"Pub Companies and Tenants: A Government Consultation" (22 April 2013)

Response of Wellington Pub Company plc

Introduction

Wellington Pub Company plc ("Wellington", "we" or "us") welcomes the opportunity to comment on the Consultation.

We are pleased that the Government recognises the importance of the pub sector to the UK economy and it should also be noted that the sector has wider social benefits too, particularly in smaller communities. We wish to see a strong, vibrant and diverse pub sector in the UK and, through our actions, help to promote the sector. For example, we often offer pub tenants rent free periods and concessionary rents for the first couple of years to help them establish a trade from the premises.

We are sure the Government shares those aims but are concerned that the proposals set out in the Consultation will not only fail to achieve those objectives but – for reasons explained below – will actually undermine and harm the pub sector.

Before we address the specific questions raised in the Consultation we think it would be helpful to explain that Wellington is not a "pubco", but rather a commercial property company that happens to own a large number of properties that are leased to tenants who operate a pub business from the premises. We have no association with, or connection to, any brewery or other pubco. To the extent we have any dealings with breweries or pubcos, these are all on arms' length terms. That we are not a pubco is reflected in the fact that at no time have we ever been involved in discussions within the pub industry about self-regulation.

We are, nonetheless, responsible landlords and recognise that the welfare of our tenants is important to us. Ultimately, if our tenants are happy and successful that is good for our business. Our commitment to the welfare of our pub tenants is demonstrated by the fact that we vet new tenants carefully, asking them to submit a business plan stating their experience within the industry, plans for the property, proof of funds and a projected cash flow. All our prospective tenants are also advised to seek professional advice before signing a long term agreement and our leases give tenants the ability to appoint a third party arbitrator at rent review if they disagree with our rental assessment, and all long term agreements are fully protected under the Landlord and Tenant 1954 Act.

We are, simply, a property company that owns a wide variety of different types of property including restaurants, retail, office, residential as well as pubs. As a property company we are not, therefore, as well-placed as others to comment on certain questions raised in the Consultation. However, we are well-placed to comment on the suggestion that the statutory Code should apply to commercial landlords with no connection to, or arrangements with, brewers or pubcos. We are strongly opposed to the suggestion that any statutory Code that may be introduced should apply to such commercial landlords. There is no reason, or legal basis, to make commercial landlords of pubs, but not other types of premises (e.g. shops, restaurants, offices etc.) subject to a statutory Code whose objective is to ensure that tied tenants are no worse off than free-of-tie pub tenants.

In this respect, we note, and agree with, the recent comments made by a spokesperson for a Liberal Democrat-led council which owns a pub in Bath. The spokesperson for the council, which is reported to own 25 pubs, is quoted as saying that:

> "*The council is not a pubco. The framework [in the Consultation] refers to tied or leased pubs, i.e. those with a brewery as landlord, and not commercial leases. The council's policy is to agree commercial contracts for its premises on market terms whatever type of business approaches us for negotiations. The comparison between a pubco and commercial estate provider is irrelevant. For example, there is no beer tie with a commercial estate provider that usually accompanies a rental agreement with the pubco.*"

The full article from which this quote is taken is available at: http://www.morningadvertiser.co.uk/General-News/Liberal-Democrats-come-under-fire-over-upward-

only-rent-review-clause-in-council-owned-pub/?utm_source=newsletter_daily&utm_medium=email&utm_campaign=Newsletter%2BDaily&c=3ZHG91J1m%2Fj%2Fis9Ger46ELux0Ew4vHoC

In light of the above, our views can be summarised as follows:

- The pub sector is an important part of the UK economy and can play an important role in fostering social cohesion and community spirit.

- Statutory regulation is generally not the most effective and efficient way to promote competition. Statutory regulation often stifles innovation and should be avoided unless there are strong and compelling reasons for it (e.g. to address natural monopolies or oligopolistic market structures).

- Regulation (if adopted) should be proportionate and non-discriminatory. In addition, regulation should only be introduced following a careful assessment of the evidence whose accuracy and completeness should be properly verified.

- If, in any particular case, the Government decides statutory regulation is appropriate, the net of such regulation should be cast narrowly to cover only those parties whose activities are the subject of the matters under consideration. The net of regulation should not be cast too widely to catch other entities which only have a peripheral connection with those matters.

- Careful consideration should be given to the unintended consequences that may flow from any proposed action, especially as market forces are likely to lead to changes in the way market participants operate once they adapt their behaviour in response to statutory regulation.

- We are concerned that the proposals detailed in the Consultation will actually harm the existing pub industry as it is likely to force some pubs and smaller breweries to close, ultimately leading to less choice for consumers.

- So far as Wellington is concerned, if the Code (as currently envisaged) comes into force our entire business model will be adversely affected as it will restrict the terms on which we are able to let our properties as pubs (and increase the costs of doing so). The end result is that in many instances it will not be commercially viable for us to invest in and improve our pubs in the way we have done to date. This is because of the unintended consequences of the Code, especially the suggestion to prohibit upwards only rent reviews; for example, there will inevitably be instances when it will not be commercially viable to support pubs within our portfolio as the Code will not only increase our costs but will give rise to a significant degree of uncertainty as to our long term income streams on which investment decisions are based. Consequently, we believe there is a material risk that the Consultation will be self-defeating as the current proposals are likely to lead to less investment in, and support for, pubs in the UK, which will ultimately be detrimental to existing and prospective tenants as well as consumers.

We now address the specific questions raised in the Consultation.

1 Should there be a statutory Code?

1.1 Although we are a property company, and have no strong views about the beer tie, we firmly believe that individuals (pub tenants) and landlords (whether pubcos, property owning companies such as ourselves or others) should have freedom of choice in deciding what sort of arrangements they wish to put in place when leasing premises to be operated as pubs. We note that the pub industry, and the tie in particular, have been subject to investigation a number of times by both the European Commission and bodies in the UK, all of which have found the tie can be beneficial.

1.2 We do not believe a statutory Code is necessary – in particular because there is no evidence of which we are aware that justifies the introduction of a statutory Code. So far as evidence is concerned, we were particularly concerned about the incorrect and misleading

statistics in Figure 1 of the Consultation which suggest that the number of calls to the BII hotline equates to the number of complaints received. As is apparent from the clarificatory letter from the BII (at Annex 1):

1.2.1 in 2009 the BII hotline received only four calls from lessees of Wellington premises, none of which were "grievances" but simply calls requesting advice about rent reviews;

1.2.2 in 2010 the BII hotline received only three calls from lessees of Wellington premises, none of which were "grievances". Each caller sought advice about a different topic (none of which related to rent reviews);

1.2.3 in 2011 the BII hotline received only two calls from lessees of Wellington premises none of which were "grievances". The callers were seeking advice about particular topics (and only caller sought advice about rent review); and

1.2.4 in 2011 the BII hotline received five calls from lessees of Wellington premises none of which were "grievances". The callers were each seeking advice about a different topic (one of which related to rent review).

1.3 It is clear that there is no basis to state that the BII hotline has received any calls from Wellington lessees to complain about our relationship with them or any aspect of our leases. Rather, as is to be expected from a hotline, lessees use it to seek advice about particular issues (and, in any event, the number of instances in which lessees have called the hotline clearly suggests that our leases are easy to understand given the relative lack of calls from our lessees).

1.4 It is abundantly clear that the information in the Consultation relating to the BII hotline cannot form any basis on which to justify the introduction of a statutory Code that should apply to Wellington.

1.5 In any event, if the Government decides that a statutory Code is appropriate, we do not consider that it should apply to Wellington or other owners of commercial property without any connection to breweries and/or pubcos.

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 any supporting evidence.**

2.1 No. We do not consider that the Code should be binding on property companies that happen to be the landlords of more than 500 pubs if there are no other connections between the commercial landlord and brewers and/or pubcos.

2.2 We note the statements at paragraph 4.24 of the Consultation, which seeks to explain why the proposed Code should "*cover all managed pubs, not just all tied pubs*". In particular, we note the comment at paragraph 4.24(b) that "*were the Code to cover only tied pubs, there would be nothing to stop a pub company from removing the tie and immediately increasing the rent to well beyond market rent values*".

2.3 In our view, at paragraph 4.24(b) of the Consultation cannot be supported for a number of reasons:

2.3.1 First, although we do not operate tied pubs and are not aware of the provisions in such leases, it seems to us highly unlikely that there would be circumstances in which the landlord could unilaterally remove the tie and increase the rent without the tenant's consent.

2.3.2 Secondly, if a landlord pursued such a strategy there is no reason to believe that the rent would be increased to "*well beyond market rent*". The rent may

increase to the market rate (with tenants then, free from the tie, also able to source beer more cheaply) but there is no basis on which to believe that the rent would exceed the market rate.

2.3.3 Thirdly, even if for argument's sake the landlord could raise the rent beyond the market rate when removing the tie, at the next rent review the rent could only be adjusted to the prevailing market rate (or remain unchanged if the market rate had fallen) . Nothing in any existing (or prospective) lease would entitle the landlord to charge a rent "*well beyond market rent values*" should it wish to remove the tie.

2.4 Therefore, we consider the premise that the Code should apply to all non-managed pubs to be flawed. There is simply no basis on which the Code should apply to pubs that are not tied.

2.5 If companies such as Wellington have chosen to invest in premises that happen to be used as pubs that is, in itself, insufficient reason to make them subject to the proposed Code. To apply the Code to such companies would not only be unfair (and potentially illegal), but would also distort the property market as it would make the investment in pubs as a property class less attractive, thereby depressing prices of pubs compared to commercial premises for other uses. That is likely to have longer term unintended consequences which may materially adversely affect the viability of the pub sector in the UK.

2.6 Taken to its logical conclusion, there would be fewer pubs, less consumer choice of pubs (and consequently beers/ales available in them) such that any valid debate as to how to protect the interests of tied tenants would become secondary as the main issue would become how to protect the UK pub sector, regardless of whether tenants were tied or free-of-tie.

2.7 If the Government decides that the Code is appropriate/necessary, it should only apply to companies that are affiliated to, or have contractual relationships with, breweries and/or pubcos. In such circumstances, Wellington does not have a view as to whether owning 500 pubs is the appropriate threshold and believes breweries, pubcos and organisations affiliated with the pub industry would be better placed to comment on this point.

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?**

3.1 No. Please see the response to Q2 above.

3.2 For the avoidance of doubt, if a commercial property company owns a number of properties some of which are subject to arrangements with brewers/pubcos and others are not subject to such arrangements, we consider that the Code should only apply to the pubs in the former category (and that only such pubs in a company's estate should count towards satisfaction of any threshold above which the Code would apply).

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

4.1 Please see the response to Q2 above.

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

5.1 Whilst we have not conducted a detailed assessment of the likely costs of the proposals contained in the Consultation, we believe that the costs are likely to be material. For

example, the costs of complying with the provisions of the proposed Code (e.g. having a compliance officer and providing tenants with the information in the Sample Rent Assessment – which an entity like Wellington would, in any event be unable to do given its lack of information about tenants' beer purchases) are likely to be more than just incidental.

5.2 The increased costs of owning premises let as pubs, together with the restrictions on lease provisions if the premises were let for other purposes, would inevitably lead commercial property companies such as Wellington to reduce the number of pubs in their property estates and seek instead to let them for other purposes (e.g. coffee shop, retail outlet restaurant etc.) and, where possible, to seek to convert them into dwellings or offices.

5.3 In addition, so far as Wellington is concerned, the costs of complying with the Code may well be passed directly onto tenants in the form of removing or reducing rent free periods and/or concessionary rents that we often offer to pub tenants in the first couple of years of a lease to help them improve the property and establish a trade from the premises. Over the past three years, the cost to Wellington of offering these benefits to tenants has been over £1 million (some, or all, of which may not have been offered if the Code had applied resulting in additional costs to Wellington).

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

6.1 As stated above, please also note that – as a property company rather than a pubco – we have not been party to any previous discussions within the pub industry concerning self-regulation. Therefore, whilst other stakeholders with a more direct involvement in the industry (such as publicans, brewers, pubcos etc.) will be better placed to comment, we believe self-regulation in the pub industry is working. This is, for example, evidenced by the lack of complaints, as opposed to enquiries, to the BII hotline.

6.2 In addition, given that the pub industry has been investigated a number of times (whether by the European Commission or institutions in the UK) and each time been given a clean bill of health, we consider that self-regulation is an appropriate framework to address any issues in the industry that may arise from time to time.

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

(i) **Principle of Fair and Lawful Dealing**

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

7.1 Whilst we support these principles we do not consider that the Code, as currently proposed, is the appropriate way to promote them, or indeed the best way to seek to enforce them.

7.2 In particular, we believe that the Code may actually undermine achievement of the second principle if the Code leads to pubs going out of business. This is because, over the medium to longer term, as pubs and small breweries close (and property companies such as Wellington no longer let their premises as pubs) it may become increasingly difficult to ascertain the overall terms available to free-of-tie tenants when seeking to compare them to those available/offered to a tied tenant.

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

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

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

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

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

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

8.1 As a company that only lets premises to third parties (some of whom wish to operate the premises as a pub) we are unable to comment on this Question.

8.2 For the sake of clarity (and to demonstrate why the Code, if introduced, should not apply to commercial landlords) we have no ability through our leases to control or influence the prices at which tenants purchase beer or any other services. We also have no transparency regarding the amount (or type) of beer the pub sells[1].

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

9.1 We do not propose to comment in detail on the draft Code (because, for reasons explained above, we do not believe that it should apply to us or other commercial property owning companies in any circumstances).

9.2 However, we believe clause 20 (dealing with upwards only rent assessments ("UORAs")) is not justified. This is because, as a commercial property owning company we should be permitted to operate like all other commercial property owning companies, a view expressed by others including a spokesperson for Bath & North East Somerset Council (see the comments in the introduction above).

9.3 UORAs are standard practice across the property industry and, in the absence of a tie or other connection with a brewer/pubco, a commercial property company should be permitted to include OURAs in its leases no matter for what purpose the premises are used. If the Code were to apply to commercial property companies this provision is likely to be an important reason why they would be likely to seek to let the premises for other purposes over the medium to longer term.

9.4 Therefore, clause 20 of the Code, if it applied to commercial property companies, would distort the market and lead to unintended consequences whereby companies would alter their behaviour. There is no basis on which to discriminate against property companies that have portfolios that happen to include a relatively large number of properties that happen to be let and operated as pubs. If the Government believes OURAs should be prohibited then a level playing field should apply and it should seek to prohibit them from all leases (of whatever type of property).

9.5 In addition, it should be noted that whereas pubcos which operate a tie have a significant degree of transparency about the success (or otherwise) of a pub – which can form the

[1] For completeness, please note that 15 of the properties we let as pubs include a gaming machine tie (a number of which are terminable on 28 days' notice). Those arrangements do not enable us to influence the prices paid for those services but rather relate to revenue and cost sharing arrangements in connection with such machines.

basis of a reasonable discussion about the level of rent at a rent review – the same is not true for property companies. As a property company we have little (if any) information about the underlying business of the tenant and cannot consider the rent as part of an overall "package" which includes remuneration from the beer tie. Whilst we consider parties to a tenancy should each have the freedom of choice concerning the provisions to be included in any lease, a distinction can be made between pubcos (i.e. entities with a connection to, or arrangements with, a brewer) and property companies when considering the legitimacy of UORAs.

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?**

10.1 Yes (should the Code be adopted, in whatever form).

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

11.1 No. Although this question does not apply to Wellington (as none of the premises we own and which are let as pubs are subject to any beer tie), as noted above, tenants and landlords should have the freedom of choice to decide the basis of their commercial relationship. In each case, the parties should weigh up the advantages of the tie/free-of-tie model and decide what is most appropriate for them in their particular circumstances.

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?**

12.1 Although we may not be best placed to respond to this question, we consider that it may be difficult to ascertain whether a tied tenant in a particular case is "no worse off" than a free-of-tie tenant. This is because much may depend on the specific location and characteristics of the pub in question and in finding appropriate comparators. What would happen if the parties each identified what they believed to be an appropriate comparator? In any event, we believe that self-regulation and the scrutiny to which the pub sector is regularly subject are likely to be sufficient to ensure that tied tenants were no worse off than free-of-tie tenants.

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

13.1 If the Code were introduced, we do not consider the appointment of an adjudicator would be necessary and would simply add to the costs of the Code. If no adjudicator were appointed it would always be possible to do so in the future if deemed necessary and supported by evidence to justify such an appointment.

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

(i) **Arbitrate individual disputes?**

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

14.1 No. Although we do not consider that the Code is necessary, if introduced and an adjudicator appointed, we consider that his/her functions should be limited to mediation if the parties agree. Disputes should be resolved in accordance with the commercial arrangements between the parties as set out in the lease agreement.

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

(i) **Recommendations?**

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

(iii) **Financial penalties?**

15.1 We believe that an adjudicator should only be able to make recommendations. Under no circumstances, without the ability to have the adjudicator's decision reviewed, should he/she be able to impose financial penalties or require information to be published. The ability to impose financial penalties or require information to be published are not necessary to achieve the Government's stated objectives of ensuring fair and lawful dealing and ensuring that tied tenants are no worse off than free-of-tie tenants, and indeed go beyond those objectives in many respects.

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

16.1 We do not consider an adjudicator is necessary.

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

17.1 If an industry levy is imposed the costs would in all likelihood eventually be passed onto tenants and ultimately consumers. This might, for example, be in the form of less generous rent free periods and/or concessionary rents. It might also lead to landlords adding a contribution to the levy as part of the rent given the costs of complying with specific legislation relating to pubs (in the form of the Code).

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