------------------|-----|
| Beer and Cider Annual Barrelage: | 395 |
| Rent Split of the Divisible Balance: | 50% |

| | £ | % Turnover |
|--------------------------------------|----------|------------|
| Original Sales Level | | |
| Turnover: | £461,062 | |
| Gross Profit (net of Cost of Sales): | £260,104 | 56% |
| Operating Costs: | £161,283 | 35% |
| Fixed Rent (50% DB): | £49,410 | 11% |
| Licensee Post Rent Profit: | £49,410 | 11% |

| | | | |
|------------|--------------------------------------|----------|-----|
| Sales -10% | Turnover: | £414,955 | |
| | Gross Profit (net of Cost of Sales): | £234,096 | 56% |
| | Operating Costs: | £154,572 | 37% |
| | Fixed Rent (50% DB): | £49,410 | 12% |
| | Licensee Post Rent Profit: | £30,114 | 7% |

| | | | |
|------------|--------------------------------------|----------|-----|
| Sales -20% | Turnover: | £368,849 | |
| | Gross Profit (net of Cost of Sales): | £208,084 | 56% |
| | Operating Costs: | £147,861 | 40% |
| | Fixed Rent (50% DB): | £49,410 | 13% |
| | Licensee Post Rent Profit: | £10,813 | 3% |

Same Example but Modelled FOT

Equivalent average discount per barrel Licensee would receive = £229

| | |
|--------------------------------------|-----|
| Beer and Cider Annual Barrelage: | 395 |
| Rent Split of the Divisible Balance: | 65% |

| | £ | % Turnover |
|--------------------------------------|----------|------------|
| Original Sales Level | | |
| Turnover: | £461,062 | |
| Gross Profit (net of Cost of Sales): | £300,750 | 65% |
| Operating Costs: | £161,283 | 35% |
| Fixed Rent (65% DB): | £90,058 | 20% |
| Licensee Post Rent Profit: | £49,410 | 11% |

| | | | |
|------------|--------------------------------------|----------|-----|
| Sales -10% | Turnover: | £414,955 | |
| | Gross Profit (net of Cost of Sales): | £270,679 | 65% |
| | Operating Costs: | £154,572 | 37% |
| | Fixed Rent (65% DB): | £90,058 | 22% |
| | Licensee Post Rent Profit: | £26,049 | 6% |

| | | | |
|------------|--------------------------------------|----------|-----|
| Sales -20% | Turnover: | £368,849 | |
| | Gross Profit (net of Cost of Sales): | £240,602 | 65% |
| | Operating Costs: | £147,861 | 40% |
| | Fixed Rent (65% DB): | £90,058 | 24% |
| | Licensee Post Rent Profit: | £2,683 | 1% |

Example assumes machine is shared and is therefore excluded from the model

Wages are assumed to be variable and hence operating costs come down in absolute terms but the % of sales represented by operating costs increases at lower levels of turnover

Appendix 3

1. The Government's Response to the House of Commons Business, Innovation and Skills Committee's Tenth Report of Session 2010-2012: Pub Companies – November 2011, page 3 notes that: *Data produced by (research consultancy) CGA Strategy clearly shows that between December 2008 and June 2011 more free-of-tie pubs closed than tied pubs, both in absolute figures and as a percentage of the total number of pubs in that category.*
2. In Paragraphs 106 and 107 of the European Commission's 2010 Guidelines on Vertical Restraints (2010/C 130/01)
3. The application (and, by correlation, the implementation) of national competition laws to agreements or concerted practices within the meaning of Article 101 (1) of the Treaty on the Functioning of the European Union may not lead to the prohibition of such agreements and concerted practices if they are not also prohibited under EU competition law. This principle is enshrined in Article 3 (2) and Recital 8 of Council Regulation No 1/2003.