



Federation of Small Businesses
The UK's Leading Business Organisation

550

14 June 2013

Dear

RE: FSB response to consultation on Pub Companies and tenants

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the above named consultation.

The FSB is the UK's leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. The FSB is non-party political, and with 215,000 members, it is also the largest organisation representing small and medium sized businesses in the UK.

Small businesses make up 99.3 per cent of all businesses in the UK, and make a huge contribution to the UK economy. They contribute 51 per cent of the GDP and employ 58 per cent of the private sector workforce.

To support a diverse and healthy pub sector the Government must introduce a statutory code on large pub companies that:

- Prohibits any products other than drinks to be tied
- Provides tied pubs with the right to sell a guest beer
- Enshrines the right to request an open market rent review if:
 - the price of tied products has increased above inflation,
 - if an event outside the tenants control significantly impacts on the tenant's ability to trade,
 - the tenant did not have a rent review within the last five years, and
 - if the pub company decides to sell the pub
- Gives tied tenants the option to go free-of-tie by paying a market rent only, on rent review, lease renewal or when the decision is made to sell the pub

Yours sincerely,

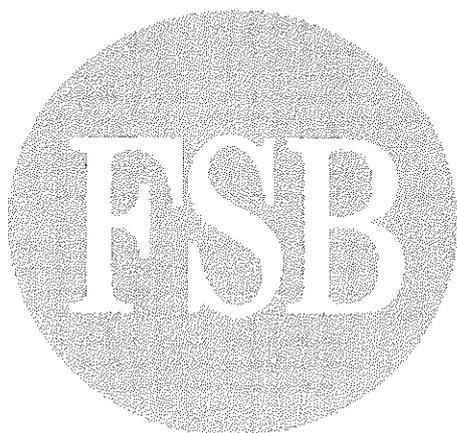
Clive Davenport

Chairman of the Enterprise and Innovation Policy Unit

Federation of Small Businesses



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FSB
response to
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Summary

The FSB supports the Government proposals for a statutory code and independent adjudicator. The six largest pub companies in particular are able to control their relationships with tenants to their own advantage and are under pressure to reduce their debt by increasing income from rents and pub selloffs. In the current conditions we believe that it is not possible for the large pub companies to operate credible voluntary regulation. Current conditions also make it more likely that large pub companies to abuse the imbalance in the relationship between pub companies and tied tenants for their own advantage.

The overwhelming majority of FSB members tied to the large pub companies feel that their current tie arrangements do not allow them to make a fair profit, respond effectively to consumer demand or to compete effectively with non-tied pubs in the area. In 2012 the Government gave the large pub companies one last chance to self regulate and it sought that self-regulation would bring about a speedier reform of the industry than statutory regulation. However, the latest attempt at self regulation by the large pub companies has failed to rebalance the contractual risk and reward structure of large pub company ties. Only a quarter of FSB members tied to a large pub company have been provided with a breakdown of their pubs Fair Maintenance Trade (FMT) and an explanation of how their dry rent is calculated.

To support a diverse and healthy pub sector the Government must introduce a statutory code on large pub companies that:

- Prohibits any products other than drinks to be tied
- Provides tied pubs with the right to sell a guest beer
- Enshrines the right to request an open market rent review if:
 - the price of tied products has increased above inflation,
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 - the tenant did not have a rent review within the last five years, and
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The statutory code must be effectively enforced by an independent adjudicator with an arbitration and investigation function. The adjudicator must also be given the power to render unfair contract terms unenforceable.

After years of failed self-regulation by the large pub companies we urge the Government to act decisively. The need for Government to protect publicans tied to the large pub companies is all the more urgent because the UK's largest pub companies are engaging in the large scale selloff of pubs in order to service their debt.

The beer tie as a traditional tenancy model was suppose to hinge on the pub company being incentivised to increase revenues from wet and dry rent by helping the publican to increase trade. This incentive structure drives pub companies' ongoing investment in their estate to respond effectively to changing consumer demand. However many of the largest UK pub companies no longer have an incentive to increase revenues by increasing pub trade and are unable to invest money across their estate. This means that increased revenues can only be achieved by squeezing tied publicans to extract ever more dry and wet rent. Under these circumstances the large pub companies cannot be trusted to operate credible self-regulation.



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Research

To inform our response to this consultation we surveyed our 3,184 publican members. The survey was open from the 23rd May and 3rd June and we received 167 responses to our self selected questionnaire from 75 tied publicans 20 free of tie publicans and 72 freehold pubs. Unless otherwise indicated the figures presented in this consultation response are based on a sample of 63 publicans tied to pub companies that own 500+ pubs. While this is a small sample size the results we obtained are consistent with research results obtained from larger samples. We believe that the research reflects the views of FSB members tied to large pub companies.

On the basis of previous research and our membership database we believe that approximately 60 percent of our publican members are tied. The majority of those who are tied are tied to pub companies that own 500+ pubs. 80 percent of our tied publican members are tied to one of the big six pub companies, that is: Admiral, Enterprise Inns, Greene King, Marstons, Punch Taverns, and Star, formally Scottish & Newcastle.

The FSB is content to provide the raw data from this research to BIS for further analysis.

The FSB is also in the process of commissioning CGA Strategy to undertake detailed research into the effect a mandatory guest beer option and a mandatory free of tie option would have on the UK brewing industry. We are hoping to interview between 500 and 600 publicans tied to the large pub companies to better understand how publicans would respond to consumer demand. We will submit the raw data from this research to BIS by the end of July.



The need for a statutory code to address market failure

The FSB strongly supports a statutory code of practice for pub companies that own more than 500 pubs. The relationship between the large pub companies and their tenants must in our view be regulated by a statutory code that is enforced by an independent adjudicator.

The six largest pub companies in particular are able to control their relationships with tenants to their own advantage and are under pressure to reduce their debts by increasing income from rents and pub selloffs. Both Enterprise Inns and Punch Taverns are in the process of selling off hundreds of underperforming or non-core pubs to help pay off debt. At the same time both companies hope to increase revenues from their pub estate through dry and wet rent, but are unable to make substantial investments to improve trade. Considering current conditions we believe that it is not possible for the large pub companies to operate credible voluntary regulation.

For example; Enterprise Inn is the UK's largest pub company and owned 5,902 pubs in 2012. Enterprise plans to reduce the estate over the next three years to approximately 5,200 pubs, disposing of about 700 pubs. Over the same period Enterprise Inn plans to maintain current levels of investment and invest approximately £60 million per year to improve the quality of the estate. In 2012 Enterprise Inns earned £184 million from disposing 301 pubs, but only invested £63 million in improving and maintaining nearly 6,000 pubs.¹

The second largest UK pub company Punch Taverns invested £42 million² in its 4,500 pubs in 2012. Punch disposed of 475 pubs, generating £130 million. In 2013 Punch is planning to sell 400 pubs, and within the next 5 years plans to reduce its estate to approximately 3,000.³ Punch is on track to raise £630m from the disposal of the 2,278 pubs over the next five years.⁴ Punch currently has debt of £2.4 billion and is planning to invest £40 million in 2013 to improve the consumer environment in 400 of its pubs.⁵

The current tie arrangement operated by the large pub companies, where significant revenues are generated through inflated wet rent and pub selloffs does not generate sustained investment in the pub sector. Punch reports that only 23 percent of its pubs had investment of over £40,000 in the last 5 years. Only 400 tied Punch pubs will benefit this year from a £40 million investment to improve the consumer environment and thus trade. Because the two largest UK pub companies are under intense pressure to repay debt and resume dividend payment to shareholders there is in our view a disproportionate risk that they will abuse the relationship with their tenants, for example through complex rent calculations and tie arrangements.

In the current climate large pub companies are more likely to abuse the imbalance in the relationship between pub companies and tenants, where the pub companies have access to more information and resources. Breweries which

¹ <http://www.enterpriseinns.com/Investors/AnnouncementAndAlerts/Documents/Annual%20Report%202012.pdf> pg.9

² http://www.punchtavernsplc.com/NR/rdonlyres/1FFF71D7-9B50-4F63-92CE-5A3BA067D33E/0/PunchAR12_Final.pdf pg.8

³ http://www.punchtavernsplc.com/NR/rdonlyres/1FFF71D7-9B50-4F63-92CE-5A3BA067D33E/0/PunchAR12_Final.pdf pg.5

⁴ http://www.punchtavernsplc.com/NR/rdonlyres/1FFF71D7-9B50-4F63-92CE-5A3BA067D33E/0/PunchAR12_Final.pdf pg.3

⁵ <http://www.punchtavernsplc.com/NR/rdonlyres/DA679071-4B0C-4AE9-99D8-12ACF33C2013/0/AnalystPresentationInterimsFINAL.pdf> pg.19



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operate a beer tie for pubs in close proximity to the brewery have an interest in their pubs performing well in the short and long term, because a substantial part of their sales depends on the tied pubs.

In the traditional tie tenancy model, the pub owner has a strong incentive to provide a good service in order to increase sales and thus increase revenues through wet rent. In contrast, many of the large pub companies are currently under pressure to sell off pubs and increase revenue from the remaining pubs through dry and wet rent, with little money to invest in the modernisation or maintenance of their vast estate. In the traditional tie tenancy model brewers are typically obliged to maintain the structure, fabric and exterior of the pub whereas publicans tied to the large pub companies are typically bound by full repairing obligations.

Many of the large pub companies divide their pub estate into core and non-core. Punch Taverns has allocated 1,595 pubs to what is termed "turnaround" or "non-core" estate. In its Annual Report 2012 Punch says about these pubs:

"These pubs are predominately small, wet led and have a much lower average net income per pub at c.£36,000 and which have declined by 9% in the last financial year. Given the limited scope for investment, these pubs are more likely to be impacted by the long-term decline in drinking out and as a result are expected in time to generate more value through disposal than retention."

Tied tenants of pubs whose owners merely manage the pub to maximise short-term revenue from dry and wet rent and optimise "disposal proceeds by selling at the right time" need the protection of a statutory code. The large pub companies clearly lack any incentive to increase their revenues by helping those tenants to increase trade. Furthermore pub companies are incentivised to let pubs run into the ground before sell off because an increasing number of local councils will only agree to a change of use to residential property, which is potentially most lucrative for the pub company, if the pub is no longer suitable for retained A4 use. Local councils typically request trade figures for the past 6 to 18 months to ascertain whether the pub is viable.

A tied FSB member described the consequences for tied tenants when the ultimate owner of the pub ceases to invest:

"We have been with Sheps for over 15 years and this pub just under 10 years. We have gone from earning as a couple in excess of £100,000 a year to earning about £20,000 between us. We had a meeting with the property director last year when we went through our accounts. He agreed the recession and current trading conditions on top of the rising overhead costs had put the trade at a tipping point. We suggested some form of temporary rent reduction or similar to give us a reasonable living standard until things improve. He agreed to consider the options and he'd get back to us. We are still waiting to hear from him. At rent review Sheps do not produce any sort of shadow profit/loss calculation or updated FMT. We very rarely see a BDM and their advice and assistance is non-existent. The exterior has not been painted in at least 10 years and has looked very tatty for at least the last 5 years. We've spent very little on the pub ourselves over the past couple of years due to lack of funds." **FSB member tied to Shepherd and Neame**

Large pub companies argue that the tie as currently operates generates substantial investment in pubs. However in reality only a fraction of pubs owned by large pub companies have benefited from substantial investment and in many cases the only investment made comes from the publicans.



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| | | |
|--|--------------------|-----|
| How much money has been invested in your pub (for maintenance and improvements) over the past 12 months? | No investment | 10% |
| | Up to £5,000 | 25% |
| | £5,001 to £10,000 | 21% |
| | £10,001 to £15,000 | 19% |
| | More than £15,000 | 25% |

| | | |
|--|-------------------------------------|-----|
| How much of this investment came from your pub company or brewery? | 100 percent | 2% |
| | 50 - 99 percent | 9% |
| | 1 - 49 percent | 11% |
| | 100% of the investment came from me | 68% |
| | No investment in the pub | 10% |

In our view repeated attempts by the large pub companies at self-regulation have failed because they need to extract as much revenue as possible out of their assets to pay off their debt. It is because they have no incentive to re-establish mutually beneficial relationships with tied tenants across their estate that progress through self-regulation has been glacial. The Business, Innovation and Skills Select Committee noted when it published its 2011 report that:

“Our report is the fourth report on those problems over the past seven years. Each report challenged the industry to deliver meaningful reform. On every occasion the industry was found wanting. The third report in 2010 delivered a final ultimatum to the industry: eighteen months to show that they were working successfully within the voluntary code. That has passed, and the evidence is that they are not. The message now can only be: three strikes and you’re out. We are firmly of the view that statutory regulation should only be used as a last resort, but we can only conclude that industry self-regulation has failed.”⁶

Yet the subsequent attempt at self regulation in 2012 through the UK Pub Industry Framework Code has again failed to ensure transparency for tenants tied to the big pub companies. Our research shows that publicans tied to the largest pub companies simply cannot rely on their pub companies to fully disclosure all relevant and appropriate information necessary for fair commercial negotiation.

| | | |
|---|----------------|-----|
| Has the pub company or brewery provided you with a breakdown of your pub's FMT (fair maintainable trade)? | Yes | 27% |
| | No | 62% |
| | Can't remember | 11% |

| | | |
|--|----------------|-----|
| Has your pub company or brewery provided you with an explanation of how your dry rent is calculated? | Yes | 25% |
| | No | 71% |
| | Can't remember | 3% |

⁶ <http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news/pub-companies-chairmans-comments/>



| | | |
|--|-----|-----|
| Is your rental agreement clear and easy to understand? | Yes | 59% |
| | No | 41% |

Tied tenants are unable to change supplier, thus tied tenants of the large pub companies are not able to drive the pub owning company to provide a good service and maintain competitive prices. Giving tied tenants of large pub companies the statutory right to request a rent review if the price of a tied product is increased significantly is in our view necessary to guard against abuse of the tie. Allowing tied tenants to exercise such a statutory right, backed by an independent adjudicator, would put pressure on pub companies to maintain competitive prices for tied products. Though the FSB is concerned that disputes may arise over what constitutes a “significant price increase”, and lack of clarity in this respect may limit tied publican’s ability to request a rent review under the proposed statutory code. Thus we suggest that the statutory code clarifies that tied tenants can call for a rent review if the price of tied drinks is increased above inflation.

The FSB therefore supports Government proposals to enshrine in a statutory code the right of tenants to request an open market rent review, which if necessary can be taken to an independent adjudicator. This right is critical in giving effect to the principle that tied tenants should not be worse off than free of tied tenants. Our research indicates that tied tenants are by enlarge not able to assess whether their dry rent is comparable to the dry rent paid by non-tied pubs in the area. The right to request a credible open market rent review would go some way to address the information asymmetry in the pub company’s relationship with the tenant.

| | | |
|--|--------------|-----|
| Is your dry rent higher than that of non-tied pubs in your area? | Yes | 37% |
| | No | 6% |
| | I don't know | 57% |

The FSB would also like to note that some large pub companies specifically aim to recruit tenants who have no previous experience as publican and tied pubs are marketed as cheap entry to the industry because of the relatively low start-capital requirement. New entrants to the pub industry are in an even worse position than experienced publicans to assess whether a pub is likely to achieve the FMT projected by the pub company. Similarly new publicans will find it more difficult to establish whether their dry rent is in line with market value and whether the price of tied products charged by the pub company is fair. Because the large pub companies are more likely to contract with inexperienced publicans the statutory code as proposed would provide new entrants to the industry with much needed protection by ensuring that would-be tenants are provided by the pub company with the information necessary to make a fully informed decision.

According to the consultation document the latest independent annual survey, conducted by CGA strategy, showed 7 out of 10 tenants would sign up again with their pub company. However, when the FSB put this question to FSB members tied to the large pub companies the majority said that they would not renew their contract with their pub company on the same terms.

| | | |
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| If your lease or tenancy came to an end tomorrow, would you renew your contract with the pub company or brewery on the same terms? | Yes | 14% |
| | No | 86% |



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It may well be that these tied tenants would wish to renew their contract with their current pub company on different terms. In our view the fact that the majority of tied tenants would not renew on the same terms is largely due to the widespread hardship that publicans tied to the large pub companies face. On the basis of the FMT pub companies will project annual earnings for the prospective tenant, which are typically in the region of 25k to 40k. Publicans tied to the large pub companies did not sign the tied tenancy contract expecting to earn a mere 10k to 15k before tax. The stark difference between the earnings projected by the pub company and actual earnings of publicans once they are tied is clear evidence that the majority of large pub companies fail to fully disclose all relevant and appropriate information necessary for a prospective tenant to establish actual earnings. The earnings of FSB members tied to the large pub are in line with figures recently published by CAMRA on how much tied publicans can expect to earn from the pub per year.

| | | |
|---|-------------------|-----|
| Please estimate your personal income from the pub, before tax, in the in the last financial year (please ignore any income you may have received from other sources): | Under £10,000 | 59% |
| | £10,000 - £14,999 | 19% |
| | £15,000 - £19,999 | 10% |
| | £20,000 - £24,999 | 5% |
| | £25,000 - £29,999 | 2% |
| | £30,000 or more | 3% |
| | Prefer not to say | 3% |

| | | |
|---|------------------|-----|
| How many hours do you typically work each week on pub business? | 20 - 29 hours | 2% |
| | 30 - 39 hours | 5% |
| | 40 - 49 hours | 2% |
| | 50 - 59 hours | 11% |
| | 60 or more hours | 81% |

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|---|---------------------------------------|-----|
| Please estimate your dry rent costs as a percentage of your turnover: | 0 - 5 percent | 0% |
| | 6 - 10 percent | 21% |
| | 11 - 15 percent | 25% |
| | 16 - 20 percent | 24% |
| | 21 - 25 percent | 27% |
| | 26 - 30 percent | 8% |
| | More than 30 per cent, please specify | 5% |

The issue of prospective tenants being able to establish actual earnings is closely linked to the problem of inflated FMTs, which project the trade the pub is to achieve and are used to calculate the dry rent for a pub.

| | | |
|--|--|-----|
| Does the FMT used by your pub company or brewery to calculate your rent reflect the level of trade your pub actually achieves? | The FMT accurately reflects the pub's annual trade | 17% |
| | The pub's annual trade is lower than the FMT | 75% |
| | The pub's annual trade is higher than the FMT | 8% |



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The FSB does not accept the assertion made by the Beer and Pub Association that the majority of “unhappy tied tenants” are long term tenants, who find that the tie arrangement they entered into several years ago was mutually beneficial to start with but has become less attractive as consumer demand has changed. More than a third of FSB members tied to the large pub companies are on tenancies no longer than 5 years. Consumer trends which adversely affect the pub trade, such as increasing home consumption of beer, will have been apparent to the pub company when the lease or tenancy was first signed. Large pub companies have a much better understanding of current and likely future market trends than the prospective tenant, or even experienced publicans, amongst others because of the scale on which large pub companies operate and because they can buy market data.

| | | |
|------------------------------------|--------------------|-----|
| How long is your lease or tenancy? | Less than one year | 3% |
| | 1 - 3 years | 14% |
| | 4 - 5 years | 22% |
| | 6 -10 years | 32% |
| | 11 - 20 years | 22% |
| | 21 years or more | 6% |

The argument that “unhappy tied publicans” are predominantly publicans at the end of long term leases is also undermined by the fact that pub companies have the opportunity to review the tie arrangements through rent reviews. Rent reviews give large pub companies the opportunity to adjust the risk and reward structure of a tie when markets conditions change. Because of significant problems identified in the past self-regulation has over the past years focused significantly focused on rent reviews. It was commonly said that a tied publicans dry rent could only ever go up in a rent review and it appears that tie publicans still have to fight very hard to secure a reduction in dry rent. However our research indicates that an increasing number of publicans tied to large pub companies are now able to secure a reduction in dry rent during rent review and that the majority of rent increases resulting from a review are in line with inflation.

| | | |
|--|---|-----|
| Thinking about your last rent review, by how many percent was your dry rent increased? | Not applicable, no rent review since beginning of the lease | 27% |
| | My rent was reduced | 24% |
| | 1 - 5 percent increase | 30% |
| | 6 - 10 percent increase | 11% |
| | 11 - 15 percent increase | 2% |
| | 16 - 20 percent increase | 2% |
| | 21 - 25 percent increase | 3% |
| | 31 percent or more, please specify | 2% |

The FSB believes that a statutory code is needed to address the issue of large pub companies inflating FMTs. Inflated FMTs in some cases may be the result of the pub companies being genuinely over-optimistic. But ultimately large pub companies who are under pressure to increase revenues from dry rent have a strong incentive to inflate FMTs. The FMTs for pubs also directly reflect the value of assets on the large pub companies’ books. Establishing realistic FMTs for their pubs would amount to the large scale re-evaluation of their assets. This is simply not in the interest of



large pub companies who have securitised large amount of debt against their assets. Therefore self-regulation by large pub companies is unlikely to rectify the widespread problem of inflated FMTs.

For the publican inflated FMTs not only result in above market rate dry rents and lower than expected income, it also means that the effort and skill invested to increase trade is not fairly rewarded. Anecdotal evidence would suggest that if a publican manages to increase trade and exceed their FMT large pub companies simply increase the FMT or the dry rent.

Large pub companies argue that the inflated dry and wet rents are justified because of the business support offered to tied tenants. Our research indicates that a significant number, but by no means all, of FSB members tied to a large pub company are offered free business support. But the fact that only 43 percent of FSB members tied to a large pub company are offered free advice on "pub promotion and marketing" in our view reflects the fact that large pub companies are not incentivised to increase revenues by working with the publican to increase trade. The claim by large pub companies that tied tenancies are business partnerships is undermined by the fact that only 24 percent of FSB members tied to large pub companies are offered free business management advice.

| | | |
|--|--|-----|
| Thinking about the support programmes and advice your pub company or brewery offers to you free of charge, are you offered advice on...? | Provision and maintenance of dispensing equipment | 46% |
| | Pub promotion and marketing | 43% |
| | Licences and any relevant training requirements | 32% |
| | Business management | 24% |
| | External decoration, signage, building repairs, car parks an | 24% |
| | Procurement benefits | 17% |
| | Rating | 3% |
| | None of the above | 29% |

| | | |
|---|-----|-----|
| Since the beginning of your lease or tenancy have you taken advantage of the advice offered to you? | Yes | 62% |
| | No | 38% |

Just over 60 percent of FSB member tied to a large pub company have since the beginning of their tenancy taken advantage of the advice offered to them by their pub company. The advice and support that is offered to tied tenants free of charge in no way justifies the inflated dry and wet rents many tied tenants pay. The FSB also reject assertions that the subsidised training programmes offered by the large pub companies would justify inflated dry and wet rents. It would be much fairer if pub companies would charge those tied tenants who use training and support programmes.

Bundling of products tend to make it very difficult for consumers to establish whether they are getting value for money, or whether they could get the same products cheaper elsewhere. The FSB believes that the offer of free or subsidised advice as part of tied tenancies should be seen in the same light. It will be very difficult for a prospective tenant to assess whether a tie offer is competitive if the pub company only provides a beer price and the vague promise of comprehensive free business advice. Because the prospective tied tenant will find it difficult to establish



how much the training is likely to cost on the open market, the prospective tied tenant will not be in a position to work out whether the beer price offered is competitive, or whether the “free” business advice offsets an inflated beer price. The FSB therefore believes that a statutory code should make provisions that force large pub companies to effectively unbundle the products and services that make up a tied tenancies. A tie offer should clearly state the price of any product or service that is part of the tie “bundle”. Large pub companies should not be allowed to use free or subsidised advice and training as a smokescreen for inflated wet rent, or dry rent for that matter.

Guest beer option

The FSB supports Government plans to include a guest beer option right in the statutory code. Because tied tenants cannot change supplier they are dependent on the pub company to respond effectively to changing consumer demand. For example, tied tenants are not currently able to respond effectively to a rising consumer demand for beer from local, micro or craft breweries. In order to ensure that such a guest beer right benefits small brewers in particular the guest beer right could be limited to beers from brewers that are subject to the small breweries’ relief on beer duty.⁷

| | | |
|---|-----|------|
| In your opinion, should pubs that are subject to a beer tie be given the right to stock one “guest beer”? | Yes | 100% |
| | No | 0% |

Pub companies no doubt argue that they can satisfy increasing consumer demand for local beer through the new SIBA-Local scheme. However, concerns have been raised about pub companies significantly over-charging tied pubs for local beer, thus making it financially less attractive for tied tenants to meet consumer demand for local beer. The FSB is also concerned about the inherent inefficiency that would be introduced to the market if tied pubs are forced to buy local beer from a national distributor at inflated prices set by the pub company. Giving the tied tenants of the large pub companies the right to stock a guest beer from a small brewery directly would encourage local trade and support a more diverse brewing industry.

The impact a general guest beer right, not limited to beer from small breweries, would have on the beer market is currently subject to debate. Concerns have been raised that if the statutory code would introduce a guest beer right tied publicans would put another premium lager on tap. Most tied pubs will already have two to three tied premium lagers on tap, therefore it appears unlikely that a vast number of tied publican would choose to put another premium lager on tap. Overall the premium lager market appears to have reached saturation point and a number of large pub companies have introduced smaller or artisan lager brands in response to changing consumer demand.

If the statutory code is introduced as currently proposed by the Government a general guest beer right would be accompanied by the right to an open market rent review, which includes tied products. This should in time correct the inflated beer prices tied tenants are charged. Therefore tied tenants would be less motivated use the guest beer right to buy their best selling tied beer (in all likelihood lager) on the open market for significantly cheaper price. The way in which the beer tie is currently operated by the large pub companies means that tied tenants are incentivised to drive sale of non-tied products if these achieve a higher gross profit than tied products. Therefore a guest beer right must be accompanied by the right to request an open market rent review, as proposed by the Government.

⁷ These are breweries that produce no more than 60,000 hectolitres of beer per year.



Prohibiting ties for products other than drink

57 percent of FSB members tied to the large pub companies are tied for Amusement with Prizes (AWP) machines. The FSB strongly supports Government proposals to prohibit any products other than drinks to be tied. We accept that some types of gaming machines require significant management, but we don't accept the assertion by the British Beer and Pub association that therefore AWP's need to be tied. AWP management services can easily be provided to publicans by third parties.

It appears to us that large pub companies are seeking to tie their tenants for an ever increasing range of products in order to increase their own revenues. In theory large pub companies could introduce significant efficiencies to the drinks markets by creating an economy of scale. Though we suspect that as with beer, the large pub companies are not passing on volume discounts to their publican members. In a situation where the costs and benefits of ties for drinks other than beer is not fully understood we believe it is wise to prohibit large pub companies for tying non-drinks products.

A mandatory free of tie option by paying market rent only

The FSB strongly supports Government proposals for tenants tied to pub companies owning more than 500 pubs to be given a free of tie option by paying market rent only. Some of the largest pub companies, such as Admiral Taverns, already offer free of tie tenancies, while others such as Wellington Inns only offer free of tie tenancies. A mandatory free of tie option therefore does not mean the end of large pub companies, as has been suggested. Only a statutory code can ensure that all large pub companies offer a free of tie option, particularly the two largest UK pub companies Enterprise Inns and Punch Taverns. Large pub companies under pressure to pay debt, and with little money to invest in the estate, rely on inflated wet rents therefore the Government cannot rely on the large pub companies' enlightened self-interest.

The FSB agrees with the Business, Innovations and Skills Select Committee that providing such an option is critical to ensure that all large pub companies operate ties fairly. In its latest report the Select Committee observes that self-regulation has failed to ensure that all tied tenants are offered a free of tie option:

"Our predecessor's recommendation clearly stated that over a period of time all existing lessees and all new lessees should be offered a free of tie lease with an open market rent review based on RICS guidance. This recommendation was endorsed by the then Government. Despite this clear instruction, the BBPA/IPC survey has shown that only 16% of new lessees and only 9% of current lessees had been offered a free-of-tie lease. Furthermore, it is open to question whether the free of tie agreements which have been offered are 'genuine' free of tie and accompanied by a full open market rent review. Again we conclude that the industry has shown itself unable or unwilling to deliver meaningful reform."⁸

All FSB members tied to a large pub company are tied for beer, and a significant number are also tied to their pub company for other products.

⁸ <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmbis/1369/136907.htm>



| | | |
|------------------------|--------------------------------------|------|
| What are you tied for? | Beer | 100% |
| | Cider | 84% |
| | Amusement with Prizes (AWP) machines | 57% |
| | Soft drinks including minerals | 35% |
| | Wine | 19% |
| | Spirits | 17% |

The responses we received from our tied publican members overwhelmingly point to problems with the beer tie as currently operated by the large pub companies.

“From what I hear from other pubs, Admiral are better than most of the other pub companies, but I run a fairly good pub with a good healthy turnover and I would like to benefit more from the work I put in. I would like to be free of tie to enable me to properly compete against other pubs in the area that are free of tie. I am paying (even with my discount) over £100 more for a barrel of Carling, even if they doubled my rent I estimate I could make £4,000 more profit per year if I was free of tie.” **FSB member tied to Admiral Taverns**

“Not only are Marstons robbing us blind on wets that they buy in to sell us tied tenants, they are also robbing us even more on their own produced ales. I could buy from an independent supplier, Marstons ales at 60% of what we are charged, I would be really interested to know how this is a fair market, when I am paying an open rent (ie not subbed on beer prices) main brand lagers etc are costing me 44% more than off an independent!” **FSB member tied to Marstons**

“In the Current Climate the pub co business model does not work I run a pub with a gross turnover that is over _____, profit none Its a slight loss. FMT is wrong rent, should be based on open market value. If it was I would save 15K. Free of tie purchases based on my volume would be an extra £100 per brewery barrel on our 600 barrel account that would be 60k that’s 75k going to my bottom line. For the effort I put in and the reinvestment needed that would be fair. The Government needs to act now. The changes brought about by the beer tie created the issues we now have that is property companies who borrowed vast amounts of money to purchase pubs who's current value on their books is greater than their current worth. They do not care about us, they only care about their shareholders. That is so wrong. I have been a licensee for over _____ years.” **FSB member tied to Enterprise Inns**

“Under the SIBA scheme I can now get a local cask ale called Gower Gold Free of tie cost £65 Enterprise price to me £117 !!??” **FSB member tied to Enterprise Inns**

“We have asked for help on several occasions but to no avail. We also receive very little maintenance support considering the amount of rent we pay and have jobs that have remained unfinished for over two years. I would never ever contemplate this kind of agreement again, especially with Marstons.” **FSB member tied to Marstons**

“Been here _____ years with no investment and worst 6 months of trade ever....nearly at end of tether” **FSB member tied to Star Pubs and Bars**



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“Enterprise are only interested in the fact that the bills are paid for the beer and the rent and how trade is working. They do not listen to opinions of their publicans. They have a deposit sitting in their bank account which makes NO interest during the course of a year - £10,000. They offer no advice or help in being able to contribute to redecoration or general upkeep of the property. They are NOT a brewery or PUBCO. They are an estate agent.” **FSB member tied to Enterprise Inns**

“FMT does not take into account the beer tie. We pay a further (average) £25k per year (half of our rent) to Punch in addition to rent. I don't mind being tied per se, however that should be reflected in the rent. It is the reason so many estate pubs have failed and are continuing to fail. Fair market rent MUST include the premium we are being charged for beer. Don't forget that J W Wetherspoons has less than a quarter of the pubs that Punch Taverns control. I would assume therefore that Punch have a greater buying and bargaining power- this should be passed on to their tenants. If it were, then in the long run, everyone would gain- we would be able to sell beer at a reasonable price, more customers would return and tenants would actually be able to make a decent living, and Punch would not have hundreds of ""dead"" pubs. But that would be a reasonable, sustainable and ethical solution- it won't happen voluntarily!” **FSB member tied to Punch Taverns**

“Punch Taverns needs to be less greedy and look at the long term gains to help it's tenants and itself. Due to the high prices charged for tied products one focuses on promoting un-tied products to try & balance the GP%'s. there is absolutely no incentive to drive beer sales.” **FSB member tied to Punch Taverns**

“The situation is dire and as Tenants we pay FAR TOO MUCH on tied beer products compared to Free Houses.” **FSB member tied to Admiral Taverns**

“Stop us getting ripped off by beer prices.” **FSB member tied to Punch Taverns**

The FSB supports a mandatory free of tie option in the statutory code primarily because allowing tenants to pay market rent only for the pub would incentivise the large pub companies to greater transparency and fair tie arrangements where tenants can objectively assess costs and benefits. The tie as it is currently operated by the large pub companies is loathed by publicans. Our tied publican members tell us that the beer tie as currently operated by the large pub companies does not allow them to make a fair profit or to respond effectively to consumer demand. It is thus not surprising that publican tied to the large pub companies would like to be free of the tie.

| | | | |
|--|--|-----|-----|
| Do you feel that your tie arrangement allows you to: | Make a fair profit | Yes | 3% |
| | | No | 97% |
| | Respond effectively to changing consumer demand | Yes | 13% |
| | | No | 87% |
| | Compete effectively with non-tied pubs in the area | Yes | 12% |
| | | No | 98% |

| | | |
|---------------------------------------|-----|------|
| Would you like to be free of the tie? | Yes | 100% |
| | No | 0% |



The FSB is puzzled by the British Institute of Innkeepers's recent claim that many free of tie publicans would rather be tied. While the number of free of tie FSB members we surveyed is small, the research results we have in no way support this assertion.

| | | Leased or tenanted free of tie pub | Freehold pubs |
|------------------------------|-----|------------------------------------|---------------|
| Would you prefer to be tied? | Yes | 0% | 0% |
| | No | 100% | 100% |

The FSB also support a mandatory free of tie option because we believe it could have a positive impact on the UK beer industry and could result in increased local trade.

| | | | |
|---|--|-----|-----|
| If you were not subject to a beer tie, which of the following would you do? | Stock beer from a wider variety of brewers | Yes | 97% |
| | | No | 3% |
| | Stock beer from local breweries | Yes | 94% |
| | | No | 6% |
| | Stock beer from micro and craft breweries | Yes | 86% |
| | | No | 14% |

The consultation document claims that the beer tie as operated by the large pub companies offers economy of scale. It does, but these benefits are not passed on to tied publicans, and neither do economy of scale benefits reflect in the price consumers are charged for a pint. The majority of the large pub companies are not brewers. Instead they buy beer in large quantities from breweries, benefitting from significant price reductions. Tied tenants are forced to buy this beer at inflated prices from their pub companies. Our research shows that pub companies do not pass on the volume discount to their tied tenants, instead pub companies charge tied tenants above the market rate for beer. Ultimately tied tenants do not reap the benefits that supposedly come with being tied to a large pub company.

| | | |
|--|--|-----|
| Compared to the price you would have to pay on the open market, is the price your pub company or brewery charges for beer: | Significantly higher (by more than 20 percent) | 90% |
| | Slightly higher (up to 20 percent) | 8% |
| | Unsure | 2% |

| | | |
|---|----------------------|-----|
| Please estimate your average gross profit from a pint of lager? | Less than 20 percent | 17% |
| | 21 - 30 percent | 10% |
| | 31 - 40 percent | 30% |
| | 41 - 50 percent | 41% |
| | 51 - 60 percent | 2% |



| | | |
|---|----------------------------|-----|
| Please estimate your average gross profit from a pint of ale? | Less than 20 percent | 17% |
| | 21 - 30 percent | 5% |
| | 31 - 40 percent | 35% |
| | 41 - 50 percent | 35% |
| | 51 - 60 percent | 5% |
| | 61 - 70 percent | 2% |
| | The pub does not serve ale | 2% |

The consultation document notes that if a tied tenant would choose to pay market rent only large pub companies may lose the incentive to invest in the pub. As explained above, the large pub companies are in any case not currently incentivised to invest to drive sales across their estate and thus increase revenue from wet and dry rent through investment in the pubs they own. Both Enterprise and Punch target investment to improve the consumer environment at a relatively small number of pubs and their overall annual investment is small compared to the size of their estate.

If the Government wants to incentivise large pub companies to invest in their estate it could provide tied tenants with the right to go free of tie if the pub company has failed to make any investment in the pub in the past 12 months. This would provide added protection for tied tenants who find that their pub has been relegated to the non-core estate. Such tenants would then be free to invest the money saved by going free of tie. The pub company would still benefit from increased revenues through the dry rent the tenant pays for the pub. The publican's investment would also maintain or increase the value of the pub on the pub company's books.

As previously noted, the majority of FSB members tied to the large pub companies have invested in their pub, while paying inflated wet and dry rent. This unfair imbalance of risk and reward means that the tie as currently operated by the large pub companies largely stifles the ability of tied publicans to effectively respond to changing consumer demand and thus increase trade.

The FSB strongly believes that providing a mandatory free of tie option in the statutory code will be critical in ensuring that large pub companies don't treat tied tenants worse than free of tie tenants. The inability of the large pub companies to make the investment needed across their estates to increased revenues through increased trade means that in many cases pub companies can only increase revenues by over-charging tied tenants for beer and other tied products.

Some suggest that tied tenants are forced to pay pub companies 70 to 80 percent more for lager than they would have to pay on the open market. Tenants tied to the large pub companies are currently not compensated for inflated beer prices through reduced dry rents, or investment for modernisation. It is worth reiterating that pub companies are currently free to over-charge tied tenants because tied tenants have no choice of supplier. The reality is that the largest pub companies have failed to provide tenants with fair tie arrangements, for example by compensating above market beer prices through investment in the pub.

If tied tenants were given the option to pay market rent only for the pub, large pub companies would have to establish transparent tie arrangements that benefit the pub company and the tied tenant. Ultimately buying on the open market comes with costs to the tenant; aside from not benefitting from significant volume discounts buying on



the open market will require time and various factors may mean that the tenant cannot always achieve the best possible price. Therefore some tenants, and especially new publicans, will choose to be tied if large pub companies offer fair and transparent tie arrangements. Mandating that the tied tenants of the large pub companies are given the option to pay market rent only, does not amount to the abolition of the beer tie. It would merely establish an incentive for pub companies to offer tie arrangement where the pub company and tenant work in partnership to maintain and increase sales on fair terms.

The impact of a statutory code on the ongoing pub selloff

The consultation document notes that providing a mandatory free of tie option in the statutory code could result in one of the large pub companies going into administration. This risk is not specific to a mandatory free of tie option, but could also be brought about by any intervention that could lead to declining revenue for the large pub companies. The right to request an open market rent review is likely to reduce dry and wet rents, thus reducing revenues for the pub company. In the short-term it is likely that pub companies under pressure to repay their debt would seek to balance out declining revenues by accelerating pub selloff.

However, BIS should not regard the largest pub companies as too big to fail. Private companies that have ruined a viable business by accumulated vast amounts of debt because of property speculation should not be rewarded or protected by the Government. The fragile financial arrangements that some of the large pub companies have constructed are in any case already unravelling. Punch Taverns is currently discussing the option of a pre-pack administrative receivership with its shareholders⁹ and is desperately seeking to restructure its £2.4 billion debt to avoid defaulting.¹⁰

The consultation document notes that hundreds or potentially thousands of pubs could be placed on the market at once, and that such a selloff could have a transformative effect on the market. However, it is also noted that if there is not enough capital in market to allow pub companies and brewers to buy up these pubs viable pubs may be sold off for alternative use. There is certainly not an abundance of finance in the market but there are currently between 30 and 40 regional brewers with significant estates and around 400+ medium sized pub companies with estates of under 100 pubs. The financial situation may mean that smaller players can do no more than cherry pick a few pubs each if one of the big pub companies goes into administration. But it appears likely that willing buyers can be found for viable pubs.

Unfortunately access to finance for small business remains limited and Government initiatives to increase lending to small businesses through banks have not been entirely successful. It is therefore difficult to predict how many tied tenants, or communities, may be able to secure the finance needed to buy the freehold of viable pubs following one of the big pub companies going into administration. However, there is anecdotal evidence to suggest that demand for freehold and leasehold pubs across the UK is currently outstripping supply, despite ongoing large scale pub selloff by large pub companies.

⁹ <http://www.morningadvertiser.co.uk/Company-City-News/Punch-Taverns-dismisses-pre-pack-administration-option>

¹⁰ <http://www.thisismoney.co.uk/money/markets/article-2323077/Punch-Taverns-face-break-talks-debt-hit-wall.html>



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The risk of large numbers of viable pubs being sold off for alternative use following one of the large pub companies going into administration is diminished by the fact that the majority of pubs would have ongoing tenancies. Most tied tenants are protected under the Landlord and Tenants Act 1954 Part II, thus if a pub is sold off that is tenanted, the licensee would simply be obliged to pay their rent to the new owner (or the administrator). Only pubs at the end of their tenancies would be attractive for property developers, and as noted above, if the pub is commercially viable councils are increasingly refusing to allow change of use. If one of the large pub companies did go into administration the administrator would treat both the property and the existing tenancy as an asset. The fact that tenanted pubs will continue to provide income reduces the need for the administrator to sell off the entire estate at once.

| Pub company | Estate | Planned selloffs |
|-----------------|------------|---|
| Admiral Taverns | 1,100 pubs | unknown, acquisitions planned by Cerberus Capital Management |
| Enterprise Inns | 5900 pubs | Will dispose of approximately 700 pubs over the next three years |
| Greene King | 1,600 pubs | Will dispose of about 400 pubs in 2013 to reduce estate to 1,200 by 2014 but also making acquisitions |
| Marstons | 2,130 pubs | At least 379 pubs identified for disposal |
| Punch Taverns | 4,500 pubs | Will sell off 2,278 pubs over the coming five years |
| Star | 1,380 pubs | Unknown |

The consultation document fails to acknowledge that the large pub companies are currently selling off hundreds of pubs every year. For example, Enterprise Inn is planning to dispose of 700 pubs over the next three years, Punch plans to sell off 2,278 pubs over the coming five years. It is currently not known how many of these pubs are bought by other pub companies or brewers, and how many are sold on for alternative use. It is likely that many of the pubs sold off by large pub companies are at the end of their tenancy. Nevertheless a better understanding of how the market is coping with the current selloffs could allow BIS to establish with greater certainty how the market would cope if one of the large pub companies would go into administration.

Default by one of the large pub companies is not unprecedented. When Admiral Taverns defaulted on £1 billion debt in 2010 Lloyds Banking Group was forced to do a debt-for-equity swap and pre-pack administration, and Admiral's 2,000 tenanted pubs were sold off over the course of two years. It appears that administrators immediately established beer and drinks distribution arrangements to allow the Admiral Tavern pubs to continued trading. As far as we can tell the Admiral Taverns were sold off in chunks to other pub companies or brewers. Again, a better understanding of the Admiral Tavern administration process would also allow BIS to better understand the impact of a large pub company defaulting on its debt in the near future.

The reality is that Government must act now to ensure that viable pubs are not sold off for alternative uses. The large scale sell off of pubs will continue, even if no statutory code is imposed. As noted above, the need to pay off debt by selling off pubs means that some large pub companies are not investing sufficiently in their estate, and are instead incentivised to extract even more revenue from pubs through dry and wet rent. Therefore viable pubs tied to the large pub companies may become unprofitable several months before sell off.



It appears that councils who scrutinise applications for change of use assess viability on the basis of trade, rather than profitability figures.¹¹ But depending on how large pub companies manage tied pubs allocated for selloff trade figures may slump as well many months before selloff. Unfortunately it is not known how many councils actually scrutinise applications for change of use with a view to establish the viability of the pub. The risk that the large scale selloff of pubs by the large pub companies destroys significant numbers of viable pubs is considerable. Therefore BIS should work with the Department for Communities and Local Government to ensure that the ongoing pub selloff does not result in large numbers of viable pubs being sold off for alternative use.

| | | |
|---|--------------------------------------|-----|
| How would you describe the financial situation of your pub? | The pub is making a healthy profit | 3% |
| | The pub is making a moderate profit | 24% |
| | The pub breaks even | 38% |
| | The pub is making a moderate loss | 23% |
| | The pub is making a significant loss | 11% |

Incidentally, the right to request an open market rent review could prevent tied pubs earmarked for selloff from being driven into unprofitability by protecting the tenant against unjustified wet or dry rent increases. If a statutory code is imposed Government could take additional steps to ensure that the ongoing selloff of pubs by the large pub companies is conducted in a fair manner for tenants. To ensure fairness the statutory code should provide tied tenants with a right to know whether the pub company has earmarked their pub for selloff, or has decided to make no further investment in the pub. Such a decision fundamentally changes the business relationship between the pub company and the tenant, and diminishes the pub companies' incentive to work with the tenant to increase revenues from wet rent through increasing trade. As noted above, we believe that such tenants in particular would benefit from a mandatory free of tie option.

The impact of the statutory code on major brewers

The consultation document notes that mandating a free of tie option in the statutory code may lead to the collapse or downsizing of a major brewer, because brewers rely heavily on their tied pubs for sale of their beer. However the majority of UK breweries which own pubs would fall below the proposed 500+ pub threshold. A number of our members are tied to a brewery, but these breweries are generally well below the proposed 500+ threshold.

Amongst others FSB members are tied to Fullers Brewery, which owns nearly 400 pubs, bars, hotels and inns; Brakspear has sold its brewery and in any case only owns 145 pubs; Wadworth breweries owns 260 pubs; Batemans Brewery owns 70 pubs; Brains Breweries have increased their estate to 129 pubs and is planning to acquire another 70 pubs over the next five years; Shepherd Neame Brewery owns about 360 pubs; Arkell's Brewery owns about 270; Thwaites Brewery owns about 350 pubs; Robinsons Brewery owns about 340 pubs; and Charles Wells Brewery owns just over 200 pubs.

¹¹ Commercial property such as shops and offices are valued on a rate per square meter, whereas pubs are valued on the basis of the so called profits method. Under this method the value of the pub as a building depends on the pub's profits.



Of the six largest pub companies three own breweries. In the case of Marston's the brewery sells 77 percent of its brewery output to third parties,¹² meaning that only 23 percent the brewery's output is sold through the 2,130 Marston's pubs. It appears unlikely to us that a mandatory free of tie option could result in Marston's brewery becoming financially unviable. Heineken has recently acquired Star Pubs & Bars, though there is no suggestion that Heineken will be primarily relying on Star's tied pubs to secure the viability of the UK based Heineken breweries.

Greene King, the other brewer among the six largest pub companies, brews a range of leading ale brands. The pub company has a diversified business, which includes significant food sales, and *only* £31 million debt. Brewing in the two Greene King breweries generates a mere 15.2 percent of the companies' revenues and while no figures are available on how much beer Greene King sells through its tied tenants, the company states: "In the [last financial] year we saw strong growth in Export, Take Home and Free Trade, and in our own Retail estate. Total volume, including third party drink sales, was up 8.1% leading to revenue up 5.0 percent to £173.8m. Operating profit was £33.0m, down 0.3%." It therefore appears that the viability of Greene King's breweries does not solely depend on sales through tied pubs.

The FSB is not convinced that the inclusion of a mandatory free of tie option in a statutory code for pub companies that own more than 500 pubs would endanger the financial viability of any major brewer. If a credible risk was identified, the FSB would be content if the at risk brewer offers a free of tie option where the tenants is free to buy the breweries' beer on the open market.

Self-regulation by brewers and small pub companies that own less than 500 pubs

The FSB backs Government proposals for brewers and pub companies that own less than 500 pubs operate self-regulation. Unfortunately we did not manage to survey enough FSB members tied to small breweries to provide a detailed response on this subject. However, the data we have indicates that at least some FSB members tied to small breweries face the same challenges as FSB members tied to the large pub companies.

Our data indicates that it is less likely that a pub tied to a small pub company or brewer has received investment in the past 12 month, but if an investment was made the small brewer was more likely to have contributed. FSB members tied to a small brewery are also more likely to have taken advantage of free advice and support programmes since the beginning of their tenancy. Rental cost as percentage of turnover appears to be lower for publicans tied to a small pub company, but about half of tied publicans earn less than 10k per year from pub business. Pubs tied to a small brewery or pub company are also more likely to make a moderate profit and less likely to make a significant loss.

Based on what we know we believe that self-regulation by small breweries can make a significant difference for tied tenants because small breweries are less likely than the large pub companies to have significant debt. Small breweries and pub companies appear to be in a better position to invest and are less likely to sell off large number of pubs. Therefore the incentive structures at work in that part of the industry support self-regulation better than the incentives that drive many of the large pub companies. However, if small breweries and pub companies are left to self regulate BIS should ensure that this part of the industry raises awareness of the voluntary code among tied

¹² http://www.marstons.co.uk/docs/financials/MARS_INTERIM_STATEMENT_16052013.pdf pg.6



tenants. BIS should in our view also keep the situation under review, and make small breweries subject to statutory regulation if they behave irresponsibly. A threat of statutory regulation may help to ensure that small breweries don't forgo mutually beneficial business relationships for the sake of short term profits.

Backing the code with an independent adjudicator

The FSB agrees with BIS that a statutory code must be backed up by an independent adjudicator. Giving the adjudicator an investigative power is in our view essential to protect tenants tied to the large pub companies who fear retribution if they speak up. In advance of the consultation we have repeatedly heard about tied tenants who support the statutory code but will not respond to the consultation because they fear retribution from their pub companies. Giving trade associations the right to bring complaints in front of the adjudicator could also assist in protecting frightened tenants.

A complaint by one tied tenant may well uncover evidence to suggest that a large pub company is systematically breaching the statutory code. In such a situation an investigative power would allow the adjudicator to probe further. It may also be appropriate to establish a referral system akin to a super complaint; where trade associations who represent publicans tied to the large pub companies can complain in relation to problems that affect large number of publicans. Such a referral system would assist in addressing breaches of the code which affect a large number of tied publican but only cause minimal financial detriment to individual publicans.

The FSB supports Government proposals to give the adjudicator strong enforcement powers, including financial penalties against the pub company. However the FSB is concerned that current proposals would not give the adjudicator the power to compensate tied publicans where necessary. If a breach of the code results in tied publicans being over-charged, for example in relation to dry or wet rent, the adjudicator must have the power to ensure that the tied tenant is repaid promptly. There are a number of enforcement bodies which have such a power. For example Ofcom not only has the power to fine telecoms providers for incorrectly billing customers but can also order telecoms providers to repay affected customers.

Finally, the FSB believes that the adjudicator must be given the power to sever unfair contract terms from tenancy and tie agreements, or render them unenforceable. Equivalent powers are available under the Competition Act 1998 as amended by the Land Exclusion Revocation Order 2010 and in the case of unfair contract terms in consumer agreements by the OFT. The FSB agrees that the statutory code should be based on the principle of *Fair and Lawful Dealing*. But it is not clear to us how the adjudicator would deal with instances of unlawful activity not relating to the statutory code, such as for example breach of contract, fraud or harassment.

Our assumption is that the adjudicator cannot rule on points of law unrelated to the statutory code, therefore the statutory code must make provisions to give the adjudicators powers in relation to unfair contract terms. The adjudicator may also need the power to refer questions of law, to for example the Chancery Division of the High Court. We also believe that tied publicans need to be clearly informed about the jurisdiction of the adjudicator. Because if the principle of fair and lawful dealing is included in the statutory code tied publicans may wrongly assume that the adjudicator can deal with any unlawful conduct by larger pub companies.



Annex – Consultation Questions

Q1. Should there be a statutory Code?

The FSB strongly supports a statutory code for pub companies that own more than 500 pubs. However we were disappointed to learn that the statutory code would only cover England and Wales. We would welcome if BIS could provide clarification on this matter. We believe that tied tenants across the UK need the protection of a statutory code.

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 FSB supports the proposed threshold.

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?

The FSB supports this proposal. However it is not clear to us whether free of tie tenants of large pub companies could rely on the code to request an open market rent review for the dry rent they pay.

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

The franchise model operated by some pub companies is very similar to the tied tenancy model. However it is not clear to us whether large pub companies are able to abuse their relationships with franchisees to the same extent. If it became apparent that large pub companies have essentially just rebranded the tie, franchisees should be given the same protection tied tenants are given.

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 are unable to assist BIS in quantifying the cost to the industry of the proposed statutory code. However we support BIS' proposal that those pub companies that attract the most complaints should contribute more to the cost of the adjudicator. We also wonder what would happen to the fines. Some of the pub companies have substantial turnovers, and fines could potentially be significant.

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

As explained above, the FSB supports proposals for brewers and small pub companies that own less than 500 pubs to operate self regulation.

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

We agree that the statutory code should be based on this principle. However, as noted above, it is not clear to us how the adjudicator would deal with instances of unlawful activity not relating to the statutory code, such as for example breach of contract, fraud or harassment.

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

The FSB believes that this principle is in effect the spirit of the statutory code, and if in doubt about how the code's provisions apply in a particular situation the adjudicator should always return to this principle.



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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.***

Yes we agree with this principle. However, in relation to the right to request a rent review after 5 years we note that many tenants tied to the large pub companies have tenancies for less than 5 years. Under the proposed rule a tied tenant with a 20 year lease can ask for at least three rent reviews during the course of the tenancy. As explained above, rent reviews are the opportunity to adjust tie arrangements to changing market conditions. It appears appropriate to us that 20 year tie arrangements are effectively reviewed every 5 years. For tied tenancies that are five years or less we would propose that the tied tenant should be able to request a rent review within two years of starting the lease. This would allow tie arrangements to be adjusted if it emerges that market and trading conditions are not as expected.

We are also concerned that the consultation document is not clear on the methodology for rent review valuations. The statutory code should in our view clarify that all rent assessments, be they for new letting, lease renewal or rent review, should be conducted in accordance with the RICS guidance. The statutory code should also clarify that the RICS guidance must always be interpreted on the basis of the principle that the tied tenants should not be worse off than free of tie tenants.

With regards to the right to request a rent review if the pub company significantly increases drinks prices, as noted above, we are worried how "significant" will be interpreted. Perhaps it would be easier to grant such a right for any above inflation increases of drinks prices.

- 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.***

The FSB fully agrees with this proposal.

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

As explained above, the FSB believes that the statutory code should prohibit any product other than drink from being tied.

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

As explained above, the FSB supports a guest beer right for publicans tied to the large pub companies.

- 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.***

We agree with this proposal.

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

The FSB believes that the statutory code must include a mandatory free of tie option, thus the draft Statutory Code should be amended accordingly. The statutory code should provide that tied tenants must be given a free of tie option when an open market rent review is undertaken.

Furthermore the draft statutory code should be amended to state that "all contracts will be fair, reasonable and compliant with the law".



Please also see our comments on tied pub that have been earmarked for selloff and the adjudicator.

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 review of the code would be assisted if the adjudicator publishes annual reports on complaints received and disputes resolved. It would also be beneficial if the adjudicator would report on complaints received which fall outside the code. A review of such complaints could provide a timely snapshot of the problems tied tenants face and provide the basis for updating the code. We also suggest that complainants are surveyed on their experience of making a complaint to the adjudicator.

We believe that the unintended consequences of the Beer Orders could have been avoided if the Beer Orders had included an effective mechanism for review. A periodical review of the statutory code will ensure that the statutory code remains relevant as the pub industry changes, and such reviews will provide Government with the ability to react quickly should unintended consequences become apparent.

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

Yes, as explained above, the FSB strongly supports the inclusion of a free of tie option in the statutory 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?

No

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

Yes, it is in our view absolutely essential that a statutory code is enforced by an independent adjudicator.

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, though the power to investigate should not be limited to "widespread breaches", amongst others because it might not be immediately apparent that breaches are systematic or widespread.

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?

We are concerned about proposals for "recommendations" to not be binding. The recommendations must be binding, otherwise the adjudicator cannot reasonably take action against a pub company that does not follow the recommendation. Ie if the recommendation is non-binding it cannot be the starting point for escalating sanctions.

II. Requirements to publish information ('name and shame')

In our view the adjudicator should have this power.



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III. Financial penalties?

Yes, we would suggest that the adjudicator can impose fines where the breach of the code has been particularly severe, or in response to a pub company not following a binding recommendation.

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

We agree with this approach.

For further information

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