



**RESPONSE TO THE DEPARTMENT FOR BUSINESS INNOVATION
AND SKILLS CONSULTATION INTO PUB COMPANIES
AND TENANTS**

This submission is made on behalf of the Federation of Licensed Victuallers Associations (FLVA) which is a members' organisation that has since 1992 looked after the business interests of self employed licensees and was a co signatory to the Framework Code of Practice. (FCOP) versions 4&5 but not version 6.

Executive Summary & Recommendations

- 1 The FLVA support the Beer Tie acknowledging the levels of aggregated discounts are there to potentially support a revised Pub Co/Licensee business relationship. These Pub Co discounts need to be maintained not diminished through FOT proposals that would inevitably result in margin moving back up the supply chain to Brewers, many of whom are foreign owned. It is from these discounts both the costs of Governance and tie improvements will be largely funded. Consequently the proposals for a mandatory Beer FOT option and/or Guest Ale option is not supported. Under this scenario of no mandatory FOT option or Guest Ale provision there is no need to consider a "500" Pub Estate threshold for smaller Pub operating Brewery Companies, which ensures all pubs can operate under the Governance and COP protections.
- 2 The FLVA recommend a removal of the wine/spirit/mineral tie from all existing agreements. We accept this may need to be followed by a de minimus interim rent review reflecting increased Licensees retail margins. The review should also recognise the current changed trading environment at the outlet in today's economic climate.
- 3 The FLVA require a formal and transparent linkage between Beer wholesale prices enjoyed by the Pub Co's and those offered to their Licensees insomuch that supplier "price increases" should only apply to the Licensee at the same time and at the same cash quantum price as those increases are levied on the Pub Co concerned. This is regarded as a tangible bankable aspect of "fair trading"

- 4 In relation to Code of Practice provisions a Universal Standard Statutory Industry COP is required on a “one code for all basis”.
- 5 It is recognised that not all Licensees are struggling financially with diminishing profitability, however as a fall back figure the FLVA recommend a minimum licensee’s profit return after rent of £20000
- 6 To ensure Licensees receive adequate support and guidance to the Governance bodies and COP remedies, we recommend the establishment of a Pub Advisory and Support body for Licensees (PASS). This will act as an independent and pro active alternative information conduit to that provided by Pub Co’s and will help to rebalance critical aspects of the Pub Co/Licensee relationship.
- 7 To ensure sound Pub Co/Licensee communications Forums should be established to facilitate sound communications between business partners. All pub owning Companies should be expected to hold their own discreet forums on a 3 monthly basis.
- 8 Whereas the “500” Pub Estate limit has doubtless been crafted with the smaller Brewers in mind, if implemented there will be adverse unintended consequences. Pub Co’s are rationalising their Estates, Punch announced in October 2012 their intention to dispose of 2278 Pubs. Individual disposals for the majority of these pubs are impractical; the likely scenario is the creation of sub 500 Pub Co’s, probably equity funded operating outside Governance and COP Licensee protections
- 9 The Industry requires oversight either from a properly constituted representative body or a Government appointed Adjudicator. PIRRS and Pica Service are sound Governance bodies but Licensee awareness of these bodies is limited which could be facilitated by the establishment of a Licensee Advisory and support body (see point 6).



FLVA RESPONSE TO CONSULTATION DOCUMENT

Q1 Should there be a statutory Code?

10. The FLVA do believe that there should be a statutory code but this code must be detailed, universal and comprehensive in its content to avoid any potential misinterpretations. The code should be a one for all and alleviate the need for individual Company codes/interpretations.

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.

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

12. Already some of the large Pub operating companies have outlined a “core estate” with a residual rump which is to be sold. It is unlikely that a bulk buyer would be found for these houses so the imposed 500 limit would be likely to leave these houses outside either statutory or Company codes. The likely outcome would be that these sub 500 companies would be outside legislation.

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?

13. Yes, all non managed pubs should be covered by the statutory code but mindful of the above waivers as detailed under Q2.

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

14. If the agreement is a true contractual franchise then it should be dealt with under the code of ethics as published by the British Franchise Association. If however if the agreement comprises of only "back office" support and is not therefore a true franchise then the Statutory code should still apply.

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

15. The benefits of a universal code to public houses is that the code would ensure operation and compliance at the highest level rather than the lowest common denominator as may well be the case with individual interpretations of a code as is the present case under the framework structure.
16. There would be no requirement for an individual code to be produced and no accreditation costs incurred in ensuring that the individual Company code is in accord with the industry code as at present, this would represent a saving to Pub Co's in comparison to the current structure.

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

17. Self regulation collapsed as a failure to assemble an overall governance body this and the lack of the establishment of a universal code. However, bodies formed as a consequence of the self regulation, namely Pubs Independent Rent Review Scheme (PIRRS) and Pubs Independent Conciliation and Arbitration Service (PICA –Service) undertake a valuable role within the industry currently and should remain in place to continue that role. Whilst PIRRS has the ability to fully resolve a rental issue, PICA-Service does lack some teeth by not having the ability to fine the pub operating company for a transgression of its code but can at best provide for restitution to the tenant for a breach. This means that a company may decide that continued transgression is a "worthwhile gamble" and perpetuate the problem. This is an issue which the adjudicator could take a stance on and if warranted impose a substantial judgement.
18. The long overdue introduction of the Overarching Governance Body (OGB) could and should have a continuing part to play in the industry in that it could make 3rd party referrals to the Adjudicator if trends in general, or specific areas of concern become apparent.

19. The major omission and where we believe the self regulation has fallen short is in that of independent advice, service and support for the licensee. An independent conduit for information to licensees remains essential to balance that information given by pub operating companies. This is despite an undertaking given by the British Beer and Pub Association (BBPA) at the end of 2011 within their commitment to government in the Tie, Code and Governance document (TCG).
20. This TCG document provided valuable protections in the establishment of the PIRRS, PICA-Service and accreditation bodies but also undertook to provide an industry funded Pubs Advisory Service (PAS) which would provide information to existing tenants as well as new entrants to the trade.
21. This PAS coupled with an element of basic support and an ownership, along with the tenant, of the issues concerned and the promotion of both PIRRS and PICA-Service would further balance the unfair and weighted bias that the Pub Companies currently enjoy. We have on several occasions, and still do attempt to bring this improved body Pubs Advisory Service and Support (PASS) into being and bring about a much needed service to the tenant body.
22. This service would act as a filter and router of the many and varied industry issues which could be resolved without reference to the adjudicator.

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

23. Fair and lawful dealing should be a central part of the code. The principle of fairness should also encompass a rebalancing of the information and knowledge available to the tenant, who often feels overpowered by the technicalities and information that is readily available to the pub operating companies and as a consequence is often lead to believe that there is no alternative solution other than that being proffered by the pub company. There remains some difference of legal opinion as to whether the current code is legally binding. This in our opinion can be resolved by the introduction of the code, or its successors by entering into a Deed of Variation to the lease/tenancy itself. This was a central part of our proposals to BBPA during discussions around the voluntary code.

24. Fairness to the tenant therefore comes from easy access to knowledge and advice relevant to the industry and the agreements offered by operators within the sector. This knowledge and advice would in all probability be multi disciplined encompassing legal, valuation principles, accountancy, stock control provision and industry guidelines and information available.
25. In the most basic of landlord and tenant relationships, consultative bodies are formed to debate and discuss matters of mutuality between equal partners. The provision of tenants forums, attended at a senior management level within each company, where the free flow of ideas and principles between elected tenant representatives and their business partners can be conducted.

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

26. This phrase can be very misleading in that many minds will focus purely on the rental application of this principle. We take as our start the principles as given by the Royal Institution of Chartered Surveyors (RICS)
27. The rent assessment models shown and described at Para 22 of the Code and annex A may also be misleading in that they may stray from the principles of profits rental calculation outlined in the RICS guidance which in part states that the valuation of rent should take into account the wholesale supply provisions, the terms and restrictions on trading and the quantum of profit. The result of this is non formulaic but will in most cases provide a landlords share (rent) of the divisible balance of between 35% - 65%.
28. The model suggesting that two differing profitability's post rent, where there is some 38% difference between the two post rent balances, would produce the same 50% bid of the Divisible balance may be inaccurate when considered against the RICS guidance and therefore be misleading to a layman. A 5% swing within the 35% - 65% RICS banding would produce a much more aligned post rent balance on both sides of the equation, but one none the less which would require rebalancing.

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 tenant's control.

29. We would see the ability to call for an open market rent review as a welcome inclusion within the code but would suggest that the period be linked to that of the rent review cycle contained within the lease which in many cases is a period of 3 years.

30. In respect of significantly increased prices this terminology would need to be very clearly defined as we have evidence that some pub companies "pass on" the brewers increases at a level higher than the rest of the market where margin maintenance is in force. (See annex 1)This in part has led to the ever increasing gulf between the pricing structure of Tied and FOT outlets.

31. An interim rent review mechanism should be introduced by the code to address the consequence of an unforeseen event beyond the control of the tenant but we would again wish to see this clearly defined. Not only in terms of the event itself but in respect of the timescales involved, where we believe that once established that an event has taken place which warrants this trigger then the review date is linked to the date of that event, or its notification to the pub company. Without this "peg in the ground" there is a positive incentive for the pub company to procrastinate and delay. This provision is no more than has been historically offered by some of the major pub companies in the relatively recent past.

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.

32. We agree that the transparency given by the production of a rent assessment statement is essential but it needs to go far beyond that of just the FOT question.

33. The model as shown in the consultation document is mathematically flawed in that it quotes the expenses as being 34.1% of turnover when in fact the quoted £85065 represents only 32.1%. If the maths is corrected and using the 34.1% cost base the revised model would show a revised Tied "rent after adjustment" of £14992 a figure which would represent some 5.6% of turnover or a 28.9% bid based on the divisible balance. If the costs were shown at the benchmarking norm of 35.3% the rent would recalculate at £13403 representing 5.1% of Turnover and 27.6% of divisible balance.

34. These figures represent a figure substantially below the recommended RICS range of 35% - 65%. If a business trading in excess of £6k per week (inc VAT) is showing substantially below the RICS guidance range how much lower would a business trading at £3k -£4k per week, of which there are many, be. Would these recalculate at a zero rent and if so would any investor or Pub Co wish to have the property within its portfolio? The resultant sale/closure of pubs could be immense without private capital allowing the purchase of the freehold outright.
35. The complexities of this assessment may well fall beyond the knowledge of an individual licensee. The individual should then have a resource to gain independent advice such as we would envisage under PASS
36. The FLVA believe that as part of any rent calculation the establishment of an overreaching minimum level of retained tenant's profit income of £20k from the divisible balance within all rental calculations. This or any other figure could be arrived at by reference to the average weekly earnings figure with an additional element to reflect the risk element of the self employed licensees investment into the pub e.g. Fixtures and Fittings, stock. This figure could then be indexed to future UK average earnings statistics.

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

37. We are not averse to the principle of tied machines, there is an argument that large scale management of machine income can be beneficial to both parties. What must become transparent is that no "royalty" payment is received by Pub Co's which could potentially distort machine rental. If an "administration charge" is levied on a tied machine this should be justified as being relevant and proportionate.
38. The current procedure of the removal of AWP income (where shared) from the divisible balance in the rent calculations is a welcome move. However existing tenants are still penalised until the next rent review date. We would therefore recommend an immediate across the board review to bring old calculations into line irrespective of whether the tie remains or not.

39. In contrast the FLVA recommend a removal of the wine/spirit/mineral tie from all agreements.. Any tie other than the beer tie should only be there on the basis that it provides a potential benefit to the partnership. Pub Co margins derived from the aggregated discounts available on wines spirits and minerals are minimal and therefore bring nothing to the partnership and therefore the freedom should be granted to the tenant to purchase free of any tie giving additional tangible benefit and equality to the licensee.

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

40. Clarification as to the exact meaning of this would need to be clearly defined as to whether this is any beer or is limited to cask/craft ales. Its potential unintended outcome to both the rent role and local producers should be carefully considered. As with previous such legislation we believe the tenant will choose the highest volume product on the bar to maximise financial benefit.

41. This may have the effect that smaller local independent brands may no longer find a place on the bar because of the profit implications.

42. Whilst we would wish to see the ability to showcase local brands to provide a point of distinction for a given pub we are also mindful of the fact that there are leases out in the market where this provision was included as a consequence of the beer orders and has been subsequently bought back by the landlord company as part of other negotiations. The blanket inclusion of this option would therefore provide a double dip for certain outlets which should be taken into account.

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.

43. We are in agreement that before any enforcement action can be instigated against a tenant that there must be evidence which is independent of flow monitoring equipment (FME) data. Examples would be foreign containers, purchase records, racking date data etc.

44. The data provided by FME can be of use to a tenant and his professional advisors when freely accessible and may be considered as a useful tool when used to the benefit of all.

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

45. Current Company codes differ widely albeit based on one framework code, by definition a signpost to individual codes, Consequently a complete rewrite of the draft statutory code to encompass the principle of fair and lawful dealing and utilising supportive specifics which are omitted such as PIRRS/PICA Service which are currently within the Framework Code. It should also encompass the introduction of PASS. The current draft statutory COP is not fit for purpose. The Government need to convene a representative body of all parties to work together to produce a statutory code for all.
46. Notwithstanding the above comment, with specific reference to the detail shown at annex A (rent assessment) it should as a minimum provide the following information.
47. Wines/Spirits/Mineral volumes for the preceding 3 years. Where known.
48. Tenants Net Machine income for the preceding 3 years . Where known.
49. The Fair Maintainable Trade (FMT) volume assumptions used in the assessment.
50. Gross Profit Margins for each income stream to be shown separately including Wines Spirits and Minerals. This is required to alleviate the skewing of GP's that these high GP items can produce. They can be worked backwards from the total wet GP's but in the spirit of transparency they should be detailed within the assessment document itself rather than having to be sought via Para 15 of part 3 of the proposed code. This detail is already included within the current voluntary code within annex A
51. An explanation by a competent valuer of the assumptions made within the assessment.
52. Full disclosure and transparent detail on the rent assessment is central and essential to the calculation of any fair rent.
53. As a clear example of its importance the inclusion of this information and the existence of PIRRS, without direct referral, has enabled this Association to negotiate a benefit to our members of £1.15M in the last financial year.

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?

54. We believe that the code should be reviewed at regular intervals with say a maximum period of 3 years. This should not however be prescriptive and there should be the ability to update the code as and when dictated by market evidence or when requested by the OGB which may point to the code being transgressed "in spirit" which is a principal ingrained within the current PICAS structure. Any review should be undertaken via consultation with appropriate industry bodies.

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

55. We do not support the oft touted solution of a fully free of tie lease because of the following.

56. The buying power of the pub companies is undeniable and there should not be an assumption that the current free of tie market discounts will remain to a solus operator. They will be replaced by discounts from the brewers in relation to the potential volumes of the individual tenants concerned, thereby putting the Tenants in an inferior negotiating position.

57. Optimising their commercial terms with a brewer with regard to a loan or discount arrangement may preclude a tenant from stocking other brewer's products thereby limiting consumer choice and inhibiting market availability for smaller brands/guest beers.

58. The FLVA are part of the United Kingdom and Ireland Licensed Trade Association (U.K.I.L.T.A) a body of licensed trade representatives from Scotland, The Scottish Licensed Trade association (SLTA), Northern Ireland, Pubs of Ulster and Eire, Vintners Federation of Ireland, (VFI) meetings are held twice a year between these associations and at the last meeting held in April these points were confirmed by 2 of the delegates who operate in a predominantly free market.

59. This flowback of profitability from the Pub Co to the brewer many of whom are non UK based, would be without any guarantee that this increased profitability would in any substantive way flow back into the pub. At present the potential exists for Pub Co's to invest in tied pubs by way of capital schemes, share of repairing obligations and to fund business recovery programmes. Perversely this profit flowback to the brewers could further support other brewer's customers through enhanced discounts i.e. supermarkets, thus bringing about further pressure to the community pub, with subsequently more pub closures.

60. Any potential Pub Co/tenant relationship would be commercially impracticable as the Pub Co's would essentially become property companies with little shared interest in the trading entity of the pub. This would manifest itself in reduced investments in pubs, and a total emphasis by the emergent property company on rental return. Property companies operating free of tie leases are currently not bound by the voluntary code, So we welcome the proposed provision that companies will be bound in all of their outlets with the exception of their managed estate although we believe that there should be no threshold of 500 outlets as detailed in our answer to Q2.

61. With all the above points in mind we would not wish to see a mandatory FOT option within the code.

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?

62. Our thoughts regarding Pub Co. price structures and increases, the terminology regarding a tied tenant being no worse off than a free of tie tenant and the detail of the rent assessment at Annex A are all detailed in this consultation document.

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

64. The real benefit to the tied tenant would come from a properly constituted OGB and a well publicised and readily accessible advice and support service which would proactively attempt to resolve issues and then when appropriate promote such bodies as PIRRS/PICA-S.

65. Pubs Advisory Service (PAS) to the industry was first outlined to government in undertakings given by the BBPA in December 2011 but has never come into being. This concept, extended to allow for a support function within that advice role should provide information and guidance to existing tenants as well as new entrants to the trade.

66. The extended body of the Pubs Advisory and Support Service (PASS) as outlined within paragraph 21 and the concept of ownership, along with the tenant, of the issues concerned, FOT options, and interpretation of rent assessment. Etc would also act as an extremely valuable body to advertise and promote both PIRRS and PICA-Service further balancing the unfair and weighted bias that the pub operating companies currently enjoy over their tied tenants. We believe that because of this lack of support and knowledge many tied tenants “roll over” under the pressure from their landlord and are unsure where to go and what courses of action are readily available to them. The service would provide an impetus and a sounding board for the lone tenant and thereby empower them. The service could point out the benefits of PIRRS/PICA-Service and by the very nature of its existence may stop some of the excesses seen from Pub Co’s or resolve many issues prior to this formalised route. We have on several occasions, and still do attempt to bring this body into being and bring about a much needed empowering service to the Tied tenant body.

67. This service is as important whether under statutory or voluntary codes and its balancing of power and knowledge to the individual tenant would act as a filter and router of the many and varied industry issues which could be resolved without reference to the adjudicator.

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

68. Working in conjunction with its subordinate body, the OGB the FLVA feel that this role is essential to the concept of a new statutory code. The position would act as a powerful break to excesses and would be in a position to take an overview of practices which were identified directly or directed to the post via other bodies. It is hoped that the existence of this post and the powers that it should have will act in a similar manner to the PIRRS/PICA-S bodies in bringing about compliance prior to conflict/adjudication. The post would be a constant and provide for continuity of Government oversight.

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

i. Arbitrate individual disputes?

69. The current scale of issues and the potential opening of the “flood gates” may not allow for individual cases to be investigated. This should be left with existing bodies who could then report on a collective basis via the OGB to the adjudicator. The adjudicator however would be able to comment on the roles and remit of the various bodies and implement addition roles and governance bodies as they see fit.

70. The prospect of an individual tenant producing a case and evidence to a government official may well prove a daunting task thereby stopping the process in its tracks, similar in many ways to the Pub Co tenant imbalance which stifles action from the tenant at the moment. Again the provision of a support service as outlined earlier would undoubtedly be a great aid to the lone tenant.

71. If the adjudicator were to deliver an open market rent review then that individual should be practiced in the role of arbitration or that of the expert witness role in the specific area of expertise required as the results of any such adjudication would have impact upon the market as a whole, this may require therefore that the adjudicator's role may well be better served by an overview rather than individual case work which may well be suited to current bodies. The adjudicator's role should police the policies and procedures of the individual and specific bodies in situ. Continual reference to these bodies by an individual Company may well then attract the attention of the adjudicator by reference from the OGB, or independently, who could then bring about sanctions.

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

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

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?

73. We would agree that all three of these sanctions should be available and be used by the adjudicator. In the case of recommendations these should have very strict timescales within them which if not complied with should automatically result in financial penalties. These penalties should comprise of restitution, at least, to the Tenant and a penalty for the transgression of the code. This penalty should be on an increasing scale, taking into account any previous breaches.

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

74. The proposals with regard to the reporting of the adjudicator would appear to cover most angles. A summary of the cases brought and a categorisation of the issues, along with a league table may also provide a useful reference for all interested parties, Government or an individual prospective tenant, who could check out the reputation and actions of their potential partner. The information would have to be statistically adjusted to reflect pub co sizes etc so as not to give any false indications

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?

75. The proposals as drafted seem a fair and equitable way of funding the proposals as currently outlined and should be extended to further include the additions as outlined in this response. If the figure quoted as the annual costs are accurate then the impact at an individual pub level of circa £40 per unit should not impact greatly, if at all at outlet level.