The views expressed here should be taken to reflect the views of the six limited companies;

Having held agreements for tied and free of tie leases, for a period of over 20 years, with a number of different pub companies, consider that they can offer views based upon significant practical experience.

1. Should there be a Statutory Code?

Yes. It is clear that even after years of wrangling, the industry is incapable of self-regulation. The many parties involved would appear to be as far away as ever from establishing common ground from which a binding voluntary Code can be put in place. The voluntary Industry Framework Code (IFC) that has been agreed to date has been quoted by a lawyer representing Enterprise Inns as having no legal standing, therefore it requires that a statutory Code be put in place such that all parties are clear that it has teeth and that its rules must be adhered to.

2. 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.

We do not agree that a threshold of 500 pubs is pertinent. If a landlord of any size operates in a way that is unacceptable abusive behaviour under the Code, then surely they should be bound by the terms of the Code. Whilst the administration of a Statutory Code may be difficult if it applies to every small landlord, surely those companies that operate generically as pub operators or as pub landlords should fall under the aegis of the Code – say those owning in excess of 100 licensed premises that are either tenanted or leased. This should also apply to those landlords which operate free of tie pubs as well as those with tied pubs.

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?

Yes, although it would be possible to exclude tenancy agreements if the difference between tenancy and leasehold agreements can be legally defined. We would expect agreements which are for a short term (five years or less), unassignable, but capable of being determined by the tenant by giving notice of no more than 6 months, and which leave the maintenance of the building structure and fixed plant or equipment in the hands of the landlord, as being defined as tenancies.

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

Franchises which are accredited as such by the British Franchise Association (BFA) will be covered by separate legislation and therefore the Code should not apply to them. However, any 'franchises' which are just leasehold agreements in disguise and are not accredited by BFA should be included in the legislation of the Code.

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

We agree that the guiding principle of the Code should be that the tied tenant should be no worse off than the free of tie tenant at open market rental value (OMV). There is strong evidence that over the period that many early leases have operated, then this has simply not been the case.

In addition to raising rents, landlords of tied pubs have taken a significant proportion of the purchase benefit available from the beers that they supply. We would argue that the basis for calculating divisible income in assessing rental levels is intrinsically flawed by virtue of the impact of price rises in tied products.

We have taken the example of one of our older agreements which exemplifies the position. The wholesale price of standard lager at the inception of the tied lease in 19 was c. £252 per brewer's barrel (36 gallons). Of the discount available, some £33 was passed to the lessee with, we believe around £120 accruing to the pub company. Today, the wholesale price is c. but the discount passed on to the lessee is only £55, with the pub company receiving around for themselves. This implies that the net purchase price for lessees has virtually doubled.

However, in common with many lessees, we have been completely unable to pass on such increases to customers because of a series of factors such as disposable income, off-trade pricing, etc. We have examined our prices over that period at this particular site and 65% is the average rise in the retail selling price. As a result, the income stream of wet rent has increased substantially for the pub company, despite a decline in overall on-trade beer sales (it has fallen more than 25% in the last 5 years according to BBPA), whilst the wet margin

earned by lessees has fallen almost universally. Whilst many of our agreements have been in place for shorter periods of time, the principal for them is the same.

Essentially, pub companies have profited from price increases presented by brewers, benefitted from commission payments on machines, and derived additional income from insurance surcharges and these profits have not been shared equitably with their leaseholders. We accept that not all of the benefits would accrue equally to both parties but in truth, the tenant has seen virtually none of them.

In addressing this question, we have attempted to assess the value of the difference between the tied and free of tie model based upon our own experience.

We support the premise of ALMR that it is not the tie of wet goods per se that is the issue, it is the operation of that tie and the product of the tie in terms of profit share between the parties, one of which has the ability to act prejudicially dominant for its own benefit if it chooses to do so. We also agree with the basic premise of the RICS guidelines that a tied tenant should be no worse off than a free of tie tenant and we perceive this premise to be consistent with the ALMR view that it can be achieved within the tie. If that presumption is assumed to be based upon open market rental value then in its simplest form, any amendment to rent or margin to achieve that would involve a transfer of value or profit from the landlord to the tenant. The extent of the value transfer will depend upon what is considered. However, we reviewed of our tied sites selecting every set of premises (good or bad) that are rented from large pub companies and which have been in our estate for a period of time long enough to have an 'established' trading pattern. These sites represent around of our substantive leased estate and are located in the The ties vary but mainly comprise beer and cider, with some element of tie release on guest ale ( ) and cider ( ), restricted guest ale (, and no tie on wines and spirits. sites have mineral ties and sites have machine ties, so the estate is a good mix.

Based upon annual financial statements to 2012, we have calculated the difference between the tied profits and the free of tie profits that would have been available without the tie. A copy of the summary calculation is attached to this submission. We estimate the wet margin difference to be an average of from an average barrelage of 297 barrels with a spread of extremes that range from : to However, if we exclude the 3 upper and lower results leaving the middle 'average' . sites, the range is £30,000 to £47,000.

Applying an average rentalisation percentage of 50%, then half of the would be paid in additional property rent to the landlord leaving an average transfer of value from the landlord to the tenant of £ per site per annum in order to ensure that the tied tenant is no worse off than a free of tie tenant. This effectively quantifies the value of benefits that

the landlord would need to demonstrate as justification for retaining that profit itself and we would contend that this would be difficult to justify.

Where machine ties exist in our sample, we estimate that the margin value of the tie is an average of £ per site with tie. However, the equation is now different following the introduction of MGD in the current financial year 2013, which reduces the net income of the tenant significantly. The tenant is now unable to reclaim input VAT on rent or on the landlord's share, the burden of which has been passed entirely from the pub company to the tenant.

Summarising the data above, the leased premises as they currently trade contain sites that make exceptional profit as a result of good operating ability, location, etc. There are sites where returns are average but there are sites that might be described as unviable and only continue to operate as a result of the company's resources or are supported by the sites that are doing well. In the event of the value transfer described above, all but one of those sites become viable businesses in their own right. In addition, the transfer of value would enable investment into many of the lower-performing sites in order to enhance and secure their trading future.

Whilst we admit that the position of having a mixed multiple pub estate gives us some advantages, there are also disadvantages and accept that we are only looking at a representative sample of our own estate. Our peers and our landlords frequently state that we are better than average operators of pubs and no-one has ever questioned at rent review whether we are decent operators when assessing Fair Maintainable Trade. We therefore cannot help but think that if this value transfer can improve the viability of out of failing sites in the estate, then other lessees with similar problems should also benefit. We should stress that this transfer of value is not going to suddenly make lessees rich and pub companies poor, but it may help to make many struggling businesses sustainable.

We also have to recognise that a wholesale transfer of value of this magnitude could have a significantly negative effect on leveraged pub companies. Whilst the desire to leverage may not have been at the request of tenants, the failure of such companies may have unforeseen consequences, the cost of which may be difficult to determine. In particular, matters to consider are:-

- What effect the possible demise of a pub company may have upon brewers' pricing – they will likely consider that to be an opportunity to obtain some value transfer for themselves;
- The effect upon other stakeholders in a failed pub company including employees, though the pubs themselves employ far more than the landlord companies.

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

The PIRRS and PICAS bodies could be beneficial to the balance in the market and these should not be abandoned even under a statutory solution. These bodies will be necessary to protect the interests of all tenants prior to statutory regulation and after that, to protect the interests of those tenants whose pub companies might not be caught by the legislation. Neither should the access to this process be impaired by substantial costs to the lessee by way of levy other than a de minimis charge to avoid frivolous or vexatious complaint.

7. **Do you agree that the Code should be based on the following two core and overarching principles?**
   (i) Principle of Fair and Lawful Dealing
   (ii) Principle that the Tied Tenant Should be No Worse Off than the Free-of-tie Tenant

The answer to both questions is yes, and making these clauses a clear part of any legal framework is of paramount importance. It is only the threat of this proposed Statutory Code that caused their recognition in the latest IFC and even now, that reference is oblique. We suggest that the actual principle should embrace the concept that the tied tenant should be no worse off than a free of tie tenant at open market rental value – pub companies cannot just provide a free of tie rent assessment as a de facto statement that allocates their wet income to rent. It must stand up on its own merits. In order for these principles to be meaningful in practice, there must be clear guidance on how they are to be applied.

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 in five years, if the pub company significantly increases drink prices or if an event occurs outside the tenant's control.

A statutory Code should include this provision.

Rent review procedures are normally embedded in lease documents and it is rare for landlords to miss these altogether. Trigger events for other open market reviews are more difficult to determine. Agreements already cover the situation of open market review in the event that the tie is withdrawn but other trigger events may include a change in local conditions, such as the imposition of an ADZ; or the removal of any previously offered benefits – but this is not exhaustive.

A trigger event created by a 'significant increase' in drink prices is hard to determine and may constitute indirect intervention into the free market. However, in the context of a decline of 54% in on-trade beer sales over the past decade, it is counter-intuitive that tied

beer prices have risen by 65% over the same period. This only reflects landlords passing on brewer price increases, though clearly the landlords have used this to their own advantage as outlined in the answer to question 5. Therefore in a market (not reflective of the current economic climate alone) all tenants have faced margin pressure at a time when volume sales are decreasing. It could therefore be argued that strict application of such a provision would give an almost continuous right to request an open market review.

Due to the subjective nature of the terms 'significant' and 'outside tenant's control' when determining a trigger event, we suggest that such definitions and dispute resolution on this matter be referred to PICAS for a ruling in the event of disagreement between a tenant and a landlord.

(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.

We strongly support the principle of increasing transparency in rental negotiations. We accept that all agreements are willingly entered into by lessees who should have taken the benefit independent advice and verification to allow them to understand the agreement and operation of the leased pub model. However, at a later time of rent assessment, when perhaps returns are under pressure and lessees can simply not afford to take professional advice, then it is vital that the landlord produces as much information as possible to permit the tenant to make the correct decision.

The notion of a parallel rent assessment is difficult due to the subjective nature of the discounts available to one party or another. However, we firmly believe in the principle that the tied tenant should be no worse off than the free of tie tenant so someone needs to demonstrate that calculation. Therefore we believe that the obligation should be imposed upon the landlord to demonstrate the value of the difference between the tied and free of tie agreement. This will require some estimate of the value of the free of tie position and demonstration of how that difference is accounted for by genuine, tangible benefits accruing from the tied arrangement. It is a moot point whether the tenant or the landlord should do it but someone must do it formally and given the likely better financial sophistication of the landlord, it would seem logical that the landlord does it in the first instance and gives the tenant the opportunity to review any margin and cost assumptions before discussing the value attributed to SCORFA.

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

Successive Select Committee recommendations since 2004 have concluded that gaming machines should be free of tie and it is astonishing that the pub companies have not acted upon those recommendations. We believe that the ties on all machines (gaming or otherwise) should be removed and we accept that the income derived should be taken into account when determining the rent.

We agree that the tie should apply to wet products alone. However, this does not to preclude pub companies from negotiating and offering purchasing deals for food or machines which would likely be better than those that a lessee could achieve alone. These could show quantifiable SCORFA for individual operators provided that the returns to the lessee are increased as a result of using them.

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

Yes, but there is an opportunity here to deliver real benefits to the consumer by the introduction of competition, and supporting smaller local and regional brewers. A guest beer should not be limited to ale and should also include locally sourced 'craft beers'.

Note also that we believe that any guest rights should be unrestricted. Currently, landlords are restricting guest rights to nominated breweries where they often control the price, charge commission or charge a listing fee to the brewer. This is not in the spirit of a 'free-of-tie guest ale' and should be outlawed to allow total freedom of choice.

Philosphically, we would like to see all ale free of tie. Ale provides a unique point of difference for a pub, it is British sourced using British products brewed by British employees, and it is the quintessential product that reflects the traditional British pub culture that is renowned the world over. Its success as a core product in pubs is part and parcel of a thriving pub industry, which is what we believe that the Government and all industry bodies are actively trying to promote. For all lessees to be able to source ale freely and at competitive prices can only benefit the category as a whole, brewers both large and small, and 'UK PLC' in terms of employment and business.

(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 believe that the use of flow monitoring equipment as a means of enforcing purchasing obligations has been heavy handed and has caused much contention in the landlord and tenant relationship. In the context of the Select Committee's comments on their accuracy and acceptance by Trading Standards, we believe that the Government would be right to rule out their use for this purpose if the evidence gathered formed the sole evidence to

enforce purchasing obligations. This statement is consistent with the latest version 6 of the IFC.

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

Not at present, but the opportunity for future review should be included.

10. **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, so long as there is a defined timeframe and set criteria for review. A Three Year Cycle of Review would seem appropriate

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

This is a very difficult question to answer, because we are intrinsically against statutory intervention into commercial arrangements of private businesses. However, the landlord needs to show the financial benchmark against which the fairness of an agreement under the basic principle of "tied tenant no worse off" must be judged. This does not amount to a demand that all leases should be free of tie and it does not have to be mandatory but we are concerned that pub companies will only pay lip-service to the free-of-tie assessment and in that event, the requirement of the option may need to be mandatory in order to force compliance with the prime principle and to provide assurance that the tie is being correctly operated.

If such an option were included, it should be offered at the inception of the agreement, at periodic rent review at renewal, or at a trigger event described above.

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?**

If the pub company is going to have to show a parallel free of tie profit and loss account as well as a tied one at rent assessment, and the principle of FMT is adhered to, then we believe that this point is covered. Clearly in order to justify rental expectations the landlord is going to have to show the benefits they impute under SCORFA, and those should be detailed and transparent.

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

It is hard to see how the Government can avoid doing this if the code is to be implemented and policed. However, one must be aware of the risk of creating a process that has significant compliance costs but unless such a process exists then the imbalance of power will continue to disadvantage the lessee.

14. **Do you agree that the Adjudicator should be able to:**
(i) Arbitrate individual disputes?
(ii) Carry out investigations into widespread breaches of the Code?

Yes, but the mechanism must also exist to avoid a logjam of frivolous complaints else the whole system will be too costly and unworkable. Clear parameters must be set as to what constitutes a serious complaint or widespread breach. It would seem reasonable that those who submit frivolous or vexatious complaints should be penalised for so doing.

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?

Only if the recommendations are binding. They must ensure that the identified breach of the Code is settled by way of redress for the affected party.

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

Naming and shaming currently exists under PIRRS, but those named seem not to find it onerous or embarrassing. Pub companies cite the number of agreements that they have and low percentage of complaints, which avoids the bigger issue of those who do not complain because they are took weak or poorly advised because they cannot afford to take advice in difficult financial circumstances.

(iii) Financial penalties?

Sanctions are necessary to have teeth and will help redress the balance of inequality where it exists. These should include financial penalties, but may also include the trigger to offer the affected party free of tie agreement. Penalties should include both compensation to tenants where breaches have been identified and penalties that contribute to the cost of regulation. The penalties and awards should be set out as a fixed tariff.

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

Yes. It is important that the costs of reporting and review are minimised in order to avoid a costly bureaucracy which will unnecessarily increase the impact on pub companies.

17. **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 that the costs of Adjudication must be funded by a levy. We believe that the levy should be based proportionately on the number of agreements that fall under the Code, rather than on the total number of pubs owned by the pub company concerned. It must also be legislated that the costs of the levy must be borne by the landlord company direct (except as below), and not be passed on to the lessee, who would in turn be incapable of passing such a cost onto the consumer.

However, we also believe it reasonable that since the Code will be of benefit to lessees, they too should contribute towards this system. It is our understanding that at least 20,000 agreements will be covered by the code, and so a small contribution of £10 per annum (charged through the rental system, collected and accounted for by the landlord, and separately identifiable) would raise a quarter of the funding requirement. The plans to raise the levy in future years in proportion to the offences committed have merit in our view.