# Pub Companies and Tenants: A Government Consultation

Response by the

## Society of Independent Brewers

### Executive Summary

The Society of Independent Brewers was formed in 1980 to promote and defend the interests of the new wave of microbrewers, who were denied access to existing trade bodies. From an inaugural meeting of just twenty pioneer founders, the organisation has grown to a membership now in excess of 650, thus representing the majority of independent beer companies in the UK, including both relatively youthful enterprises and many of the long established family brewers.

Throughout its history, SIBA* has sought pragmatic solutions to the difficulties its members have faced, essentially in pursuit of a marketplace that allows the opportunity for its members to bring their goods to the consumer.

Because over 80% of SIBA members' beer production volume is sold in the on trade, it is essential that a strong and vibrant pub sector is given the opportunity to attract investment and retain its position at the heart of British community life.

It is our current view that legislative intervention should be recourse of last resort. This is based on experience of previous statutory attempts to enforce change, most notably the Beer Orders of 1989. We would much prefer to see the continued evolution of the market, which has undoubtedly been significant in recent years. Unwarranted intervention will lead to a further period of uncertainty – from which the industry has already suffered for a number of years. If legislation is to be introduced it should seek first and foremost to embolden investment opportunities in the pub sector and to encourage investment in pubs from all stakeholding parties.

We have grave concerns about the unintended consequences of well-meaning but poorly drafted legislation. The Beer Orders, which actually created the circumstances that led to the creation of those pubcos now targeted by these proposed new laws, are a classic example of this. SIBA welcomed the 1989 guest beer provision as the solution to market foreclosure; hindsight has proved that it actually exacerbated foreclosed market access for small brewers. The laudable theory that opening trading routes would generate opportunity for all resulted in practice in giving additional market share to the national and global brands that had the 'deepest pockets'.

Recognising the Government's desire to support a thriving and diverse pubs sector, we would question the validity of some of the complaints of abuse of the tie. Whilst not denying the evidence of historical cases, we contend that the major pubcos have improved dramatically in

* The acronym reflects the original name of Small Independent Brewers' Association

recent times under self-regulation, and that as a result the frequency of justifiable complaints that are not resolved satisfactorily is reducing. The tenor of the consultation briefing seems to ignore these improvements and thus is potentially looking to introduce blanket legislative action to tackle an already declining problem.

It is also surprising to see a defined value for the transference of profitability from one party to another, and we would question how that figure has been arrived at. More importantly, we have doubts that legislation is the right way to deal with such a desire. Again, without denying historical inequities in lease terms and operational practice, it remains our view that self-regulation has begun to correct the market, that the market is becoming increasingly geared to engender appropriate division of profits over time, and that more time should be afforded for this evolutionary change before any intervention is considered.

Overall, the consultation appears to be attempting to find an incredibly large sledgehammer to smash an ever-diminishing nut. If legislation is to be sought that supports the licensee, it should be without presuming the guilt of the landlord.

Many of our members have grown their businesses without pubs of their own, but share an understandable ambition to enter the pub market. In current economic conditions, the difficulty they face in particular is the failure of the banks to provide the capital necessary to fulfil this desire. However, pubcos are increasingly offering an alternative route for independent brewers to secure on-trade outlets, with leases that are free-of-tie for the brewing leaseholder's own products, but partially tied elsewhere to facilitate low-cost entry into the trade. Developments such as this, and the constructive and mutually beneficial partnerships they encourage – which do not need to be legislated for – are proof of the evolving pub market.

Q.1 **Should there be a statutory code?**

No: more time should be given to assess the current self-regulatory system.

The introduction of a statutory code would add additional cost to a sector that is already under pressure; money will need to be found from somewhere, further reducing the available divisible funds. It appears that any statutory code would be based largely on the current Industry Framework Code and thus, if the code is being adhered to, then there would be no additional benefit to licensees. If the current code is not being adhered to then there are appropriate mechanisms in place for licensees to challenge their landlord.

Analysis of how well self-regulation is working will take some time, and recognition of the steps that have been taken by the industry will be needed. It is SIBA's view that there has been historic abuse of the tie but that self-regulation has dramatically reduced such instances. It is also worth pointing out that much of the hardship faced by individual licensees has been caused by the economic downturn, not by the tie. Many licensees purchased assignable leases at high premiums when times were good; much of that value, if not all, has been destroyed by poorer trading conditions. The pubcos themselves have to wrestle with similar issues; having purchased properties at the height of the market, they now have to deal with the slump in values. It is difficult to understand how a statutory code would provide any additional benefits to licensees or how it would support growth and investment in the pub sector.

Q.2 **Do you agree that the Code should be binding on all companies that own more than 500 pubs?**

No: alternative qualifications for inclusion/exclusion should be considered.

SIBA supports the principle of targeting any legislation at those who have historically abused the tie. It appears to us that this proposal is designed specifically to exclude the family brewers from a statutory code. It is undoubtedly true that brewers selling their own products through a tied estate have a vested interest in investing in that estate and finding the right entrepreneurs to sell the maximum amount of their wares.

It then begs the question of whether a figure of 500 pubs delivers this pragmatic objective. Our concerns lie not with an arbitrary number, but with the consequences of such legislation.

It was the introduction of a 2,000 pub limit in the 1989 Beer Orders that led to the existence of the pubcos; would imposing a limit of 500 this time have the potential to cause the creation of smaller pubcos, free to operate lease and tenancy agreements beyond the jurisdiction of the statutory code?

The introduction of a statutory code covering only those companies who have over 500 pubs would weaken the self-regulatory regime for those operating fewer than 500 pubs. Whilst it is currently the case that those companies are not regularly accused of abuse, it may be an unintended consequence of this legislation to remove protection for tenants and leaseholders of smaller companies.

We would propose consideration be given to excluding companies that operate a vertically integrated model, rather than merely imposing an arbitrary threshold. Consideration would need to be given to the definition, which should be based on all the pubs operated by a pubco having access to the beers produced, to prevent a large pubco merely buying a small brewery in order to circumvent the Code. We would also propose that the statutory code should only cover those companies that operate a tied tenancy or tied leasehold model, removing the managed house operators and those companies who operate entirely free-of-tie agreements.

Q.3 **Do you agree that, for those companies on which the Code is binding, all of those companies' non-managed pubs should be covered by the Code?**

Yes.

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

Where franchises exist, it is our understanding that they are already adequately provided for and should thus be excluded from the Code.

Q.5 **What is your assessment of the likely costs and benefits of these proposals on pubs and the pubs sector?**

As outlined in our previous answers, it is our view that there would be no additional benefits for licensees from the introduction of a statutory code. We believe that any proposals for legislative intervention in the pub sector should be targeted at driving investment and growth.

We do however also acknowledge that the spotlight cast by this consultation (and by others before it) will lead to greater transparency within commercial agreements signed by tenant and pubco. This will greatly enhance the opportunity for high-quality licensees to run profitable businesses. It will inculcate an understanding of the wet and dry rent mechanisms and of the potential saving on dry rent that the wet rent affords. A modular tie, where the tenant can fully understand options open to them, and a clear understanding of the benefits and value of landlord support within tied agreements (SCORFA) will improve the quality of those entering the trade.

We would also contend that the future of the British pub and of all pub operators depends on attracting the right candidates to run pubs. The market will consequently need to provide increased potential for profit, which will over time transfer value from pubco to tenant. We therefore accept that it is imperative that pressure is maintained to see that large pubcos deliver on their promises; that abuse of the landlord and tenant relationship disappears entirely; and that government policy targets continued and additional infrastructure support for small businesses.

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

We believe that self-regulation has begun to resolve many of the issues that have led to this consultation and would like to see further time to see how effective self-regulation has been. We are also concerned that a statutory code applied to only the largest companies will diminish the effectiveness of self-regulation that falls outside the statutory code.

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

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

Yes.

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

The principle is sound in our view, but the reality of how this can be measured leaves significant pragmatic problems, particularly around the value of benefits (SCORFA). The principle provides solid foundations on which to build.

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

***i*- Provide the tenant the right to request an open market rent review:**

**- if they have not had one for five years**

Yes.

**- If the pub company significantly increases drink prices or if an event occurs outside the tenant's control**

We believe that price increases are driven by two factors only: cost increases and increases in the rate of duty. We have seen no evidence of pubcos manipulating pricing for any other reason. In instances of pricing being changed for any other reason, then by the principle of being no worse off than a free-of-tie tenant this should be challengeable.

Presumably events outside the tenant's control would also affect the pubco; it is difficult to envisage quite what is meant but each case should be dealt with fairly. We cannot automatically agree that legislation should include this.

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

We believe that increasing transparency in all aspects of the commercial agreement is a good thing; however it is still difficult to assess exactly how comparisons could be made.

We have argued that all elements of the tie should be negotiable with clearly defined costs for removal of the tie when the agreement is signed; these modular ties could be reviewed alongside rent reviews to allow the tenant to 'buy' tie freedoms or even to agree to become more tied, depending on how successful they are in identifiable areas of their business. This would allow them flexibility to make sound commercial decisions to adapt and grow the profitability of their operational model. This removes the issue of products that are tied suffering reduced sales as licensees concentrate on the more profitable parts of their business. Whilst SIBA fully supports the

existence of the beer tie, we believe that in the right businesses freedom would generate additional sales.

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

No: as we have outlined above all supplies, whether drink or not, should be allowed to be tied, with transparency around differential pricing.

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

Having seen this policy tried before, it should be remembered that the only winners after the Beer Orders were the multi-national brewers. As outlined in the consultation document we believe that the majority of licensees would simply buy their best-selling lager as the guest beer. This would allow the multi-national brewers further scope to foreclose the market to our members. It would also allow the pubcos to remove the current supply agreements through our Direct Delivery Scheme (SIBA DDS) on the grounds that the value of such agreements would be negated by the guest beer provision. SIBA DDS was designed to prove to licensees and the pubcos that choosing a local beer drives footfall and sales, and has been hugely successful in demonstrating this. We would like to see pubcos promoting the scheme much more within their estates.

It has been suggested that a guest beer option that only allowed 'real ale' to be chosen could be drafted, as in the 1989 Beer Orders, or that 'locally brewed' beer could be used as a definition. There is some attraction in these options for our members, but we fear that the former would inevitably face legal challenges from those producing other beer styles, and that in the latter case further clarity would be needed on what local means and how this would affect the market.

In its current form we believe the guest beer provision would destroy current routes to market for independent brewers; our research shows that the leading brand in over 97% of pubco pubs is a standard lager, which as the free-of-tie guest could lead to significant Independent brewery closures.

***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.**

No: if the principle of the tied tenant being no worse off than a free-of-tie tenant becomes the norm then monitoring of agreed purchasing obligations seems to be perfectly sensible, or even a necessary means of evaluating the attainment of the principle. The only reason for such a suggestion appears to be to make it more difficult for pubcos to monitor legally binding agreements, or to make it easier for tenants to abuse the system. Surely the reasoning behind this consultation is about fairness, not to provide one side or the other with an advantage.

Q.9 **Are there any areas where you consider the draft Statutory Code should be altered?**

Based as it appears to be on the current code, which as we have seen continues to evolve, we have no specific comments at this stage.

Q.10 **Do you agree that the Statutory Code should be periodically reviewed and if appropriate amended, if there was evidence that such amendments would deliver more effectively the two overarching principles?**

Yes, as has been the case with the self-regulatory code.

Q.11 **Should the Government include a mandatory free of tie option in the statutory code?**

No: there seems to be widespread misunderstanding of what a mandatory free-of-tie option would provide, with many licensees believing their current rent would stay the same if they exercised the option. We believe that faced with the significant increase in dry rent very few tied tenants would choose this course. The instability and unintended consequences of the inclusion of an enforced free-of-tie option far outweigh the limited benefits. It is our experience that pubcos are offering a wide range of agreements, including in some cases free-of-tie, which will allow tenants to choose the level of risk and reward that the wet and dry rent system affords.

We would also contend that should the market move towards more pubs being free-of-tie ~~that~~ the market for independent brewers' beers would be significantly affected. From our experience of the free trade, and of the consequences of the Beer Orders, we know that the largest brewers would utilise soft loans to tie licensees to buy only their products. We also predict that licensees free of any tie would 'band together' to form buying groups, able to use additional buying power to elicit additional discount from the largest brewers or wholesalers whilst reducing competition. These two factors would seriously impact upon independent brewers' route to market with potential to irrevocably damage both the brewers and consumer choice.

Q.12 **Other than (a) a mandatory free-of-tie option or (b) mandating that higher beer prices must be compensated for by lower rents, do you have any other suggestions as to how the Government could ensure that tied tenants were no worse off than free-of-tie tenants?**

No.

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

In the event of a Statutory Code being introduced it seems appropriate that an independent adjudicator be appointed.

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

**(i) Arbitrate individual disputes?**

Only where all other alternatives have been exhausted.

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

Yes.

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

**(i) Recommendations**

**(ii) Requirement to publish information ("name and shame")**

**(iii) Financial Penalties**

Yes, based upon the overarching principle and with a clearly defined appeals process.

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

Any implementation of a Statutory Code and the Adjudicator should be regularly reviewed so that any benefits they bring are clearly defined and evaluated.

Q.17 **Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code paying a proportionally 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?**

The impact of the levy should only be on pub companies and should have no impact on tenants, consumers and the overall industry. It seems sensible that the cost be split between those who are subject to the Code and exclude those who operate managed houses that fall outside the Code. The principle of those who breach the code paying more seems fair.