

## BIS Pubs Consultation Response

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### Introduction

The crux issue in the sector is that pub owning companies operating on a leased model take more than is reasonable from pub turnover (in both inflated beer prices and rents), making it difficult or impossible for the licensee (the small business) to make a living.

This is causing viable pubs to close that would otherwise survive. Nothing in the so-called self regulatory reform package changes this fundamental problem.

The supposed basis of the 'tie' and how it used to operate is that licensees pay more for beer (and other product) but pay a lower than market rent – but this stopped being the case and leases became unfair, based on hugely inflated beer prices and high rents.

The latest Association of Licensed Multiple Retailers Benchmarking survey showed that for the first time, tied rents are actually higher than rents for free of tie. Tenants/lessees are being double overcharged and there is currently nothing written in to legislation to stop this.

The tied tenant should not be worse off than if they were free of tie. That is clearly not the case, so it seems clear that this exemption is being breached. It is also notable that the decision made by the Office of Fair Trading not to investigate the sector was partly made on the basis that tenants/lessees had lower rent than free of tie licensees, which completely undermines the findings of their response to the super complaint made by the Campaign for Real Ale.

As currently drafted, the statutory code would not deliver anything substantial beyond the current unsatisfactory voluntary arrangements and crucially would not do anything to deal with the fundamental problem: that currently pub owning companies take more than is reasonable, fair or sustainable from pub profits, preventing the licensee from making a fair return. This overcharging takes the form of both excessive rents and product prices.

The only demonstrable way to deal with this overcharging – which is causing pubs up and down the country to close and resultantly costing the tax payer a significant amount in welfare payments – and the only way for the Government to fulfil its clear promise to enshrine the principle in law that the tied licensee should not be worse off than the free of tie licensee, is to do what the Department for Business, Innovation and Skills were committed to between February 2010 and November 2011 and to back the then Business and Enterprise Select Committee solution of a '**market rent only**' option for large pub owning company lessees and tenants (also known as the 'genuine free of tie option with open market rent review').

This remains the solution proposed by the then Business and Enterprise Select Committee, who in four exhaustive and detailed reports have laid bare the chronic overcharging and abuse in the sector. It is also the position of the Federation of Small Businesses, The Guild of Master Victuallers, The Campaign for Real Ale, Fair Pint, Pubs Advisory Service, Forum for Private Business, Licensees Supporting Licensees, Justice for Licensees, Licensees Unite the Union, the Fair Deal for Your Local campaign and the GMB.

### **Consultation questions**

#### **Q1. Should there be a statutory Code?**

Yes.

However having a statutory code in itself does not address the fundamental problem. Putting the current Framework Code on a statutory footing would not only maintain the current situation, but would actually make things worse for licensees. This is because in the current situation, the Framework Code is only legally binding if both parties sign up to it, which means that existing lessees do not have to and may choose to opt out. Many lessees believe that the Framework Code actually imposes new restrictions on the licensee.

To reiterate, it was never about whether there were codes or not, it was always about stopping the pub companies from taking more than is reasonable, fair or sustainable from pub profits.

**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.**

Yes.

The new code should apply to all companies that own 500 pubs or more (under any model) to all their tied houses, tenanted and leased (and any definition of tied pubs, as in the Beer Orders). It must apply to all companies who have above the de minimus number of pubs regardless of how many are tied pubs as this is about market share.

Even if a company only has only one tied pub, but one over the de minimus, they must be covered by the code. The code will then apply to their only tied pub.

Whilst there are sometime issues involving the family brewers, it is important that they continue to be allowed to sell their beer in their pubs. It will also be much easier to get a meaningful code through with the family brewers all being excluded. This also helpfully means that if they do prosper as the large pub owning companies continue to sell off pubs, which will now escalate, they would find themselves bound by the code as soon as they get bigger.

It is vital to consider what happens if the pub owning companies restructure into a number of smaller companies to get under the limit. This may need to be reviewed in the event that any of the larger companies seek to divide themselves into smaller companies to continue to overcharge their tenants and lessees.

**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?**

Yes.

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

Yes. The statutory code should contain a provision that all agreements that contain tied provisions, whatever they are called, should be fair, reasonable and comply with all legal requirements.

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

### *Summary*

A market-rent only option will mean that tied licensees would receive a fairer share of pub profit.

Currently, many tied tenants earn below the equivalent of the national minimum wage from their pubs. In 2009, the then Business and Enterprise Committee published their findings that 67 per cent of lessees of tied pubs said that they earned less than £15,000 per annum and even where pubs had a turnover of more than £500,000 a year, over 50% of lessees earned less than £15,000. The Institute of Public Policy Research also found in 2011 that 46 per cent of tied publicans earn less than £15,000 per year, in contrast to only 22 per cent of non-tied publicans.

The Impact Assessment indicates a best estimate that an average licensee's earnings would improve by £4,000 annually under a market-rent only option. The reality is that the overcharging is much much more than this in many cases.

For example, *the pub* is a very busy, popular, thriving pub. *the pub* had a turnover last year of £600,000. Enterprise Inns take almost £133,000 per year in wet rent (beer and other product prices) and £48,000 in rent *the pub*. A ludicrous proportion of turnover (and not at all uncommon). She made hardly anything. **As is often the case, Enterprise take ALL the pub profit.** They have now committed to drop the rent to £32,000 but the amount they will still take from the pub is clearly unreasonable, unfair and unsustainable for the small business.

Enterprise always trot out their earning "potential" that bear no relation to the reality of what their tenants earn. They also have been shown to present utterly unrealistic turnover figures to people (which amounts to mis-selling) and many licensees have soon found the pub takes nothing like what they have been told it would. Yet of course, Enterprise get their guaranteed rent and mark-up on the beer then blame the tenant. It's little more than a racket.

A fair split of pub profits is all that is needed. No more and no less; but only a market rent only option will deliver this. This would also reduce the cost to the taxpayer of tax credits paid to publicans (so it would stop the taxpayer subsidy to the large pub owning companies) and reduce the cost to the taxpayer of business failure.

This kind of financial improvement will encourage entrepreneurial flair where it is currently lacking, reinvestment, training jobs, and most importantly profitability will ease the closure of pubs and business failure rate of tied publicans.

### *The need for reform*

Delivering the prime principle through market rent only/genuine free of tie option would free up what has become a stifled market, dominated by a handful of companies whose business models are considered by many as discredited and who have made it difficult or impossible for many small businesses, the lessees and tenants, to make a success, despite adequate or indeed healthy turnover figures.

The pub owning company tied model has clearly failed and the pubs sector has been stifled by the unreasonable and unsustainable business practices of the larger pub companies. There are parallels with what happened with the banks speculation, which did so much damage to the economy. Some of the pub owning companies can be seen to have behaved in a similarly irresponsible manner, overvaluing their estates and borrowing vast sums against this, which has led to both their mind boggling levels of debt (in reality some are described as 'zombie' companies) but also to them taking much more than is reasonable as a proportion of income from their pubs. This is damaging and destroying what would otherwise, even in difficult economic times, be viable small businesses that of course also employ local people and buy local produce.

The negative and unsustainability of the pub owning company business model is evident not only from the disastrous effects it has had on many pubs, but also by the impact it has had on its own shareholders, including their pension funds. Punch has now split into two and along with Enterprise has lost around 95% of its peak market value. The model is not only now failing lessees, pubs and the

communities who rely on them but the pub owning company's own shareholders, it is also failing and damaging the entire pub 'industry' and indeed the UK economy itself.

A statutory code, delivering the prime principle via a market rent only/genuine free of tie option, would free up the pub sector would encourage growth as a result of a renewed, rejuvenated pub sector, with more diverse ownership that will promote entrepreneurial flair and ensure communities are able to enjoy thriving local pubs, with a good range of beers available at fair prices (which would also help breweries, as they would no longer be subject to the same unreasonable buying power of the big pub owning companies, who squeeze them to a barely sustainable price, in a very similar way to the way that supermarkets have done with pubs.

The pub owning companies, big breweries and their association, the British Beer and Pubs Association, hysterically claim that reform would be bad for the 'industry' and economically damaging. However, the reality is that neither Enterprise nor Punch are large employers and neither have any growth opportunity at all. Instead both have seen a huge rate of lessee and tenant failure within their own estates and many of their pubs are now closed and converted into alternative use. The real growth opportunity is in the pubs themselves, but this will not happen without the introduction of a statutory code delivering the prime principle, this is the way to encourage fair trading within the existing tied model, deregulate the market and to create growth, something which is so vital to the British economy at the moment. Maintaining the status quo (or not delivering the prime principle) will see many hundreds of pubs continue to close each year. Reforming it would allow many of those pubs to succeed under a more competitive existing model, a different model or even new ownership.

It is very notable that call for reform, as envisaged by the Select Committee, are fully backed by the Federation of Small Businesses and the Forum of Private Business who are all too aware, from their own members, that pub owning company tied lessees operate on unreasonable terms skewed very heavily in favour of the pub owning company. Both organisations back the Select Committee's insistence (which is also now backed by Ministers) that a statutory code of practice with a genuine free of tie option and both have stressed the huge opportunity that exists through this to allow the pub lessees/tenants, the small businesses and the ones that actually operate the business, to innovate and thrive.

The All Party Parliamentary Save the Pub Group and the Campaign for Real Ale have compiled a list of examples of pubs around the country that had been deemed 'unviable' by the pub owning company owner, yet now were succeeding under new ownership being run on a different business model. This is a very positive trend in the sector, however it is currently only happening on a small scale because pub owning companies are disposing of pubs, even when they are viable, simply to pay off their debts and appease their increasingly disgruntled creditors. Real reform – which means a statutory code delivering the prime principle (through a market rent only/genuine free of tie option) would lead to this happening with hundreds and possibly thousands of pubs, who could then be taken on and operated on a different and sustainable business model.

It is notable that British Brewing is more diverse than it ever has been and that is to be celebrated, with 1000 breweries currently brewing up and down the country. These companies are succeeding, producing excellent products and expanding and taking on pubs, however, this will only be able to flourish with reform and the MRO option. This is a clear example of where Government can and should intervene to free up and release the opportunity that exists.

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

There have been four Select Committee enquires and two unanimous (unopposed) motions of the House of Commons in support of reform. The Select Committee solution was adopted as the official Department position in early 2010 and was then backed post 2010 General Election by Coalition Ministers from the Department for Business, Innovation and Skills. The reform solution (a statutory code including an option to pay market rent only, backed by an adjudicator) was the solution put forward by the then Business and Enterprise Select Committee, chaired at the time by Conservative MP Peter Luff.

Self regulation was given several last chances, including an additional 18 months beyond the original deadline (June 2011) that had been suggested by the Select Committee and signed up to by Ministers from the Department for Business, Innovation and Skills in both the previous and current Governments. Self regulation failed by the tests set by the Select Committee and adopted by Ministers from the Department for Business, Innovation and Skills. Despite the further unexpected period to allow self regulation to work, it emerged in December 2012 that the British Beer and Pubs Association (who speak for the pub owning companies and big brewers) who had proposed their voluntary code admitted they had no role in dealing with tenant profitability – the fundamental issue at stake!

The new proposed self Regulatory Board does not share the same commitments as Government, seeking to deliver fairness and a tied licensee no worse off than if they were free of tie. Self Regulation is not accepted as 'independent' by many licensees. Until it can commit to the same objectives for reform it has little future.

Furthermore, credible self regulation is suitable for companies that own less than 500 pubs, where there is much less of a problem of overcharging. However, statutory regulation is crucial for companies who own 500 or more pubs.

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

***i. Principle of Fair and Lawful Dealing***

The principle should be fairness not the rather odd 'fair dealing', indeed the phrase to adopt is the one already in the voluntary code of practice, yet strangely then not included in actual company codes (another failure of self regulation). The phrase is "All contracts will be fair, reasonable and comply with all legal requirements." Talking about 'fair dealing' could be meaningless if contracts are unfair in the first place! So we are concerned as to why this strange and seemingly watered down phrase is included instead of the clause. The clause from the voluntary codes is the one that should be adopted.

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

Yes.

**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 owning company significantly increases drink prices or if an event occurs outside the tenant's control.**

Yes.

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

Yes.

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

Yes.

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

Yes, but a market rent only/genuine free of tie option is essential as the solution. A guest beer option is additional and then needs the second calculation of a 'part tied' dry rent. To increase benefits to the consumer and to allow for greater and fairer access to the market for the country's many microbrewers (the key issue being fair access, as currently pub owning companies demand prices mean that they can't sell to tied pubs) then a guest beer option could be introduced for all tenants and lessees who choose a tied lease. This should allow them one hand pulled beer that can be bought direct from brewers. (Ironically, this is in the pub owning company's interest in a strange way, as offering this does make tied leases and tenancies considerably more attractive!). It would also be a huge boost to the microbrewing sector and be great for consumers. As the microbrewers sell more beer, they themselves will be able to buy more pubs. We then end up with stronger small businesses, employing more people and with more diverse pub ownership than the current one that has done so much damage!

A 'tied market rent only' option should also be explored. This means that brewers (only) could continue to insist as proportion of their beers (e.g. 100%, 80% etc) being sold through their pubs, but that the licensee would be able to buy that beer from any source, to ensure they get lowest/best price (which would be expected to be the brewery – but the freedom would prevent artificial mark-up by the pub owning brewer).

The concept of the tie appears to have changed in understanding. All it technically means is that in a lease for a public house, there is an obligation on the tenant to purchase all or some of the beer (and other products) sold on the premises from the pub owning company or a supplier nominated by the pub owning company.

It does not actually mean that these products have to be purchased at a higher than market/wholesale price – and did not used to mean that, even for brewery tied pubs!

Because the purpose of the Government intervention is to stop the overcharging and abuse, not to widen the choice of beer on offer (and this is not a problem in the market), then it could be possible to introduce, in the code (for pub owning breweries above the de minimus), a 'tied' rent only agreement that allows pub owning breweries to tie licensees to only selling their beer (with or without guest beer, dependent if this is introduced) but that they can buy from wherever i.e. at wholesale brewery price. This means that brewers could continue to sell just their beers (or all bar one of their beers) – thus maintaining 'tied' brewery pubs in the traditional sense but with no overcharging.

Indeed, in this form of agreement, the brewery should be able to offer its licensees the lowest (brewery) price, so this should lead to them buying their beer from the brewery!

The idea that “the tie”, meaning overcharging for beer, is essential to Britain’s brewers is simply not true. The tie, as meaning that a brewery can sell only its beer in a pub, is different.

Of course, managed pubs can continue to insist on selling whatever beers they like – which will mean often only the beers of the pub owning companies and subsidiaries also. That would be unaffected.

**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.**

Yes.

The code must include flow monitoring. Brulines as currently applied could not get past a truly independent adjudicator. It needs to be properly tested and regulated.

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

There needs to be a Market Rent Only option - where a licensee can choose to remain tied or simply pay a market rent and purchase beer (and any other formerly tied products from any source).

Like the Industry Framework Code (in which it is an empty promise as it cannot be enforced) there needs to be a clause in the Statutory Code that:

"All contracts will be fair, reasonable and comply with all legal requirements."

It should be made clearer that all rent assessments (especially at rent review and lease renewal) need to be undertaken on the basis that Royal Institution of Chartered Surveyors guidance should be interpreted on the principle that the tied licensee is no worse off than the free of tie licensee.

**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 two overarching principles?**

Yes.

The opportunity to review and amend was the main failing of the Beer Orders which led to unintended consequences. The statutory code and Adjudicator proposals seek to avoid such gaming of well meaning Government intentions.

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

Yes.

It is essential, as it offers the opportunity for a licensee to sever unfair contract terms presented in tied agreements. Without free of tie option and an open market rent the code can be easily exploited.

**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?**



This is not an either or deal. A package of reforms are necessary all outlined in the proposed Statutory Code with the exception of the most important feature a mandatory free-of-tie option with an open market rent. If the rent cannot be agreed between the parties then it should be determined (in accordance with the lease terms) by an independent third party in accordance with Royal Institution of Chartered Surveyors rent assessment guidance.

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

An adjudicator is welcome but not essential and is not itself the solution, whereas a market rent only/genuine free of tie option is. A properly defined market rent only option, with a clear defined process of establishing it is the solution – and would deliver the reform needed (and a fairer split of pub profits in without need for adjudication, except where there had been any abuse of process).

The market rent only option reduces adjudicator workload by offering a self policing opportunity at an individual pub level - a 'market rent only' option, available to tied lessees and tenants, would enable individual operators to compare and contrast their tied agreement with the circumstances and profitability of being free of tie. It is the terms of the tied agreements, if perceived to be unfair and unreasonable that will result in tied operatives choosing to release themselves of the burden of being tied. The threat alone of this flexibility will ensure that those pub owning companies operating tied agreements will seek to maintain fairness and competitive behaviour rather than using their inflexible models as a tool to oppress their licensees.

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

**i. Arbitrate individual disputes?**

Yes.

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

Yes.

**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?**

Yes.

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

Yes.

**iii. Financial penalties?**

Yes.

The Adjudicator also needs more powers than this. The Adjudicator should have similar powers to those afforded to the Office of Fair Trading in the case of Unfair Contract Terms in consumer Tenancy Agreements; essentially have the power to render an unfair contract term unenforceable.

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

Yes.

**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?**

Yes, but with the caveat that market rent only option is more important – and that without a market rent only option, an adjudicator's job is impossible.

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

The large pub owning companies and brewers are already paying for the self regulatory approach, the levy for the statutory code will reduce the funds for self regulation but the work load for the regime will be dramatically decreased (as most complaints are from pub owning company licensees of the six biggest firms). The costs associated with the adjudicator and statutory regulation will largely depend on the behaviour of the pub owning companies. Worse behaviour would lead to more complaints which would lead to more work and higher costs.

## **Conclusion**

### **The solution**

The solution is simple – and a market based one: to give licensees the option of either a tied lease (agreeing to buy beer and other product from the pub owning company and rent) or a rent only (free of tie) (i.e. they pay rent only, at an independently assessed fair market rent and can buy all produce on the open market at wholesale/brewery prices).

This is not 'regulation' or interference in contractual relationships, it is a simple mechanism that would reintroduce competition into the sector as well as stop the ongoing abuse of small businesses by offering them a choice – and an assessment of market rent.

This is effectively a self regulatory mechanism. If the tied agreements are fair and competitive then tenants will seek to remain in such agreements rather than go free of tie.

If an offer of a free of tie option with an open market rent assessment were made mandatory, there would be no necessity for Framework or Company Codes, Pubs Independent Conciliation and Arbitration Service, Pubs Independent Rent Review Scheme or accreditation.

This is not abolishing the 'beer tie', it is simply ensuring that pub owning companies can no longer overcharge their tenants with the double whammy of extortionate beer prices and high rents. Tied leases remain an option, but would again be what the tie is supposed to deliver – a lower than market rent in exchange for paying higher beer prices. That can be attractive to tenants as it lowers their fixed costs, but the pub owning companies could no longer overcharge, as the market rent figure becomes the comparator. Managed pubs owned by breweries would of course continue to be permitted to sell only that brewers' beer.

The solution is clear. We need a market rent only option that would enshrine in law the 'prime principle' that the tied licensee should not be worse off than the tied licensee. This would stop the endemic overcharging). The tie should be made to work as it should. This option, would only apply to companies who own more than 500 pubs, and as such, family brewers would all be excluded.

**Greg Mulholland MP**

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