551

ALMR

PUB COMPANIES AND TENANTS: A GOVERNMENT CONSULTATION
A SUBMISSION BY THE ASSOCIATION OF LICENSED MULTIPLE RETAILERS

The Association of Licensed Multiple Retailers (*ALMR*) welcomes the opportunity to comment on the government's proposals to improve the regulation of the pub sector, and in particular the relationship between the landlord companies and their tenants and lessees in the setting and review of rents. This has been a core campaign objective since the Association's inception in 1992 and we continue to seek to improve lease terms and the rent setting process not only in relation to pub companies but all other commercial landlords.

As the only national trade body dedicated to representing actual pub and bar operators, including many tied lessees, the *ALMR* has been actively involved in all four recent Select Committee Inquiries in this area and has participated in negotiations to attempt to develop a robust self-regulatory structure, including instigating a formal mediation process in 2008. We also sit on the Board of the Pub Industry Rent Review Service (PIRRS) and, have engaged with other stakeholders to develop the Pub Industry Conciliation and Arbitration Service (PICAS).

By way of background, between them our member companies operate just over 13,500 outlets, employing 325,000 staff; these are jobs in all regions and at all skill levels. These outlets are primarily pubs and bars but also include casual dining outlets, licensed accommodation providers and nightclubs. Two-thirds of our members are small independent companies operating 50 outlets or fewer under their own branding, predominantly suburban community outlets. These are valuable social, cultural and economic assets – community centres, social spaces, tourist attractions and significant revenue generators – as well as providing a well regulated and controlled environment for people to enjoy alcohol responsibly and socially.

Our members are multi-site retailers, and their estate will be a mix of freehold, commercial and pub company/brewery leases. The business model and dynamics arising from these different ownership styles are substantially different, in particular the way in which rent is calculated for commercial and industry leases. Long, assignable industry leases remain a popular method of expansion for small, multiple operators because they provide a lower cost route of entry but also allow them to build up assignable value within the business.

Just over half our members' outlets operate on a leasehold basis. Of these, 57% are commercial leases issued by a property landlord, usually in high street, town centre or retail destinations and the majority of these will operate as a wine or café style bars or late night venues. Just over 40% are industry leases issued by a pub company or brewer and almost all of these will be traditional wet-led, community pubs. Almost all the industry leases in our membership are subject to a product tie, with just 1% being free of tie. Whilst concerns arise with regard to commercial lease terms – many of which are considerably more onerous than those contained in traditional pub lease/tenancy agreements – we believe that few of these will be caught by the provisions of the draft Statutory Code and regulatory regime.

We are therefore well placed to comment on the Government's proposals, and their implications for the sector as a whole, and would welcome the opportunity to continue to engage in their evolution going forward.

Background & Overview

Licensed hospitality is one of the UK's primary economic sectors and is a resilient part of the economy even through a recessionary period – adding jobs and increasing productivity and turnover over the last 2 years. Our industry makes a positive contribution to high streets, local economies and communities throughout the country in the following ways:

- Serving 20 million meals a week, 3.6 million cups of coffee and 15 million customers
- Employing 5% of the UK workforce – 550,000 directly and 450,000 indirectly
- Generating £21bn in turnover and £8bn contribution to GDP (2%)
- Paying 46% of turnover in taxes which fund vital public services
- Generating £170k per outlet for the wider local economy
- Created 1 in 6 of all new jobs for 18-24 year olds

We therefore welcome the Government's stated aim in the consultation to support a thriving and diverse pubs sector and to ensure that no pub becomes unviable as a result of regulation. This must be the acid test in assessing the impact of the proposals and in determining whether they are targeted, proportionate and fair. What the sector needs is a period of certainty to rebuild confidence and investment.

While the sector is vibrant, organic growth is only being seen in the food-led market. Over half of all new openings last year were recorded by food led pubs. There are just over 10 new openings for every one closure in the food led market segment and there is significant transfer into food led from other operating styles. Despite this, the pub market as a whole continued to record net closure levels of around 14 per week and wet led community pubs continue to struggle. This segment of the market has seen a 25% decline over the last 7 years recorded just 1 new opening for every 3 closures. The Government is right to investigate more fully

It is clear that certain segments of the market remain fragile therefore, and care must be taken not only to take steps to underpin them but also to ensure that no additional unsustainable costs or regulatory measures are imposed which would undermine their viability further. We have included market information at Annex 1.

The Government is therefore right to focus its proposals on the introduction of a general principle of fairness and the tied lessee being no worse off than a free of tie lessee in rent setting. **The key to delivering this will be through the introduction of even greater transparency into the rent setting process and regulation of the assessment of key variables within that, namely fair maintainable trade and operating costs.** This more than anything has been the root cause of dispute between landlord and lessee and we believe that the Government is right to make this the central plank of its proposals. It is lack of regulation in this area and not the tie - as the consultation document suggests - which provides the potential for abuse.

The pub leasing model is by no means perfect; as in other commercial business relationships, there are inherent tensions. On the one hand, tenants resist direct costs and constraints and need to extract maximum value from their investment in order to not only cover costs but to grow and invest in the business. On the other, the landlord needs adequate compensation to reflect the nature and level of risk taken on as a property owner. What is beyond doubt is that the business model for leases has to work for both parties: without a secure income stream, the landlord is unable to invest for the long-term not only in the individual property but the estate as a whole – which may have an impact on decisions about business viability; equally, without stable and successful lessees the pubcos unarguably have no business.

This is a fine balance to achieve. In a strong market, it is less of a problem as reasonable business growth and price inflation will compensate for any over-rental. But in a declining beer market with rising costs, the lessees' share of a reducing profit can diminish – sometimes to an unjustifiable extent. The effects of this may be felt for some time as the rent review cycle feeds through. **It is therefore vital that the rent assessment process is properly regulated.**

We therefore support the Government's proposal to conduct further research into the likely costs and implications of proposals on pub closures. We would urge that this looks at the sector as a whole rather than just the small segment of it which will be affected by these proposals as we do not believe any impact will be able to be contained but will be more wide-ranging. As currently drafted, the proposals will draw in some businesses outside the pubco universe and debate and will undoubtedly lead to changes at smaller companies as well.

We also note that some of the problems identified – UORR, advance rent payments, indexation and surrender - are not unique to traditional pub tenancies or leases but are shared with commercial leases for pubs and bars and other retail/hospitality outlets, which will remain unregulated.

Response to Consultation Questions

1. **Should there be a Statutory Code?**
   The *ALMR's* objective throughout the dialogue with stakeholders on this issue over the past decade has been to promote constructive proposals to encourage the evolution of the leased market – greater choice of lease terms and better information to equip lessees to enter into a commercial negotiation – and to rebalance the share of profit, risk and reward enjoyed by both parties.

   Our preference has always been for this to be delivered through self-regulation and we have worked hard over the course of the past year to try to achieve this. Negotiations on Version 6 of the Code were only concluded at the end of 2012 and, whilst it is immeasurably improved, as the consultation makes clear it cannot address the fundamental issue of the balance of risk and reward with which the Government is most concerned. We remain disappointed that, despite our best endeavours, faster and greater progress had not been made and agree with Government that a Statutory Code is now required.

2. **Do you agree that the Code should be binding on all companies that own more than 500 pubs?**
   We agree with the Government's proposal that the regulation must be proportionate, minimise any burden on companies which have acted responsibly and targeted on the source of the identified problems. We are concerned that the proposed threshold is not sufficiently precise to deliver those objectives and in particular will bring in a number of non-traditional landlord companies outside the core pub company sector.

   The threshold is only relevant for determining the ability to pay for the proposed costs of enforcement, compliance and statutory adjudication. These will be borne by all companies which are caught by the definition, not just those who are the source of complaints or concerns.

   In order to deliver the Government's objectives of proportionality and targeting, we believe that the Code should be binding on companies which operate more than 500 pub lease or tenancy agreements. This is because total ownership of an estate does not indicate market power in one market segment – a company with more than 500 pubs but only a small number of leases is no more likely to be abusive than a smaller company which operates only traditional pub leases or tenancies. In fact, our recent members' surveys have reported exactly the opposite. Companies whose core business is not property ownership are less likely to impose punitive, restrictive conditions. Equally, size alone is not indicative of risk or the likelihood of abuse.

We are also concerned that the proposed definition would significantly increase the scope of the legislation. Many of our largest managed multiple chains will sub-let a small number of premises. This is usually of necessity rather than preference and occurs when they have a head lease interest in a site but the commercial landlord will not allow them to surrender the lease; this is a very common occurrence across retail and is absolute. The proposed wording of the definition would therefore bring Stonegate, Wetherspoon and Mitchells & Butler within the scope of the legislation, all of whom will have a very small number of sub-lets issued on free of tie commercial terms and none of whom would consider themselves to be landlord companies. It is also possible that some commercial landlords would also have more than 500 pubs within their estate but we have no means of identifying this. We believe that the inclusion of these companies is an unintended consequence.

We would note that none of these companies is concerned about the content of the proposed Statutory Code, it is the cost of the internal compliance requirements and the Statutory Levy in particular which is punitive in these circumstances.

We have included an analysis of the market and pub ownership in Annex 1.

To be successful and sufficiently robust to deliver change, we urge the Government to refocus the scope of the Code on those companies whose business model is predicated on operating leases and tenancies by defining the threshold by reference to number of pub agreements issued.

We also note that two different forms of words for the threshold are used in the impact assessment - paragraph 38 refers to 500 non managed pubs and paragraph 87 refers to 500 pubs – as well as talking about pub owning companies. There are also references to 6 or 7 affected companies, which adds to the confusion and uncertainty for operators. We anticipate that, as currently drafted, between 10-12 companies could be affected by the statutory regime.

3. **Do you agree that, for companies on which the Code is binding, all of that company's non-managed pubs should be covered by the Code?**
While we agree in principle that the Code should apply to all of a company's non-managed pubs, this will be dependent on the final threshold of ownership/operation which is chosen as well as the treatment of genuine franchises, which we believe should be outside the scope of the Code (see below).

As noted above, we believe that the Code should only be binding on companies that issue more than 500 leases and tenancies. If this definition is adopted, then we would be content for the Code to apply to all non-managed pubs. If not, then this may need more careful drafting to focus on the source of the problem.

The *ALMR* has always been of the view that the potential for abuse and the imbalance of risk and reward only emerges to any significant extent in longer term agreements which have no exit mechanism or notice and which contain significant repair liabilities. We understand the Government's concern (para 4.20) that definitions of lease or tenancy are not currently set out in legislation, but believe it would be possible to do so in any new primary instrument going forward.

4. **Do you consider that franchises should be treated under the Code?**
There are only a small number of genuine franchises in operation within the sector. Some agreements may be called a franchise but are, in effect, a managed tenancy or lease agreement and should be treated as such. This is, however, an area of new product development and innovation within the sector.

If the agreement is a genuine franchise – generally relating to a branded outlet and supported by centralised marketing of that brand - accredited under the BFA and subject to separate regulation of its terms and requirements, then we do not believe that the agreement should be covered by the proposed Code. Indeed, the proposed Code terms would be wholly incompatible with a franchise operation - where product and brand restrictions are an integral part of the model – and may stifle innovation or bring in a wider range of businesses.

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

We are concerned about the drafting of this question and what exactly respondents are being asked to consider. It is not clear whether this question is asking about the costs and benefits just of a Statutory Code in principle or the impact of the proposals taken as a whole and assuming all of the Government's proposals were taken forward as outlined in Annex A. As a result, there is a very real danger that the wording of this question will fail to deliver meaningful, comparable answers from respondents.

The likely costs, and benefits, to business will be variable depending on which elements of the proposals for Code contents are taken forward and, as the consultation notes, the impact will be felt particularly on those outlets with the most restrictive lease terms and the poorest business relations.

Benefits

We believe that the proposals for a Statutory Code will bring clarity and certainty to lessees and end the ongoing unhelpful dialogue about whether the current voluntary Code is or is not legally binding, as well as interpretation over RICS Guidance. Crucially, it will also properly regulate the rent assessment process. It is clear from evidence submitted to OFT and to successive select committees that this is the heart of the problem and provides the potential for abuse, rather than the tie per se, and it is the key to delivering an effective solution.

It has always been our understanding that a correct interpretation and application of RICS Guidance should result in a tied tenant being no worse off than a free of tied tenant, and indeed the Chair of the RICS Forum confirmed this to be the case in 2010. Despite this, lessees have been unable to rely on this principle on a day-to-day basis in rent negotiations. The inclusion of this principle in statute – together with the detailed requirements for rent assessment calculations and justification of assumptions - will be immeasurably beneficial in delivering the culture change the Government is seeking.

A recent *ALMR* survey of tied lessees who had recently undergone a rent review - carried out in 2011/12 and including predominantly lessees of the two major pub companies - found that FMT volumes were often over inflated, far in excess of average barrelage, and no justification was provided to support the barrelage claimed. Beer volumes have been in long term decline over the past decade, yet none of our members has reported a rent review where reduced barrelages have been put forward. In 29% of cases, the initial rent bid proposed by the pub company was based on a barrelage in excess of not only the previous rental agreement but in excess of actual trade in the intervening period.

Equally, in many cases, insufficient allowance is made for realistic operating costs. Our survey found that just 13% of recent rent reviews were prepared using a realistic assessment of operating costs, 39% of turnover. In almost three quarters of cases, allowances for costs in the rental bid were as low as 33% of turnover. This depression of operating costs, particularly when coupled with inaccurate assumptions on FMT results in a distortion of the valuation model and an over-inflated rent.

Equipped with the information from the *ALMR* Benchmarking Report and an awareness of their rights, our members had challenged these assumptions but it is far harder for a singleton or independent operator. The same survey found that 43% of rent reviews in the period 2011/12 had resulted in a reduction in rent or an increase in beer discounts and a fifth of members reported that they had had discussions about free of tie pricing options, but few had exercised them due to the fees involved. The key therefore is to prevent the systematic manipulation in the first instance and then to equip the lessee with the information they need to make an informed commercial decision.

The current self-regulatory regime has not proved a sufficient check on this as it has proved impossible to secure effective enforcement by RICS of its own Guidance. **Version 6 of the Industry Framework Code did make a great deal of progress in this area and the inclusion of detailed rent assessment models and reference to material considerations to which valuers should have regard is the single biggest commercial benefit arising for the majority of lessees.** We believe more can be done to require greater disclosure of justification and evidence to support rental assumptions and we have referenced this below (qu 9). **Regulation of the rent assessment process remains the key to rebalancing risk and reward.**

As the consultation itself notes, however, successful delivery depends on a "concerted, long-term effort to inform tenants of their rights". This has been an area where the pub companies and landlord bodies have not done enough and we urge Government to ensure that this is addressed going forward. The introduction of legislation alone will do little to change commercial practice unless it is accompanied by education and awareness raising with lessees of their rights and how to use them. We stand ready to assist in this process and would welcome a discussion with Government about how it can be delivered.

Transfer of Profit

The Regulatory Impact Assessment sets out how the Government believes the dual rent assessment will be used to deliver the overarching principles and result in a transfer of profits from landlord to lessee. It is difficult to quantify this precisely as there may well be a revaluation of rent when a free of tie market assessment is made and there is a need to take account rentalisation of free of tie machine income. We have, however, carried out a snapshot survey of a representative sample of our tied lessees in order to test the Government's assumptions in the RIA.

We would note, however, that we do not believe a totally formulaic industry average approach is the most appropriate way forward. The assumptions in paragraphs 71-75 of the RIA must be indicative only and each one calculated on an individual site basis. We would be concerned if these figures were adopted or applied in generically in individual rent assessments.

The RIA assumes that the average free of tie price is 30% higher than the average tied price across the range of beer product. Taking a representative sample of products and comparing the tied price offered to our members – who, as multiples, will attract a higher volume discount from the pub company – and the prices offered free of tie suggests that, on average, the tied price will be 40-45% higher depending on the landlord in question. An individual operator may find that the price differential is significantly more depending on his buying power in the market. It is worth noting in this case that the RIA is incorrect, FMT is predominantly barrelage not turnover based.

The RIA also looks at a range of valuations for SCORFA. Again, we emphasise that this must be calculated and quantified on an individual basis and not applied as a generic benefit across all agreements. It has

been extremely difficult to quantify, but our members believe the OFT assumption of £1.5k of basic support to be the most appropriate figure. As multiple operators, they use far fewer of the centralized support services but do acknowledge that there is a value and a benefit to them knowing that they are available. It would, of course, be possible for a pub company to offer additional services and SCORFA, but we disagree with the RIA assumption of £6-7k valuation and believe £1.5-2k to be more realistic.

Applying these assumptions to a selection of members' tied outlets, suggests that for an average barrelage pub of 200-300 barrels, the margin difference between a tied and free of tie price for wet products is £36,000. The average for all outlets, irrespective of barrelage is £40,000 and the range was between £18,000-£72,000. The range of price differentials varied considerably according to size of outlet but more particularly also by landlord, with Spirit having a far lower price differential than either Punch or Enterprise.

There was also a margin difference of, on average, £7k per pub where machine income was tied. Clearly, if the gaming machine tie was abolished, this income would be included in the rent assessment calculation.

This suggests that the average transfer of profits to a lessee may be more considerable than that envisaged by the consultation document and could be between £13.5-15.5k depending on the barrelage of the pub or as high as £20k if SCORFA was low. We should note, however, that these figures must be treated with caution as the sample size is low and no assessment has been made of the dry rent calculation: it is therefore only possible to say that these outlets are paying more for their beer and it is not being offset by SCORFA; it is not possible to determine whether it is being compensated for by a lower than market rent.

This highlights why it is essential that these calculations are carried out on an individual site basis and not subject to generic industry assumptions or averages.

Costs

Contrary to the Government's assumptions, we do not believe that a transfer of profits from one party to another will have no impact on an assessment of business viability. This is almost impossible to predict, but a landlord as asset owner will clearly want to review profitability in the same way that a lessee will.

The proposals are not, however, cost free and there is a danger that a significant proportion of these costs will be passed through to lessees, and ultimately consumers, if they are punitive. There will also be an adverse impact on the current self-regulatory dispute resolution schemes.

We note the Government's suggestion at para 4.21 that companies who operate fairly, and in particular those operating tenancies, are more likely to satisfy the provisions of the Statutory Code and that the proposals will therefore have little impact on them. This will clearly be dependent on which elements of the Code proposals are taken forward. Whilst much of the Code is based on Version 6 of the Industry Framework, the key elements relating to rebalancing risk and reward will be new to most companies; indeed, there would be little purpose in regulating if those substantive provisions were not included. We know of no company which applies all of the proposed provisions outlined in section 5.8-5.21 and therefore all will be affected to a greater or lesser degree, even if they currently treat tenants fairly.

Even if a pub company were already meeting all the proposed requirements under the Statutory Code, however, there will be considerable impact on the business from the costs associated with the Statutory Adjudicator. Notwithstanding the fact that in later years the levy will be determined by the number of complaints, the initial charge is based purely on pub ownership. Given the wider range of companies we anticipate being brought within the scope of the legislation, we estimate that the levy could be in the higher range of the Government's estimate. We do not believe that even the largest companies will be able to totally absorb the costs outlined in the RIA and that the costs of the levy may be passed on to tenants/lessees and ultimately consumers. We are not clear what mechanism will be in place to stop this happening.

As we have already noted, the proposed Code threshold will have the unforeseen consequence of bringing in sub-lets and some commercial leases as well as businesses totally without the current pub company debate. It is the cost of the Adjudicator which is the only source of concern for these businesses. In addition, all will be required to employ at least one additional member of staff to manage the internal compliance requirements. If the scope is to be drawn more widely, Government needs to carefully consider the costs of compliance.

We welcome the suggestion in the consultation that "no pub should become unviable as a result of this policy, as profit is only moved from one party to another". We firmly believe that this should be the aspiration but believe that the assumptions underpinning it may be commercially naive. The pub itself may not become viable in and of its own right, but the business model as a whole may become unviable. A landlord will assess business viability not just on a case by case basis, but also across the estate as a whole and will take into account not only the transfer of profit but also the additional costs involved in running a leased estate and may decide to realise the value of their assets in a different way, removing it from use as a pub.

Finally, we are concerned that there will be repercussions across the sector as a whole in terms of investment. There are aspects of the Government's proposals which will mean that businesses on either side of the commercial negotiation cannot plan for certainty across the life time of the lease and this has a material impact on willingness to lend and invest in the sector at all levels. Although the regulatory intervention is in a small area of the market, we do not believe that this will necessarily be taken into account in investment decisions and the impacts of this will not just be felt by that part of the industry which is facing acute problems.

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

ALMR is a Board member of PIRRS, which provides a low cost alternative dispute resolution process for rent disputes. We have worked with other stakeholders through PIRRS to develop a separate PICA Service to deal with non-rent Code complaints and breaches. The development of these bodies is arguably the single biggest step taken in direct response to the successive Select Committee Inquiries and the bodies are working to provide a vehicle for independent dispute resolution.

In its first year of operation, the PICA Service has received 63 enquiries and a quarter of these were carried forward as full cases. Over a three year period, PIRRS has received 285 cases and a fifth of these have been carried forward as full cases. Whilst the overwhelming majority of these related to the 3 largest pub companies - and indeed two thirds of rent disputes related to a single company – a small minority are derived from those companies which would fall under the proposed regulatory threshold. 22% of PICA Service enquiries and 12% of cases are from non-regulated companies. Similarly, 9% of PIRRS cases come from non-regulated companies and indeed 1.5% of cases are from commercial or

private landlords. This suggests that there is a role and a need for an independent redress mechanism over and above the statutory regime.

It is worth noting in this context that one of the valuable benefits of the scheme has been the encouragement it gives to both sides to seek a resolution to the dispute. Whilst only a quarter of cases raised with PICA Service gave rise to a full hearing, a third were mutually resolved by the dialogue between the parties during the course of the process. In the case of PIRRS, just under a fifth of cases are resolved before hearing. This is a positive outcome.

The processes and procedures of the two bodies are by no means perfect but we are working to improve and refine them, and they are proving effective in helping to resolve lessee concerns and to police the self-regulatory regime. **The *ALMR* has been pressing for a new Industry Regulatory Board to be established further to improve the work of these bodies and to ensure that they are fully responsive to lessee needs.** The Board will develop case-handling protocols for both bodies, commission services and provide strategic direction for the future development of the self regulatory regime. It is envisaged that the Board will be independently chaired and include all landlord and lessee representatives as well as independent participants. We hope that the Board will be established later this summer.

We agree with the Government's conclusion (para 4.28) that it will be strongly beneficial for the self-regulatory regime to continue up to and after a statutory solution is in place. We believe it to not only be beneficial but essential that it does if we are not to abandon tenants/lessees outside of the scope of statutory regime. Whilst a voluntary code may still be in operation, without the self-regulatory structure of PIRRS and PICAS, there will be no mechanism to enforce it and those individuals will be back to the same situation which applied pre-2008. There is a fear that, after legislation takes effect, companies not caught by the statutory regime will remove their support for the current voluntary Code and independent redress mechanism and we welcome the clear statement from Government that that must not happen.

We also believe it will be helpful for PIRRS and PICAS to remain in place after the statutory regime is effected not only for use by those companies and their lessees that fall outside the remit of statutory protection but also as an ongoing dispute resolution service. PIRRS and PICAS offer a low cost alternative for airing and resolving commercial disagreements, and we agree with the Government that a range of options should be available to lessees. In these cases, the Adjudicator could act as a final ombudsman and it may help to reduce its ongoing operating costs, allowing the focus of resources to be on the most significant and substantive cases. We strongly recommend that there is close liaison between the Adjudicator and the Industry Governing Body, which will oversee the work of PIRRS and PICA Services.

We would therefore urge government not to undermine PIRRS and PICAS by imposing substantive or excessive costs through the levy. As outlined, we fear that financial support for voluntary self-regulation may be withdrawn if the cost is as high as that outlined in the impact assessment. The current levy for pub companies to fund PIRRS and PICAS is £5 per pub for BBPA members and £10 per pub for non-BBPA members and the current total costs of the self-regulatory regime is met from this.

7. **Do you agree that the Code should be based on the following two core and over-arching principles? Fair and lawful dealing and the principle that the tied tenant should be no worse off than free of tie tenant?**
We fully support the Government's proposals to incorporate these two principles within the Statutory Code. It was the failure to satisfactorily incorporate them in the self-regulatory Code which led to deadlock in discussions between BBPA and *ALMR* on revisions to Version 5 of the Code during the second half of 2012. While both were finally referred to in Version 6, they are not clear and unambiguous. Making them over-arching principles against which to interpret and apply Code provisions will deliver a step change behaviour, particularly with regard to rent assessments.

   We believe that these are the correct principles against which purposively to interpret the Code. They are best and most effectively delivered through the proposal to regulate the rent assessment process and the provision of dual rent assessment at initial rent setting, rent review and lease renewal.

8. **Do you agree that the following provisions should be included in the Statutory Code?**
We note that the Regulatory Impact Assessment provides no analysis of the likely cost or benefit to a lessee or landlord company of the following provisions. It will be important for this assessment to be made in advance of the Statutory Code being finalised to ensure that it is delivering against the Government's objectives.

   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.**
   The provision for rent review, at lessee request is already included in most industry leases, but this clause provides additional certainty over when and how it may be exercised. It will be particularly beneficial to have this included as a right where there is a change of ownership of the head lease as it is this which often triggers a change in pricing or other terms. It will only be meaningful, however, if the requirement to provide a detailed rent assessment as outlined in Annex A of the Code also applies in these circumstances. At present and as drafted, the Code appears to state that this level of detail and reasoned justification of assumptions is only required at initial rent setting. It must apply to any rent review or rent negotiation.

   We also believe that it will be necessary to give some indication or guidance on what is a significant increase in drinks prices. The absence of freely available national wholesale beer prices means it is impossible to tell what a fair price is and when a price increase falls outside the norm. Over the course of the past decade, wholesale beer prices have increased year on year by between 3-5% (5-8p per pint), after a period of steady decline in the 1990s.[1] National wholesale prices were required to be published under the Beer Orders but have not been available since the Order was rescinded, so these figures are based on assumptions and market intelligence.

   ii. **Parallel 'tied' and 'free of tie' rent assessments so that a tenant can ensure that they are no worse off.**
   We believe that a Statutory Requirement to produce a detailed rent assessment statement, as outlined in Annex A of the proposed Code, with sufficient level of information on cost and sales lines and a requirement to provide reasoned justification for any assumptions made is the single

[1] OFT *The Supply of Beer (2000)* states that wholesale prices fell by 15% between January 1992 and 2000.

most effective measure to deliver a fairer share of risk and reward. As has already been noted, it is the ability to manipulate the key variables contained within the statement which provides the potential for abuse, not the tie per se. Successive Select Committees have highlighted that the root of the problem is a lack of transparency and disclosure of information, which places the average tenant at a disadvantage.

We are therefore concerned that, as drafted, this would only be required at initial rent setting. To provide a true check on commercial behavior and ensure that the core principles of the Code are delivered, **the level of detail and type of information to be provided ahead of any rent negotiation must be similarly regulated. Failure to do so will offer little meaningful benefit to existing lessees.**

A detailed rent assessment statement, ideally providing parallel assessments of tied vs free of tie terms, must be provided not only ahead of initial rent setting but also rent review and lease renewal. This will equip the lessee with the information required to enter into a genuine commercial negotiation and to assess the fairness and full implications of the deal being offered to him. It therefore fulfils the long term objective of the *ALMR* in seeking to reform the relationship between landlord and lessee.

We note that the Government has expressed concerns about pub companies seeking to 'game' the system. We believe that the requirement to provide a detailed, evidence based rent assessment, with justification for key assumptions such as FMT will be the single most effective way to limit this and to deliver the culture change the Government is seeking. Properly constructed and required ahead of all rent negotiations, it will require companies to be more diligent in their preparation of rent assessments and assessment of total earnings from the site as a whole, if the calculations may be subject to scrutiny not only by PIRRS, Independent Expert, Court or Adjudicator. We have identified some changes which may be required under question 9 (see below).

We also note suggestions that a formulaic approach, whilst helpful in initial rent setting, could leave a lessee vulnerable to change of landlord or where a landlord chooses to increase prices or alter terms in order to encourage a lessee to leave; the suggestion being that this in and of itself would not deliver meaningful change. We disagree with this. Should a landlord increase prices in such a way, it would be subject to the provision to request an urgent rent review and seek redress. If the property interest was sold to a smaller landlord outside the scope of the regulatory regime then there is a slim possibility that a lessee could be left vulnerable, but we believe that this is best addressed by following the method adopted in V6 FC: namely to require the Code to be incorporated into the lease either as a matter of law or by means of deed of variation if the lease is sold to a non-regulated landlord.

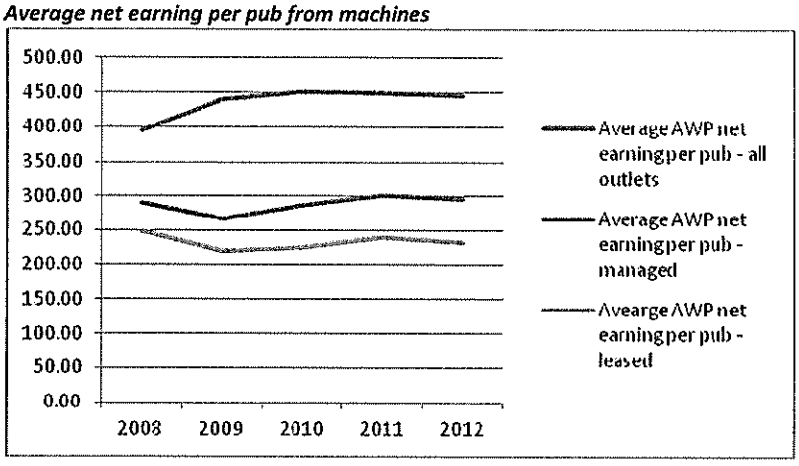
To be meaningful, these assessments – particularly the quantifying of SCORFA, assessment of FMT and market free of tie rent – must be specific to the individual circumstances of a particular pub, rather than generic FOT assessments or industry wide assumptions about the value of SCORFA. The principle of a tied tenant being no worse off than free of tie tenant should not be averaged across an estate or the industry if it is to deliver meaningful change to lessees.

iii. **Abolish the gaming machine tie and mandate that no products other than drinks may be tied.** Successive Select Committee reports since 2004 have concluded that the benefits of a machine tie do not outweigh the income that the tenant must forgo and that the machine tie should be removed. We share the Government's disappointment that more action in this area was not forthcoming under the self-regulatory approach.

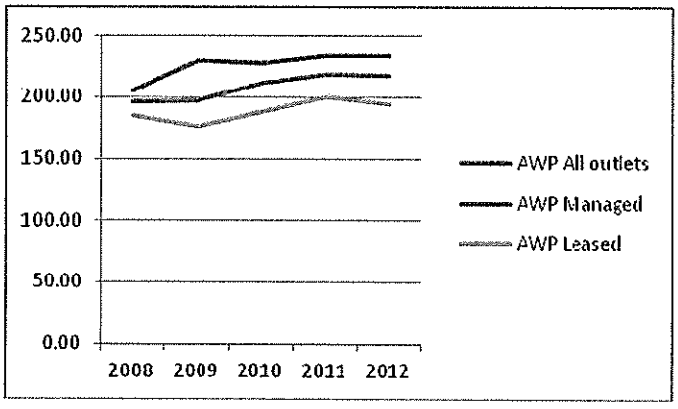
We note the concerns expressed by some that proactively managed machines outperform the market in terms of income generated. We would concur with this, but would dispute the suggestion that it is the tie which is critical to delivering this. It is the management and oversight of the estate which is key – ensuring a regular turnover of new machines, monitoring performance and rotating games - and our multiple lessees are able to do this themselves and generate market equivalent returns from their free of tie machines. Equally, there are independent companies and games machine suppliers who will provide a similar service to individual tenants.

Our recent industry-wide surveys of machine income and contribution to pub profitability consistently show machines in managed house (including multiple lessee businesses) outperforming those in independent, individual tenanted and leased sites. These figures are net cash-in-box, so the lessee share would be reduced further once the tied income is shared.

Average net earning per pub from machines



Average earnings per machine - £ per week net:



In 2009, the *ALMR* carried out a survey to assess the loss of amusement machine revenue to the landlord company if the machine tie was removed. This is heavily dependent on the terms of the lease and the nature of the machine supply agreement – some companies charge a fee and at the time many charged a royalty payment – but in 2009, the loss of income was estimated to be between £47-71 per machine per week. This figure will undoubtedly have been eroded as machine incomes have fallen across the estate in recent years as stakes and prizes have not been increased for some time and Gaming Machine Duty has seen the total tax take increase. A separate survey of a sample of members tied sites also suggested that the average tied/free of tie margin difference on gaming machines is some £6-7K per outlet per annum.

The abolition of non-core product ties would not preclude a management service being offered by pub companies – it may even be a quantifiable SCORFA – and, if the returns to the lessee are enhanced as a result, we see no reason for these non-tie agreements to be prohibited. We note also that free of tie machine income will be included in the rent assessment statement, thus militating the potential loss of profit to the landlord.

The Government is proposing to go further and to ban all other non-product ties. While we support this and understand the rationale behind it, **we are concerned about the proposed wording,** which refers to "any product unconnected to the core business of a pub". We understand this to mean that the only ties which may be permitted are for alcoholic and soft drinks. The wording, however, may be open to interpretation in individual cases where the business model is not wet led and we would welcome clarification.

As noted above, **we do not believe that the Code should apply to genuine franchises,** properly accredited and regulated under the BFA. Genuine franchise operations usually involve a high degree of control over the product offering and include a tie for food as this is normally part of the core business of the operation.

iv. **Provide a 'guest beer' option in all tied pubs.**
Again, while we agree with the proposals, we are concerned that the proposed wording may fail to deliver the Government's objectives of strengthening community links. In order to deliver this, the option would need to be more clearly defined in order to deliver real benefits to consumers, introduce competition into the market and support small, local brewers and we fear that this will fall foul of EU and competition law. We do not believe it will be possible to circumscribe the order to refer specifically to craft beer, locally sourced; although we support that aspiration.

v. **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 believe that changes made to Version 6 of the Code to prevent the use of flow monitoring equipment alone as evidence of buying out or for the levying of fines to be sufficient to remedy the problems arising in this area. We do not believe that this proposal will materially affect balance of risk and reward between landlord and lessee.

9. **Are there any areas where the draft Code should be altered?**
The proposed Statutory Code (SC) outlined in Annex A of the consultation is based on the core provisions of Version 6 of the Framework Code (V6 FC), but has not necessarily captured all of the intentions behind it. In some parts, therefore, it appears to be weaker than the existing voluntary self-regulatory framework – in terms of when information must be provided and what information is given to the lessee during the course of the lease; **we do not believe this to be the intention and would urge careful attention to be directed to the wording.**

V6 FC states that a detailed rent assessment statement must be provided not only at initial rent setting but also at any rent negotiation, particularly rent review and lease renewal. Part 3 of the SC clearly states that only "initial rent assessments" need to be accompanied by a Rent Assessment Statement as set out in Annex A and paragraph 14 makes clear that only the information set out in paragraph 9 is required before other rent negotiations, not the assessment statement.

The only additional time the detailed rent assessment is envisaged being used is if the lessee requests an exceptional rent review. These will not be the only rent reviews and rent negotiations tenants and lessees enter into with their landlords. Most leases provide for a routine rent review and it would seem strange to leave these normal commercial negotiations unregulated. **We recommend that all rent negotiations are subject to the same provisions.**

It is vital that the information a lessee is provided with at rent review is regulated if lessees are not to have a lower level of protection and information than they currently enjoy under V6 FC. We recommend that the draft SC is amended to make clear that a detailed, justified rent assessment statement is required to be produced in advance of <u>any</u> rent negotiation.

Equally, under the terms of the draft SC, only initial rent assessments need to be signed off by a qualified RICS valuer as being compliant with Guidance. Again, V6 FC requires all rent assessments and negotiations to be signed off by a senior company representatives as being compliant with RICS Guidance. It also requires valuers to provide justification for their assumptions in a commentary box.

The draft SC only provides a timetable for the completion of rent reviews carried out at the lessees request under the exceptional circumstances outlined in paragraph 16. V6 FC requires the relevant information to be provided 6 months before rent review date and negotiations to be completed 3 months after the due date. This is missing from the draft SC. The only timetable refers to exceptional rent reviews requested by the lessee, not routine rent reviews and places no timetable on the completion. **Again, we recommend that the intention of V6 FC is applied to impose the same information and timetable requirements for all rent negotiations.**

Finally, V6 FC requires all assumptions included in the rental assessment model be "explained and supporting evidence where available will be fully justified". A valuers commentary on assumptions was included as part of the assessment. This is critical to ensuring that the key variables – and in particular FMT barrelage - are robust and realistic. **Failure to translate across a requirement for assumptions to be not just disclosed but also explained and justified will undermine the delivery of further change.** This must be included in Annex A.

10. **Do you agree that the Statutory Code should be periodically reviewed and, if appropriate, amended, if there was evidence that showed such amendments would deliver more effectively the two overarching principles?**
While we agree in principle to the need to keep the Code under review, what all sides of the industry need more than anything else is stability and certainty about the future of the business model and the individual terms and conditions under which they are operating. This is essential for business planning by both landlord and lessee and to the securing of investment. We therefore propose that the review process is clearly set out in legislation. There must be an agreed timetable – we recommend the current three year cycle for Code review and reaccreditation - and pre-established criteria for review, particularly pertaining to the evidence to be provided.

11. **Should the Government include a mandatory free of tie option in the Statutory Code?**
We believe that the principle that a tied tenant should be no worse off than a free of tie tenant is most effectively delivered through regulation of the rent assessment process and the assumptions made within it. The regulatory impact assessment appears to present this as an either/or choice between Option 2 – a statutory code with provisions to rebalance risk and reward as outlined in question 8 above - and Option 3 – a mandatory free of tie option.

As the Government acknowledges, the arguments for and against a free of tie option are finely balanced – the outcomes identified in 5.36 and 5.37 are very real but cannot be predicted with any certainty. There is clearly a need for additional evidence to determine conclusively what the impact will be, not just on the tied lease model adopted by the major pub companies, but the sector as a whole. We therefore agree with the need for additional research to be carried out to produce a fully detailed impact assessment. We note that the current impact assessment makes no allowances for any additional costs in this area, indeed it assumes that the Cost of Option 2 and Option 3 are the same but these appear principally to relate to the cost of the Adjudicator.

It is almost impossible to answer the question without a detailed Regulatory Impact Assessment quantifying the benefits, costs and potential consequences for the sector as a whole. We believe it is imperative that the results of independent analysis are published as a matter of urgency to allow all stakeholders to make a fully informed comment.

This must not hold up other vital action and the introduction of a Statutory Code, however. Enshrining in law the key principle that a tied tenant should be no worse off than a free of tied tenant and regulating the rent assessment process will deliver immediate benefits to all lessees – existing and new – and must be pursued as a matter of urgency.

12. **Other than a mandatory free of tie option or 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?**
Enshrining in law the key principle that a tied tenant should be no worse off than a free of tied tenant and regulating the rent assessment process are the most effective means of delivering immediate benefits to all lessees. The requirement for a more detailed, transparent dual rent assessment are the quickest means of delivering this in practice, particularly if rent assessments may be challenged in light of this principle.

We would also welcome dialogue with RICS to ensure that its members are fully conversant with and comply with their own internal guidance, together with effective enforcement activity against members

who fail to do so. This is a matter of concern that spreads beyond the pub company sector and applies to commercial leases and rent reviews.

13. **Should the Government appoint an independent Adjudicator to enforce the new statutory code?**
The changes which have been made since 2011 to improve dispute resolution within the voluntary self-regulatory regime are a big step forward and, as previously noted, we would be concerned if the introduction of a statutory regime undermined them. We nevertheless concur with the Government's view that if a statutory code is to be introduced, then an independent adjudicator to enforce it would be helpful as otherwise the only alternative form of enforcement would be through the courts. This is prohibitively expensive for lessees and unduly adversarial.

The principle of an Adjudicator or ombudsman is not in question. The issue is the cost and who bears it in reality.

Given the very high costs of the proposed adjudicator and the associated internal compliance mechanisms it will require to support it, we strongly recommend that the Government review its decision on how the threshold for inclusion will be determined. This will ensure that the most onerous aspect of the Government's proposals is borne only by those whose businesses pose the greatest risk and where the largest numbers of issues arise and those whose core business is the leasing of pubs. We believe it is important that the costs are fair and proportionate to avoid uncertainty and any adverse impact on business viability – both landlord and lessee.

14. **Do you agree that the Adjudicator should be able to arbitrate individual disputes and carry out investigations into widespread breaches of the Code?**
We welcome the proposed remit of the Adjudicator. We have always been concerned that the current self-regulatory regime can only addresses those cases which are raised by lessees; it is possible that many other breaches go unnoticed because tenants either do not know their rights or are unaware of how to seek redress if they feel that they have been unfairly treated.

Our experience on the PIRRS and PICAS Board, however, leads us to suggest that there will be a need for clear parameters and evidential requirements to guide lessees in bringing a complaint to ensure that the Adjudicator has meaningful information on which to assess the merits of a case. This will also help to ensure that the resources are focused on substantive and serious problems which cannot be otherwise resolved. In our experience, this is a far more substantive issue than addressing frivolous, vexatious or repetitious complaints. Tenants and lessees are not always well equipped to provide the detailed information which is required and the Secretariat of PIRRS and PICAS will often need to spend a great deal of time in helping them to prepare a case.

We agree with the implicit suggestion that a lessee should first try to resolve a complaint, dispute or issue with their pub company before referring a case to the Adjudicator. We believe that this should be made more explicit and the reference to 21 days may not be sufficient to allow the company to respond to the satisfaction of the lessee. Many cases will be complex and detailed and may require ongoing discussion. If 21 days is retained, it should be made clear that this is working days.

We note the Government's suggestion that it should be free for a tenant to bring a complaint for arbitration. Under the current self-regulatory arrangements, tenants and lessees make a small contribution to the costs of a case - £200. We believe that it would be a helpful model to filter frivolous or vexatious complaints while not deterring genuine substantive cases.

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 recommendations, name and shame and financial penalties?**
We note the range of proposed sanctions available to the Adjudicator. Whilst this are all helpful, the most important power that the Adjudicator must have is the ability to offer compensation or redress to the aggrieved party for any detriment suffered and to have that put right. That must be the key focus of the Adjudicator's role.

16. **Do you consider the Government's proposals for reporting and review of the Adjudicator are satisfactory?**
Yes, we agree. It is important that the Adjudicator is accountable for his or her actions and we agree that regular reporting is essential. We are keen to avoid imposing unnecessary levels of red tape and bureaucracy which may lead to increased operational costs which will inevitably be passed on to business.

17. **Do you agree that the Adjudicator should be funded by an industry levy with companies who breach the code paying a proportionately greater share of the levy? What, in your view, would the impact of the levy be on pub companies, pub tenants, consumers and the overall industry?**
Yes, we agree. The industry already pays a levy per pub to fund the ongoing costs of the self regulatory regime and alternative dispute resolution mechanisms, PIRRS and PICAS. The principle of a levy-based contribution to costs is therefore established, but it must be fair, targeted and proportionate if it is not to impose an undue burden on the sector.

    The scope of work of the Adjudicator and therefore the size of the proposed levy will be directly affected by the number of companies on which the Code is binding and for, the basis on which the threshold is determined. If the Code is applied on the basis of pub ownership, then the potential workload and hence levy required to fund the operating costs will be huge. If the Code is applied to those whose core business is leased/tenanted operations, then it will be correspondingly reduced. The Regulatory Impact Assessment refers to 7 affected companies and two different definitions of which businesses will be affected. We believe that the scope will be far wider and will bring in more businesses, but we are unclear from the analysis provided whether this will reduce the cost per company or will simply increase the Adjudicator's operating costs.

    We are also concerned, however, at the wide disparity of figures being discussed in the Regulatory Impact Assessment and the very high level of operating costs which are envisaged from the setting up of a totally new body and secretariat to sit alongside the Grocery Code Adjudicator, potentially within the OFT. This does not appear to be a cost effective option and we believe that there may be scope for sharing staff and resources between the bodies to reduce the overheads and hence levy.

    We note that the figures set out in paragraph 63 of the Regulatory Impact Assessment are different from the estimates of set up on and ongoing costs earlier in the document. There are also large differences between the best/worst case figures and best estimate. We are unclear on what basis they have been derived. Whichever figure is the best estimate, it would appear that an affected business would face an additional operating cost of between £150,000 – 200,000 a year. In the first year, this would be a flat rate for all pub owning companies, irrespective of number of leases/tenancies issued or complaints registered.

We do not believe it will be possible for the affected companies to absorb this level of additional operating costs and that they will be passed down to the tenant/lessee in the form of rent and other charges. In a competitive market, as the Government acknowledges in paragraph 6.17 the price to the consumer is unlikely to change, it is likely to be taken out of lessee margin – which is the only point of flexibility in the model. We are unclear how this sits with the Government's stated aim of ensuring a thriving pub sector.

ALMR

Annex 1 – Market Information

Table 1: ***Ownership of UK Pubs***

Type of operator	*1989*	*2004*	*2008*	*2012*	*% market*
INDEPENDENTS					
Single outlets	16,000	16,850	17,700	18,250	36.5%
PUB CO					
Tenanted/managed	Neg	34,125	30,800	23,000	46%
SUB-TOTAL	16,000	50, 975	48,500	41,250	
BREWER					
National	32,000	0	0		
Regional	12,000	8,589	9,000	8,750	17.5%
(Tenanted					
Managed)					
SUB-TOTAL	44,000	8,589	9,000	8750	
TOTAL	60,000	59,564	57,500	50,000	

Source: *ALMR* members and Quantum Business Media

Table 2: UK Managed Pub/Bar Estate

	2004	**2008**	**2012**
Community local	4,311	2,750	2053
Food led outlet	3,180	3,045	3254
Town centre bar	3,428	3,260	2797
Accommodation led pub	641	488	479
Nightclub	421	485	361
Seated café/wine bar	1,053	1,211	1060
Total Managed Estate	13,034	11,239	10,004

Source: CGA /ALMR Benchmarking Survey