From:
Sent: 14 June 2013 09:48
To: Pubs Consultation Responses
Subject: Pub Companies and tenants consultation response form
Attachments: 13-718RF-pub-companies-and-tenants-a-government-consultation-response-form.docx

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation and Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

Dear Sirs

COMMENTS ON THE STATUTORY CODE: PUBLIC CONSULTATION PROCESS

Introduction

I have great pleasure in submitting my comments on the public consultation process regarding the proposed statutory code and the planned adjudicator.

use the Pub Independent Conciliation and Arbitration Service (PICA-Service) in and was disillusioned by the process even though the PICA-Service ruled in my favour. I am also pursuing a tenancy agreement with another Pub Company so I have a personal interest in seeing a fair relationship developing between Pub Companies and tenants. I am passionate about the importance and uniqueness of the British pub industry and my ultimate interest in submitting comments is to contribute to its much needed reform.

I have done extensive research in my personal capacity on the industry based on information in the public domain and have included such information in this document where relevant and appropriate. One of the challenges facing industry stakeholders and government is the limited and inconsistent information that has been published on a selective basis by various interest groups, including some of the Pub Companies.

It should be noted that I have deliberately avoided joining interest groups as I do not believe that there is a wide-ranging and robust debate of the pub industry by a sufficiently diverse groups or individuals.

I will appreciate any opportunity to provide further information if requested.

I hope that this public consultation process will contribute to the reform of the pub industry.

Yours faithfully

Department for Business, Innovation & Skills

Pub companies and tenants - A government consultation Response form

The consultation will begin on 22/04/2013 and will run for 8 weeks, closing on 14/06/2013

When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation response form and, where applicable, how the views of members were assembled.

This response form can be returned to:

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation and Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

Email: pubs.consultation@bis.gsi.gov.uk

Please tick one box from a list of options that best describes you as a respondent. This will enable views to be presented by group type.
Representative Organisation
Trade Union
Interest Group
Small to Medium Enterprise
Large Enterprise
Local Government
Central Government
Legal
Academic
Other (please describe): Former Pub tenant

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

CONSULTATION QUESTIONS

QUESTION 1: SHOULD THERE BE A STATUTORY CODE?

There must be a Statutory Code.

The following points support my answer: -

a) The BBPA has issued Version 6 of the Industry Framework Code (IFC) as part of the self-regulation framework. Version 5 was considered by many to not address the fundamental imbalance between Pub Companies and tied tenants regarding risk and reward. However, in the Introduction to Version 6, the following statement is recorded ***"The over-riding principles of the Code remain the same and are enhanced in this revision to it"***.
Version 6 addresses the poor readability and understandability of Version 5 and is much better in this regard but does not make any fundamental changes to the business relationships between Pub Companies and tenants. I have done a detailed comparison between both versions of the IFC (not attached to this document but can be provided if required) and this confirms that only cosmetic and meaningless changes have been made to Version 6. It is therefore pointless and wrong to continue with a self-regulatory code that still does not address the fundamental challenges of balancing risk and reward between Pub Companies and tenants and which will not contribute to the long-term sustainability of the pub industry.

b) Most large Pub Companies are members of the BBPA. The BBPA has assumed and has been given responsibility for driving the self-regulation process. It has shown inflexibility in changing the imbalance of risk and reward between Pub Companies and tenants and hence the lack of progress in Version 6 versus previous versions of the IFC. Individual tenants are typically unable to participate in the self-regulation process because they lack the capacity and time to do so. It is well known that tenant interest groups (for example the IPC and FSB) have been excluded from the self-regulation process and their participation in future processes is not guaranteed. Government has no option but to play this role as it is effectively the only organisation that can mediate and balance the conflicting interests of both Pub Companies and tenants. A Statutory Code is the best instrument available to government to undertake this important role.

c) It was reported in the electronic version of the Publican's Morning Advertiser dated 17 April 2013 that Enterprise Inns' barrister in a recent court case stated that the IFC is not legally binding. He was quoted as saying ***"The code of practice doesn't have any binding force [in statute]. It is accepted voluntarily by the landlord pending legislation to what otherwise is a voluntary code. This is a voluntary concession that the landlord has agreed to offer to the tenant". "At the moment, the binding nature of the code of practice is in relation to its enforcement by the PICAS body and the rules of that body give the tenant a remedy".*** This is contrary to the IFC and proves that the BBPA's assertion that Codes of Practice have legal status is not correct. Not only is this disingenuous on behalf of the BBPA, but it proves that a Statutory Code is necessary to prevent legal ambiguities arising in future.

d) The accreditation of Codes of Practice has been done without regard to their compliance with the IFC in some instances. I have done a comparison of Version 5 of the IFC against the Enterprise Inns' Code of Practice that was accredited by BIIBAS as being complaint with the IFC. I found that certain provisions in the Enterprise Inns' Code of Practice are contrary to the IFC but nevertheless the Code was accredited. I have written to BIIBAS (See , A to this submission) and have also included their response, which quite frankly, is inadequate (see , : B to this submission). This is a further instance where self-regulation has failed. Critics will argue that a tenant must rely on the IFC and not Company Codes of Practice but then why have a confusing situation where there is an IFC and an individual Pub Company Code of Practice which although accredited cannot be relied upon for completeness and accuracy? These anomalies can only be addressed through a Statutory Code.

e) Lastly and very importantly, various BIS Committees (and their predecessors) have found that self-regulation does not work and that little or no progress has been made in recent years in addressing the challenges facing the pub industry. The only option is therefore a Statutory Code.

QUESTION 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

I disagree with this question.

The Statutory Code should be binding on all Pub Companies that had their Codes of Practice accredited by BIIBAS in terms of IFC Version 5. If such Pub Companies were willing to voluntarily participate in self-regulation, there can be no reason why such companies should not be subject to the Statutory Code.

In respect of Pub Companies that did not have their Codes of Practice accredited or which may be established independently of existing Pub Companies, the proposed threshold of 500 pubs would be acceptable, provided the threshold could be subject to review if needed to achieve its objectives (which has been proposed – see paragraph 4.26 of your Government Consultation Document).

There will be a need to prevent companies, on which the Code is binding due to a threshold number, to restructure their operations into small corporate entities to circumvent application of the Statutory Code. The only other way to address this risk is to specifically state that the pubs of all Pub Companies that have common controlling shareholders/owners should be aggregated for the purposes of determining the threshold number of pubs for Statutory Code application purposes.

QUESTION 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?

I agree with this question.

Non-managed pubs will also need to be carefully defined, which unfortunately has not been done in the proposed Statutory Code attached as Annex A to your Government Consultation Document.

My suggested definition of a non-managed pub is where the tenant is: -

- unsalaried;
- substantially responsible for the risks and rewards associated with running the pub;
- responsible for purchasing or renting the fixture and fittings used in the pub;
- responsible for providing working capital or paying a deposit to finance the pub's trading operations;
- responsible for the purchases of pub inventory from their own bank accounts; and/or
- responsible for paying rent to the pub landlord from the their own bank accounts.

If this definition is incorporated into the Statutory Code, then tenants of non-managed pubs will be provided with appropriate protection by the Code.

QUESTION 4: HOW DO YOU CONSIDER THAT FRANCHISES SHOULD BE TREATED UNDER THE CODE?

The statutory code should not apply to franchises, provided that the franchisee earns the rewards (goodwill) from selling the franchise during the period of the franchise and the terms and conditions of such a franchise are common to typical franchise agreements in any other industry.

It would have been helpful if a definition of a franchise was provided in the Government Consultation Paper.

QUESTION 5: WHAT IS YOUR ASSESSMENT OF THE LIKELY COSTS AND BENEFITS OF THESE PROPOSALS ON PUBS AND THE PUB SECTOR? PLEASE INCLUDE SUPPORTING EVIDENCE.

Question 5 is ambiguous because it is not clear to what "these proposals" refer. I have assumed that the proposals relate to Question 1 – Question 4.

Benefits

1. Protection will be provided to both Pub Companies and tenants. Vested interests will no longer be preserved as is clearly happening in the current self-regulation process. Also see my response to Question 1.
2. The uncertainty and ambiguity of the legal status of the IFC will be removed. A tenant will be able to rely on a statutory code without any doubt or legal uncertainty. Also see my response to Question 1.
   I have been recently negotiating with a relatively large Pub Company to enter into a tenancy agreement on a free-of-tie basis. I was told that I would not be given protection from the Company's Code of Practice because it was a free-of-tie agreement and Codes of Practice according to this Pub Company do not apply to free-of-tie agreements. It appears that such exclusions will be prohibited in the Statutory Code. This will provide benefit to free-of-tie tenants who have been excluded from the self-regulation process.
3. There will be a process to update the Statutory Code using governmental processes, which will be more open and inclusive than the self-regulation process has been.
4. At present some key processes (for example the preparation of business plans) are undertaken for compliance purposes – there is insufficient focus on content issues. The reason is that there is no sanction in the self-regulation process for tacit compliance. A benefit is that "tick box" checking will no longer be appropriate.
5. The BBPA and its stakeholders will not have to invest in developing future versions of the IFC. There will also be no need to have individual Company Codes of Practice accredited by BIIBAS (see part 7 of the proposed Statutory Code).

Costs

1. The industry will continue to contract and job losses will increase if there is not reform to the Pub Industry. The cost of not implementing these proposals will be the continued exploitation of a significant number of tenants and the potential loss of any assets that they currently own. There is also a high social responsibility cost to government in such circumstances. These costs are significant but unfortunately are not possibly quantifiable by individuals because of a lack of overall information.

Some additional factors to consider from a cost and benefit perspective are as follows: -

1. The retail price of lager has increased by 4.06% from 2007 to 2012 whilst the retail price of ale has increased by 4.09% over the same period[1]. For comparative purposes, the UK national price of a litre of unleaded 95 Octane petrol has only increased by 5.25% from 2007 to 2012[2]. This is despite an increase in the price of Brent Crude Oil of 15.27%[3] over the same period. The purpose of this analysis is to highlight that the major challenge facing the pub industry is the high retail price of beer and that the beer tie and current structure of the tied industry is contributing to high prices. There has to be a relationship between high beer prices and low employment (see next point below).
2. When I was running a pub, I was faced with price increases in my tied beer prices of 4% in 2012 (excluding the additional 2012 increase in beer duty), and taking into account an increase in discounts from in 2011 to) per barrel in 2012. The high increases in tied beer prices are indefensible and contribute to the high retail prices of beer which in turn has an adverse impact on the pub industry.

[1] Calculated from Office of National Statistics data
[2] Calculated from the Automobile Association's Average UK Price
[3] Calculated from the House of Commons Library Standard Note SN/SG/2106 on oil prices

The BBPA earlier in the year used research from Oxford University to argue that increases in the beer duty escalator would have an adverse impact on employment in the pub sector. Paragraph 3.18 of your Government Consultation Document confirms this by stating that cutting beer duty will have a significant [positive] impact on the beer industry. Unaffordable and unjustifiable increases in tied beer prices by implication must have an adverse economic impact. By removing the ability of pub companies to unilaterally increase beer prices (through reforms to the tie), the pub industry will benefit greatly.

3. The information contained in paragraph 3.6 of your Government Consultation Document sets out the financial hardships faced by tied tenants. Recently there has been much dispute over these and similar statistics, which detracts from the need for significant reform of the pub industry. For the purposes of illustrating the extent of the conflicting reporting on the pub industry, I will use Enterprise Inns as an example.

   The Chief Executive of Enterprise Inns claimed in the Publican's Morning Advertiser dated 6 December 2012 that the average Enterprise Inns' publican profit decreased from £37,000 in 2008 to £35,000 in 2012 excluding the living allowance of £10,000. The Chief Executive claimed in the same article that rental income earned by Enterprise Inns had declined from £37,000 in 2008 to £32,000 in 2012 and that Enterprise Inns' profit per pub had declined from £76,000 per pub to £67,000 per pub. Whilst this may apply to a sample of Enterprise Inns' pubs, it certainly contradicts information contained in the audited annual report of Enterprise Inns for the same period.

   Based on the total number of pubs included in the annual reports, revenue per pub had declined from £67,113 in 2008 to £64,724 in 2012. The total revenue per pub increased in both the 2011 and 2012 financial years indicating that the declining trend in total revenue earned per pub from 2008 to 2010 has started to reverse. Total rental income per pub has only decreased from £33,235 in 2008 to £31,345 in 2012, a far less decline than the Chief Executive has publically stated. However, if pubs subject to substantive agreements are used (this information is only included in the Enterprise Inns' annual reports from 2010 to 2012) rather than total number of pubs the Company owns, than total revenue per pub subject to substantive agreements has actually increased from £71,299 in 2010 to £72,596 in 2012. This contradicts the information provided by the Chief Executive to the Publican's Morning Advertiser.

   The importance of providing this analysis is to highlight the need for fairness, highlight the misinformation that exists and to confirm that Enterprise Inns is responding to the pressures facing the pub industry by increasing its revenue in a contracting pub industry at the expense of its tenants. Therefore the proposed reforms can only have an overall significant long-term benefit to the pub industry. The excessive revenue generating capacity of the Pub Companies may be undermined in the short-term but that is the risk of using a historical model that is frankly no longer fit for purpose.

QUESTION 6: WHAT ARE YOUR VIEWS ON THE FUTURE OF SELF-REGULATION WITHIN THE INDUSTRY?

In my opinion, self-regulation within the industry is ineffective because the objectives of self-regulation have never been articulated by the BBPA or by Government. A process can only be assessed for effectiveness if the desired result is clearly articulated. In the absence of clearly defined objectives expected of the self-regulation process, I doubt that anyone can conclude on its appropriateness or on its ability to address some of the key challenges within the pub industry.

There are aspects of self-regulation that clearly are not working. I have commented on these based on my personal experiences and research undertaken: -

a.

PICA-Service has no accountability and does not publically reason their decisions.

b.

c. Information on the number of PICA-Service disputes is not in the public domain. The last press release by the PICA-Service was dated 19 December 2012. So in all the time that it has been established (from 1 March 2012 until now), it has only published details of three disputes. This can only be interpreted as a lack of confidence in the PICA-Service process, that the PICA-Service is ineffective or that it is secretive about its work. Furthermore the fact that PICA-Service case have resulted in subsequent legal action (i.e. 66.67% of cases finalised!!) is a poor indictment on the PICA-Service. How paragraph 4.29 of your Government Consultation Paper can recognise the positive role played by the PICA-Service is therefore questioned. There is no mechanism to measure its success or lack thereof.

d. The accreditation of Company Codes of Practice by BIIBAS is done regardless of whether or not the Company Codes are compliant with the IFC. I found numerous instances in the Enterprise Inns' Code of Practice that contradict the IFC Version 5. I have documented these in Annexure A to this Code – see my response to Question 1. I have also recently reviewed the latest Greene King Code of Practice and have found that their "accredited" Code contradicts the IFC Version 5 regarding "Dispute Resolution". The question that has to be asked is what is the point in having an accreditation process underpinning self-regulation that is not thorough or robust?

e. The PEAT training is outdated, incomplete and does not adequately equip potential tenants to negotiate agreements or understand why it is important to use the services of financial and legal experts. I have undertaken PEAT training twice; firstly before I entered into a tenancy agreement and the second time after the termination of my tenancy agreement. I was immediately able to identify the weaknesses in PEAT when undertaking it for a second time and have recorded improvements that are required in Annexure D. Why PEAT has not been updated is not understood and is probably due to the lack of accountability inherent in a self-regulation process. It is also important to note that paragraph 4.2 effectively contradicts paragraph 3.5 of your Government Consultation Document

Self-regulation can only work when all parties have a vested interest in achieving a desired result (objective) that is clearly articulated. It can also only work effectively when there is diverse representation and differing viewpoints as to how the agreed objective will be achieved. Until this is done, there is no future for self-regulation. Government, which is ultimately accountable to all parties, will have to play that role.

The points that I have raised in answering Question 1 also relate to the answer to this Question but have not been duplicated here.

QUESTION 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

PRINCIPLE OF FAIR AND LAWFUL DEALING

This principle should underpin the proposed Statutory Code.

There is a risk that these are merely words on a "piece of paper" and will remain so in the proposed Statutory Code. The inclusion of these words in "paragraph 2 a" of the proposed Statutory Code in Annex A to the Government Consultation Document reinforces my comment.

Fairness is very difficult to define, interpret and incorporate into a Statutory Code. My review of the proposed Statutory Code in Annex A of your Government Consultation Document does not further expand the concept of fairness other than making reference to the second principle referred to above.

It would be expected that current legislation will address unlawful dealings in any contract.

PRINCIPLE THAT THE TIED TENANT SHOULD BE NO WORSE OFF THAN THE FREE-OF-TIE TENANT

This is an extremely complex matter and in my opinion may have unintended consequences for the pub industry as a whole. In reforming the tied industry, there is a risk that there will be adverse consequences for the freehouse or untied beer pub operator. Whilst idealistic, this principle should not be included in the Statutory Code because it is impractical and impossible to define.

The question has to be asked "What are the costs incurred and benefits earned by a free-of tie tenant?" Will the free-of-tie costs include a scenario where an individual who owns a pub and leases it out on a free-of-tie basis because they do not want the burden of administering a beer or drinks tie and always want their property occupied, be an appropriate benchmark? Will a pub landlord who determines a free-of-tie rent to enable a constant rate of return on his/her investment in the pub be an appropriate benchmark? Alternatively, what about a free-of-tie tenant that has repairing responsibilities versus a free-of-tie tenant that has no repairing responsibilities? These different scenarios show the difficulty of understanding the costs and benefits of a free-of-tie tenant.

Put more bluntly, why should an investor in a pub that rents it out on a free-of-tie basis be prejudiced by a proposed Statutory Code that removes his/her competitive advantage over a nearby tied pub owned by a Pub Company that until the Statutory Code was introduced enforced a tie? This unfortunately will be the unintended consequence of the principle that a "tied tenant" should be no better off than a "free-of tie" tenant if applied without careful consideration.

Ultimately, the **capital cost of acquiring a pub** or the **economic benefit of investing in a pub (i.e. yield on investment)** has to be recovered from beer selling prices and other revenue generated from operating a pub, regardless of whether a publican is tied or untied. That is a business reality. When a tenant rents a pub, the landlord should be able to generate rent in whatever form (provided it is legal) to pay their costs and generate a profit. If they are unable to find a tenant because rents are too high then the landlord has to face economic reality and dispose of the pub, change its use, lower the rent to attract tenants or board up the building.

The principle that the tied tenant should be no worse off than the free of tie tenant cannot be clearly or easily defined and incorporated into a statutory code and therefore has to be disregarded because it will have unintended consequences for individual or non-Pub Company landlords.

My answer to Question 11 also has relevance in answering this question.

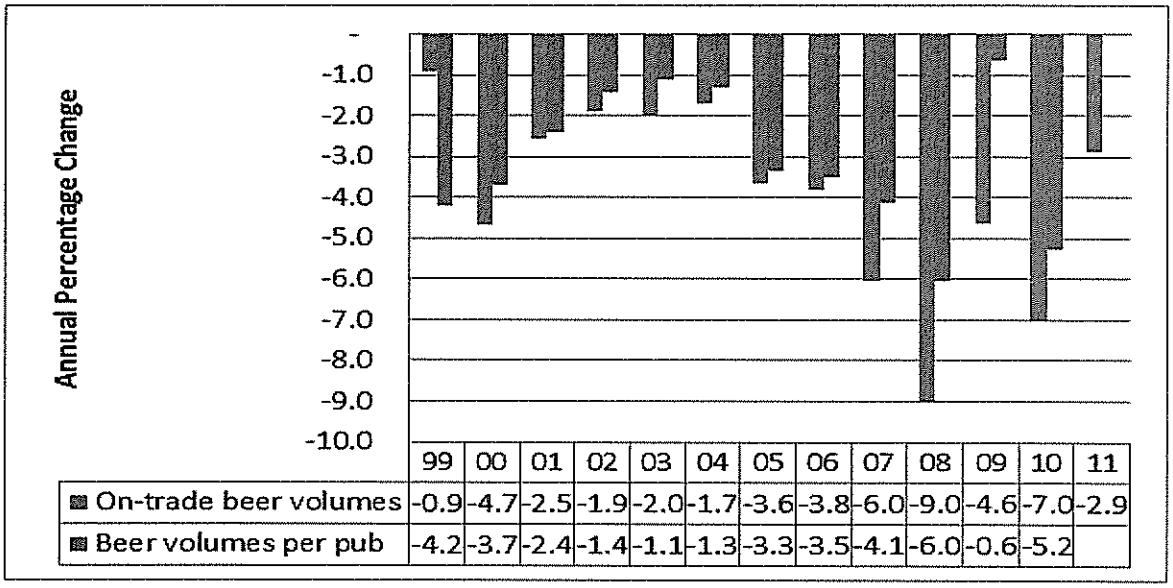
As an alternative, I would propose a principle that states "A tied tenant should only be offered a tenancy which is likely to be financially viable". I have expanded on this in answering Question 12.

QUESTION 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**

This provision, whilst supported, needs to be further strengthened to shorten the timeframe between rent reviews being required, the use of annual RPI linked rent increases and the non-achievement of FMT targets to initiate a rent review. The following points support this argument: -

a. On-trade beer volumes are falling significantly and sales of beer per pub are declining according to data obtained from the website of the BBPA. Despite the closure in the number of pubs, beer volumes per pub are still declining, which means that in general most pubs are selling less beer. This is illustrated below.



	99	00	01	02	03	04	05	06	07	08	09	10	11
On-trade beer volumes	-0.9	-4.7	-2.5	-1.9	-2.0	-1.7	-3.6	-3.8	-6.0	-9.0	-4.6	-7.0	-2.9
Beer volumes per pub	-4.2	-3.7	-2.4	-1.4	-1.1	-1.3	-3.3	-3.5	-4.1	-6.0	-0.6	-5.2	

b. Beer sales to the on-trade have declined by 43% between 1999 and 2012. From 2007 to 2012 the decline was effectively 5.68% per annum. The lower the beer volumes sold in pubs, the higher is the sustainability risk to publicans in general. Few, if any rent assessments, will take this into account. This data shows that the industry is changing rapidly and 5 years is too long a time period to wait to respond to these changes.

c. The fact that dry rents are not adjusted more frequently means that the dry rent will be too high if beer volumes fall and trading potential declines. As this is not done frequently, or in the case of some tenancies done at all, dry rent remains too high. A recent article in the daily electronic version of the Publican Morning Advertiser[4] on Spirit, a Pub Company, proves this point: ***"Spirit said its performance in the leased division was expected, with the decline driven by rent re-basing and falling beer volumes. Over a third of our year end leased estate underwent a rent review during this financial year. As these reviews are typically on a five year cycle, the initial rents were set at the peak of the market in 2006/7 and there has thus been a significant downward revision on many of the current rent settlements"***. It is easy to conclude that there was possibly an unduly high or unaffordable dry rent burden on Spirit's tied publicans over a 5 year. If rent reviews were done more frequently, say every 3 years, then instances like this will be avoided.

d. A reason for requesting a rent review should be if the Fair Maintainable Trade (FMT) on which the rent has been determined, is not reached. A tenant should be able to request a rent review so that the Pub Company can identify and explain why the FMT is not being achieved. A tenant will then be in a position to challenge the rent assessment more vigorously and the Pub Company will need to explain why the tenant "is not an efficient operator". A tenant may not have the knowledge of local conditions and trading circumstances at the commencement of an agreement to understand or challenge the rent assessment. After trading has commenced, the tenant will better understand the trading environment of their tenanted pub. A rent review should be held

[4] http://www.morningadvertiser.co.uk dated 16 October 2012

if the FMT has not been achieved within 2 years of entering into an agreement or having previously had a rent review. This has significant advantages in that the FMT will need to be justified and the Pub Company will need to highlight the so-called inefficiencies of the tenant if they have not been able to reach the FMT for their pub.

e. Although upward only rent reviews have been effectively abolished, the use of RPI linked annual rental increases is a questionable business practice that effectively negates the abolition of the upward only rent increases. The general decline in pub beer sales and the reference to Spirit, both referred to above, confirms the inappropriateness of this practice. Enterprise Inns CEO Ted Tuppen claimed in an article that from 2008 to 2012 the average Enterprise Inns publican rental costs declined from £37,000 to £32,000[5] (15.6%) but yet their Company includes RPI linked rental increases in all new agreements. The argument for RPI linked rental increases is supposedly based on the need to cushion tenants from significant rental increases between rent reviews. But if rents are declining, from what do tenants need to be cushioned? It is pointless to have a rent assessment every five years that assumes marginal change when all the evidence, including that of a large Pub Company such as Enterprise Inns, points to the contrary. The use of RPI linked rental increases should therefore also be a basis to request an open market review at more regular intervals.

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

Noting that this does not entrench the principle that a tied tenant should not be worse off than a free-of-tie tenant, it is agreed that this disclosure will greatly increase transparency and enable a tenant to make a more informed decision. At present, a tenant may not understand the total rent payable or the percentage of turnover that is payable to their Pub Company.

The following additional recommendations will also greatly improve transparency and further promote the principle of fairness: -

a. Rent assessment should show a sensitivity analysis over a three-year period. For example, if a tenant only achieves 90% of the FMT that underpins the rent assessment, over a three period in an inflationary environment, the sensitivity analysis should show what the financial impact will be on publican potential profitability. To be balanced the sensitivity analysis should also show what the impact will be on publican potential profitability if FMT is exceeded. This will not only improve transparency but will also underpin the principle of fairness.

b. A sensitivity analysis on the impact of falling beer sales volumes in line with industry trends. Every quarter the BBPA publishes a beer barometer that always shows falling on-trade beer volumes and yet there is silence over the effect that this has on the risk and reward balance between Pub Companies and tied tenants. Declining beer volumes ***significantly erode*** tenant profitability in a relatively short period of time. To prove this point, I have developed a financial model using the BBPA's own cost estimates for 2011 and an Enterprise Inns pricelist for a pub in the South-East of England (. ....) and which I have explained in more detail in E to this submission What the model shows is that for a small wet-led pub (80% wet led) is that if beer sales volumes decline by 3% per annum over a 3 year period and all costs including beer prices and rent increase by 4% per annum over the same period, ***the tied tenant's earnings*** as a percentage of turnover ***decline from 8% to 4%***. Conversely, the ***Pub Company's share*** of turnover ***increases by 1% to 27%*** over the same three-year period. If beer prices rise by more than a decline in beer volumes, the Pub Company's share of turnover increases whereas the tenant's share of turnover (i.e. gross earnings) decline by 50%. I will happily provide more information on my model if required.

[5] http: //www.morningadvertiser.co.uk dated 6 December 2012

III. ABOLISH THE GAMING MACHINE TIE AND MANDATE THAT NO PRODUCTS OTHER THAN DRINKS MAY BE TIED

I agree with this inclusion in the proposed statutory code.

IV. PROVIDE A "GUEST BEER" OPTION IN ALL TIED PUBS

I agree with this provision. It will allow the British micro-brewing industry to further grow and provide an easier route to market for small micro-brewers, who at present are excluded from tied pubs.

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

Pub Companies have other mechanisms at their disposal. All the tenancy agreements that I have read permit the Pub Company access to the accounting records of their tenant. These are mechanisms that are available to agencies such as HRMC and are deemed adequate. Providing Pub Companies with similar mechanisms will therefore be appropriate.

QUESTION 9: ARE THERE ANY AREAS WHERE YOU CONSIDER THE DRAFT STATUTORY CODE (AT ANNEX A) SHOULD BE ALTERED?

I have the following suggestions: -

1. Part 1 should include the requirement that a tenant can only be treated fairly if they are provided with sufficient and accurate information to make an informed decision to contract with a Pub Company.
2. Part 2 Paragraphs 5(b) and 6(a). The business plan should be for a minimum of three years and should include a sensitivity analysis of (a) being within 90% of the FMT used to determine rent and (b) the effect of declining beer volumes in accordance with national industry trends. The rent assessment provided by the Pub Company should also include a sensitivity analysis as mentioned earlier in this submission. Furthermore, the Pub Company will have to estimate beer price increases for the next three years. If these estimates are exceeded, then the tenant should have the right to request a review of the rent assessment (see point I of Question 8).
3. Part 2 Paragraph 9(c) should also include a physical plan of the premises showing the licensable area and any parking or other property that form part of the premises.
4. Part 2 Paragraph 9(g) should state the basis of valuation and how values are determined. There is also a need to state how fixtures and fittings purchased by the tenant will be valued at the conclusion of the agreement.
5. Part 3 Paragraph 11 undermines the fairness principle included in Part 1 of the proposed Code. What will stop a Pub Company from making a projection of profit that is unattainable and unrealistic and not be accountable for what is effectively a false misrepresentation. The RICS Guidelines are just that; a guideline and my understanding is that they are subjective in application. The rent assessment ***must*** reconcile current trading information to the FMT that is used in the rent assessment. In this way, a prospective tenant will be better informed to understand the challenge they face and the principle of fairness will be further entrenched in the proposed Statutory Code.
6. Clarity should be provided where a tenant who is entering into a 3 year tenancy agreement will obtain valuation advice (see Part 3 Paragraph 12 of the proposed Code). Evidence provided to some of the BIS Committee Hearings in recent years indicate that the RICS Guidelines have not been adequately updated so the question that has to be asked is from where and from whom will a prospective tenant obtain such advice. The cost of obtaining such advice could also be high and unaffordable (legal and financial advice will rightly also have to be obtained in accordance with the proposed Statutory Code).

7. Part 4 Paragraph 22 is supported provided that a cost of capital is permitted by Pub Companies in the calculation of a free-of-tie option. This will ensure that a free-of-tie comparison is realistic and will negate the possibility of unintended consequences that I have made reference to in answering Question 11.

QUESTION 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?

I agree with this inclusion in the proposed statutory code.

QUESTION 11: SHOULD THE GOVERNMENT INCLUDE A MANDATORY FREE-OF-TIE OPTION IN THE STATUTORY CODE?

The question is complex and will depend on how the dry rental will be determined. If the resultant rental is regulated (such as using the RICS Guidelines or a hybrid thereof) in a mandatory free-of-tie option, then my answer to Question 11 is no. However, if rentals are not regulated in a mandatory free-of-tie option and are determined in terms of the free market, and take into account the cost of capital, then the answer to Question 11 is yes.

In answering this question, my answer to Question 7 has to also be considered (the principle that the tied tenant should be no worse off than the free of tie tenant).

I will explain my argument by comparing a freehouse publican with a tied tenant in tabular format below: -

Freehouse publican	Tied tenant
An individual purchases a pub using borrowing. Capital cost high and needs to be serviced from the earnings of the pub.	The Pub Company has incurred the capital cost of acquiring the pub. Tenant pays rent only for the use of the pub.
Free of tie enables publican to purchase beer on the wholesale market and earn a higher margin on the sale of beer.	Tied purchases mean that trading margin lower because capital cost is not being financed from profits – only rent is being financed.
High margin enables individual investor to repay borrowings used to purchase pub.	Rent from pub is used by Pub Company to pay the capital costs together with the margin on tied products earned by Pub Company.
In conclusion, high cost of entry offset by ability to have lower trading costs.	In conclusion, low cost of entry to tenant offset by higher trading costs.

If I was a freehouse publican that had recently purchased a pub and my direct competition was a tied tenant, I would be prejudiced if I have to still pay a mortgage from my earnings but the tied tenant, who will now be "no worse off" than me, will not have to repay a mortgage or the cost of servicing a mortgage (i.e. the capital cost of the pub) is excluded from the formerly "tied" tenant's rental calculations. In fact, the "tied" tenant may now be "better off" than me because they do not have a high cost of capital in the form of a mortgage bond to service from their earnings.

It is therefore important that the dry rental set by the Pub Company incorporates a capital cost to offset the tie. The reason again is that in a tied model, the tie produces the return on capital together with a dry rental determined on a trading (the RICS) basis. By removing part of the model (the tie), the dry rental has to be changed to a market related or cost of capital basis. Keeping dry rental on a trading (RICS) basis but removing the tie creates a hybrid model that will have major unintended consequences for the freehouse sector.

The reason for the unintended consequence is that the proposed alternative of doing a rental calculation based on a modified FMT basis does not work for a freehouse publican. A freehouse publican does not repay a

mortgage on an FMT basis. They have a fixed commitment that is payable on a constant basis to provide a an appropriate yield to their financier.

However, if the question is whether a tied tenant must be offered a tie or free of tie agreement, and the dry rental compensates the Pub Company for the loss of the tie, then this should be included in the Statutory Code. The proviso is still that a cost of capital must be included in the dry rental to prevent unintended consequences or to undermine the freehouse sector.

The only significant advantage to a tied tenant of this recommendation is that if a dry rent is determined at the commencement of an agreement, this will apply throughout the agreement subject to minor revisions. The "tied" tenant will be insulated from Pub Companies increasing tied beer prices unilaterally, a trend that has happened more and more in recent years. This can be the only major benefit derived by a "tied" tenant in from being offered a free of tie option in the proposed Statutory Code.

QUESTION 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?

The main criticism of the existing tied model is that a Pub Company offers a pub to a prospective tenant that is not or will never be sustainable. The Pub Company will claim that it is providing a low cost of entry to the market but an unsustainable pub will have a very high continuous operating cost that can have severe future financial ramifications for tenants.

In my opinion, it is this factor that impacts most significantly on the current pub sector and which needs to be the focus for reform. Until this is addressed, the principle of "fair and lawful dealing" will not be achieved and the effectiveness of the proposed Statutory Code will be limited.

A Pub Company will be required to prepare a rent assessment and will give it to a prospective tenant but does so "without prejudice" regardless of the realism or accuracy of the projections in the shadow Profit & Loss. A financial or legal advisor that provides advice to a prospective publican will offer such advice but understandably will be guided by the rent assessment or shadow Profit & Loss account prepared by the Pub Company.

The tenant takes all the risk in the transaction; there is little risk to the Pub Company (a pub that is trading and has a tenant is their ultimate goal) and no risk to the professional advisors. If the Pub Company makes a misrepresentation of the rent potential of the pub, it does not face any sanction for doing so. Yet in any other business, the seller of a service would be held accountable if a significant misrepresentation was made.

I therefore believe that the Statutory Code should include the following provisions: -

1. The Pub Company should provide two shadow profit & loss statements, one based on the existing trading performance of the pub and the second a target or potential trading performance.
2. The prospective publican should also prepare a business plan. This business plan should be subject to professional scrutiny by a financial adviser.
3. The Pub Company must signs off the business plan once the rent and other commercial terms are finalised.

After 6 months of signing the agreement, the Pub Company and the tenant should undertake a detailed business review to better understand actual performance against that in the business plan. There will be a number of options available to the Pub Company:

1. The Pub Company and the tenant will be able to identify trading issues that were not evident or obvious when the rent setting process was done. Adjustments to rent or beer prices can then be made to correct the omission.
2. The Pub Company can agree to a change in business plan and adjustments to the rent setting process and beer prices made.
3. The Pub Company can assess whether the tenant has implemented the agreed business plan. If the business plan is not implemented, then the Pub Company is resolved of any responsibility regarding possible misrepresentations.
4. The Pub Company can offer business support and other assistance to overcome a lack of skills or experience to manage the pub.
5. The Pub Company can terminate the agreement because the tenant does not have sufficient skills to operate the pub.

The tenant will be able to: -

1. Re-negotiate terms of business if the business plan has been fully implemented.
2. Claim misrepresentation by the Pub Company if the pub is still unsustainable regardless of the appropriateness of the business plan and lodge a claim to the Adjudicator to investigate.
3. Claim damages from financial and other advisors if the advice provided was inappropriate.

The recommendations made are illustrated diagrammatically in F to this submission.

The advantages of this recommendation are that:

1. It will strengthen existing processes that are included in the IFC, the proposed Statutory Code and removes a "tickbox" compliance process from the various current requirements contained in the IFC and proposed Statutory Code;
2. It stops Pub Companies from offering unviable pubs to tenants. This is the biggest challenge facing new publicans – a Pub Company can make a representation regarding the "rent potential" but has no accountability for such representation. The pub that I rented from Enterprise Inns had a FMT that was unrealistic and it was unlikely that the FMT target was going to be met in the short-term. I believe that Enterprise Inns misrepresented the sustainability of the pub to me; however, at the time of signing the agreement, I would not have known better. However, I have no doubt that Enterprise Inns knew that with the pressures facing the industry, over-trading and the declining beer volumes sold, the FMT was unrealistic.
   Enterprise Inns have decided to dispose of the pub that I previously rented. This supports my comment regarding unsustainability.
3. It should result in more realistic rent assessments. I have been investigating a tenancy with a large Pub Company. In my opinion the shadow profit and loss was unrealistic at the commencement of pursuing this opportunity and had merely been prepared to support a predetermined rental. As I went through the process of renegotiating the rent, the shadow profit and loss was adjusted accordingly to support the negotiated rental. The Pub Company had no accountability to ensure that the shadow profit and loss was realistic at the outset of negotiations. However, if the shadow profit and loss was possibly subject to external scrutiny (say by an Adjudicator), then it is more likely that a realistic shadow Profit & Loss would have been prepared.
4. Pub Companies will be more prudent in selecting potential publicans. At the moment the selection process is not as robust as it could or should be. Pub Companies will deny this allegation but it is logical that having an operator in a pub is far better than closing and boarding it up.
5. Financial advisers will also be more prudent in providing advice that can also be held up to scrutiny.

A criticism of this recommendation is that it can be argued that there is a transfer of risk from the tenant to the Pub Company landlord.

However, if the Pub Company has reviewed the business plan of the publican, monitored its implementation and provided other support, then clearly the publican will be accountable for the financial success or failure of their pub. However, if the Pub Company has misrepresented the earnings capacity of a pub, then surely that is an unfair practice which should be censured?

In any other industry, if a sales person misrepresents what they are selling, consumer protection laws would hold that sales person or the company they represent accountable for the misrepresentation. There is no reason why the tied pub company model should be any different.

If a pub company sets a rent on a market basis and does not share in the risk or rewards of the publican, then the risk of misrepresentation is low and such provisions become redundant. In other words the transaction is no different to any other rental retail property transaction that happens all the time.

Another significant advantage of my recommendation is that it ties into the role of the proposed Adjudicator as illustrated in . F to this submission.

I have also shown how this recommendation can be applied to existing tenants. This is illustrated in , G to this submission but has not been explained in detail in this section of my submission.

QUESTIONS 13 TO QUESTION 17

I answer positively to all these questions.

[Annexes A, B and C withheld]

ANNEXURE D: ARTICLE WRITTEN BY ME ON PEAT SHORTCOMINGS

Introduction

The conduct of Pub Company landlords has received a lot of attention from parliamentarians, particularly since 2008/09 and in response numerous industry-led reforms have been instituted and given legally binding effect on Pub Company landlords through an Industry Framework Code (IFC). The later versions of the IFC (there are 6 versions published) require prospective tenants and lessees to undertake Pre-Entry Awareness Training (PEAT) prior to signing an agreement. PEAT is administered by the British Institute of Innkeepers' Benchmarking and Accreditation Service (BIIBAS) and is supposed to educate and empower prospective tenants and lessees to enter into agreements with sufficient knowledge.

Unfortunately in its current form PEAT fails to achieve its objective as an empowerment tool. Specifically, it has a number of critical shortcomings in that it does not explain the mechanics of the tied pub industry nor does it highlight the potential pitfalls facing prospective publicans in signing a tenancy or lease agreement. It also does not empower prospective tied publicans to understand the negotiable aspects of a tenancy or a lease. It is also mistakenly seen by some in the industry as indemnity from applying unfair and inappropriate industry practices.

The purpose of this paper is to constructively assess PEAT and identify those areas where it needs to be improved. It is targeted at BIIBAS, the pub industry as represented by the British Beer and Pub Association and policy makers. It is hoped that in this way prospective publicans can receive pre-entry awareness training that is empowering, educational and relevant. Ultimately, to be fit for purpose and relevant, PEAT must provide information to enable prospective publicans to make informed decisions and enter into agreements that are fair to both parties or explain to prospective publicans where they can obtain such information.

Putting this assessment into perspective

PEAT is theoretically aimed at inexperienced prospective publicans who have no or very little industry experience. PEAT therefore should provide industry information explaining key industry business practices and recent industry trends. This is very important information that enables prospective publicans to enter into agreements in an informed manner. Unfortunately the lack of focus on describing the industry is a significant shortcoming in PEAT as it does not educate or empower prospective publicans to make informed decisions. Instead it unfortunately implies that seeking financial and legal support, which PEAT emphasises repeatedly, offers sufficient protection to prospective publicans. This is misleading and a simplification of the challenges facing prospective publicans.

This research paper explains, in a constructive manner, the shortcomings that PEAT as a minimum should be addressing.

Shortcoming 1: PEAT does not explain its importance

What is the shortcoming?

PEAT does not explain its own importance and why it was developed, which is a significant omission. It therefore does not focus on matters that are important to prospective publicans and consequentially becomes a document that is too generic and studied from a "tick-box completion step" rather than as an empowering and educational document that adds value to its users.

Why is it important that this shortcoming is addressed?

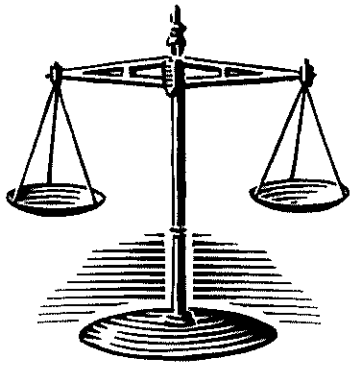
PEAT can only be successful if it highlights and explains the obligations of both the Pub Company landlord and the prospective tenants. These obligations can be sub-divided into 2 distinct areas: -

- Appropriate ethics, values and principles expected of Pub Company businesses in the UK (this applies equally to pub company landlords and prospective publicans).

  PEAT should categorically state that prospective tenants must not automatically assume that Pub Companies will be fair and equitable. Pub Companies want their properties occupied and subject to substantive agreements. Understandably that is their primary objective. The future financial success of potential tenants is secondary to the primary objective and therefore Pub Companies will conduct their business accordingly.

- The need to ensure that there is a fair and balanced agreement.

  The following diagram illustrates the consequences towards both the prospective publican and the Pub Company if a fair agreement (the ideal equilibrium in a set of scales) is not achieved. One party will profit at the expense of the other party.

Prospective Publican	**A Fair Agreement (Equilibrium)**	**Pub Company**
Financial unsustainability of publican undermined (if agreement biased towards Pub Company)		Exploitation by Pub Company of publican (if agreement biased towards Pub Company)

Pub Company landlords have years of experience and it is unlikely that the agreement will have negative implications to them. Unfortunately, prospective publicans are far more vulnerable to agreeing to terms or conditions which may not be balanced or fair. Entering into an agreement with a prospective publican that lacks this knowledge is quite frankly exploitation.

What should be done to rectify the shortcoming?

The IFC should set out the appropriate ethics, values and principles that Pub Companies should adopt when dealing with prospective and existing publicans and vice versa. Whilst Codes of Practice have been developed by Pub Company landlords, most do not contain a statement of ethics, values and principles that have been used to prepare such Codes. The reason for this omission is that the IFC (up to Version 5) does not contain such principles.

Unfortunately, until the adoption of ethics, values and principles is addressed at an industry level, there are limitations as to how this can be addressed within PEAT. Until addressed, PEAT should as a minimum highlight this shortcoming and explain that negotiating the taking on of a pub is risky and that it cannot be assumed that Pub Company landlords are ethical, fair or balanced in their dealings with prospective tenants.

As regards a fair agreement, PEAT needs to empower prospective publicans to understand or assess the fairness of agreements. A fair agreement is where there is a willing and knowledgeable prospective publican that enters into an agreement with a willing and knowledgeable Pub Company

Shortcoming 2: PEAT does not explain the differing typical pub offerings

What is the shortcoming?

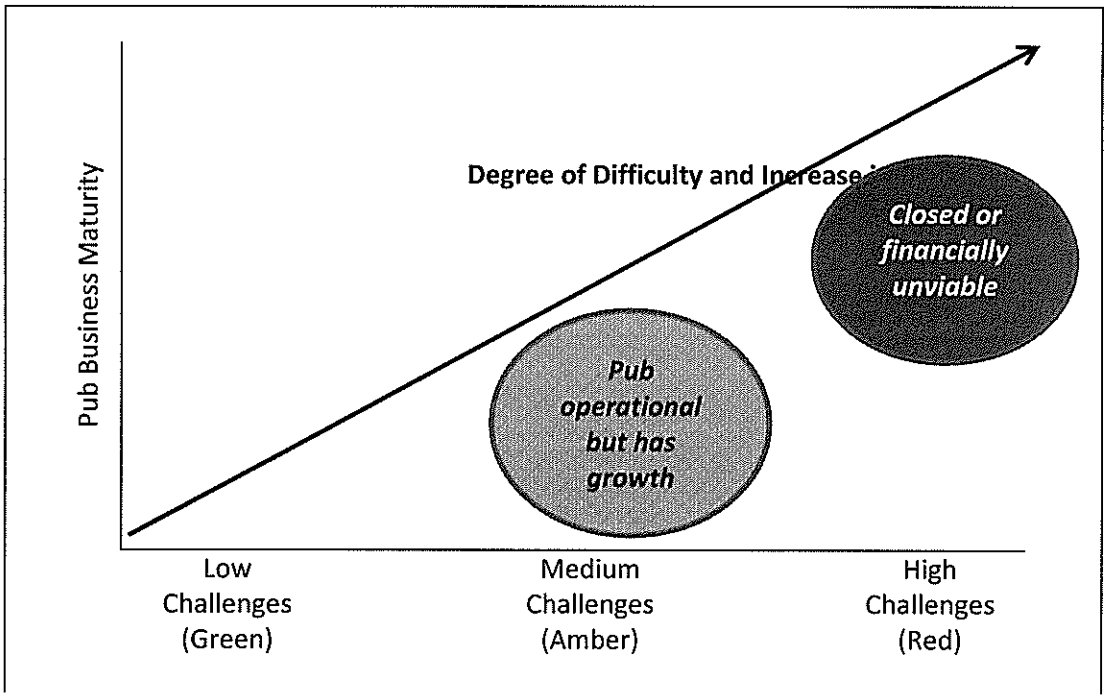
There are different pub offerings which have different risks from a growth and sustainability perspective. There are also different growth prospects dependent on the maturity of the pub business opportunity offered by the Pub Company landlord. This is not explained at all in PEAT.

Why is it important that this shortcoming is addressed?

There are two distinct components of pub offerings. Firstly, there is a distinction between wet-led pubs, which predominately sell beer and other alcoholic drinks, and food-led pubs which predominately sell food rather than beer and other alcoholic drinks. Reference is sometimes made to in the industry to different sized and type of pubs. These typically include a rural pub which would be located in a small village or hamlet (with a fairly even wet and food offering), a community pub which would be located predominately in a town or where there are a significant number of local inhabitants (mainly wet-led), a country pub to which customers will travel to for dining (mainly food-led) and a circuit or traditional bar which will be in a urban area, provide entertainment and have a licence that will enable late closing times (mainly wet-led). It is important that the differing pub offering is understood by prospective publicans and that this is done by PEAT.

Changing the offering of a pub may also be challenging and initially financially costly, particularly if a change in clientele is expected. Negotiating favourable rental and beer prices will be fundamental to cushioning the financial challenges of changing a pub offering.

Secondly, there is a further risk based on the maturity of the pub business opportunity as illustrated in the diagram below. The importance of this diagram is to identify the degree of difficulty and consequently the risk associated there



It is unlikely that a well-established pub with a balanced wet or food offering will have significant growth prospects. A prospective publican taking on a well-established pub will focus on either marginally growing or maintaining the pub business. On the other hand, a pub that is currently closed, having previously been operated by an unskilled publican, and which has been for a period of time could have good growth prospects but will need significant effort to attract new custom. Such a pub may have growth prospects but it will take time for the pub to become financially sustainable. Negotiating favourable rental and beer prices will be fundamental to cushion the financial challenges of re-opening such a pub.

What should be done to rectify the shortcoming?

PEAT should explain the different pub offering scenarios and identify important factors, including risks that a prospective publican will need to take into account when assessing the pub being offered by the Pub Company landlord.

Shortcoming 3: PEAT does not explain the rent setting process in a tied pub

What is the shortcoming?

The standard industry practices regarding the setting of rent is not adequately explained. Although reference is made to the standard industry rent setting practices in the IFC, they are not explained in detail in PEAT. The consequences of rent, particularly wet rent, are therefore not fully understood until the tenancy or lease agreement has been signed and the prospective publican starts trading.

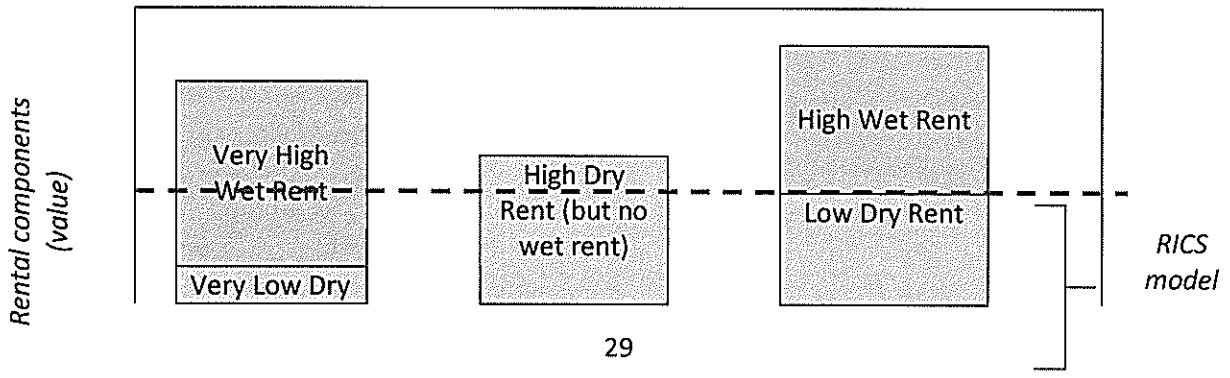
Why is it important that this shortcoming is addressed?

It is not possible for prospective publicans to make informed decisions if the rent setting process is not explained. For explanatory purposes, the standard industry rent setting process is made up of two components, namely "dry rent" and "wet rent".

Dry rent is determined on the trading potential of the pub premises assessed in accordance with the Royal Institute of Chartered Surveyors' (RICS) Guidelines. These Guidelines assume that a "reasonably efficient" pub operator can achieve the trading potential of the premises. For dry rental purposes, the Guidelines calculate a divisible balance (the trading potential), which is used to determine the fixed rental payable to the Pub Company landlord (50% of the divisible balance) and the earnings that a tied publican can expect (the remaining 50%).

Wet rent is the difference between what the Pub Company landlord pays for beer that it on-sells to tied publicans. The "on-sell" price is highly inflated relative to wholesale prices. However, this is supposedly to compensate for the" low" dry rent.

Not all Pub Companies apply the industry standard rental model.



Different rental models

For example, Pub Company landlords that are also brewers may charge a very low dry rent (lower than that which would have been determined by the RICS) but charge a higher wet rent to maximise the profitability of supplying their own brewed beer. The diagram above explains the different components of rent that may be used by Pub Company landlords.

What should be done to rectify the shortcoming?

PEAT should explain the rent setting process so that prospective publicans are better informed to make appropriate decisions and not be faced with dashed expectations once they commence trading.

Shortcoming 4: PEAT does not inform prospective publicans of their rights to request rent assessments

What is the shortcoming?

PEAT does not explain the rights of prospective publicans to obtain rent assessments. The IFC requires a Pub Company landlord to ensure that a prospective publican is made aware of the rental assessment and how the market rent for the property is established. Unfortunately the IFC does not indicate how this will be done. Furthermore some of the larger Pub Companies landlords do not incorporate this important IFC requirement in their Codes of Practice, even though they have been accredited by BIIBAS.

Why is it important that this shortcoming is addressed?

Prospective publicans should be informed of their rights to obtain a rent assessment or the factors that were taken into account in determining the rent of the pub being offered to them. PEAT should advise those prospective publicans that are given a Fair Maintainable Trade (FMT) target instead of or as a substitute of a rent assessment to be extremely vigilant. Quite often these FMT targets are outdated, misleading and unachievable. If the industry valuation Royal Institute of Chartered Surveyors (RICS) guidelines have been used, it should be noted that these are potential targets or the pub based on an experienced and competent operator. However, they may not be updated for declining pub footfall trends, outdated beer prices and the general decline in national beer volumes sold through pubs. It is therefore important to understand that in some instances, the FMT target may never have been achieved in the past when the pub industry was more vibrant.

It is important for a prospective publican to investigate how the FMT is determined, when was it last achieved (if ever), why the current or previous tenants/lessees did not achieve it and whether there has been a change in focus from wet-led to food led. All these factors will indicate how realistic the FMT is for the pub business in question and ultimately how affordable is dry rent and wet rent.

Unfortunately, when a Pub Company landlord specifies a FMT, it is important to note that this creates an expectation of the tied beer sales that the Pub Company landlord expects. Professional advisers understand this and will help you meet this expectation even though it may not be achievable in the short to medium-term. A consequence is that financial plans are prepared that are not as robust as they would be in the absence of an FMT target.

What should be done to rectify the shortcoming?

A rent assessment needs to be obtained from their landlord Pub Company so that prospective publicans can forward this to their legal and financial professional advisors. Ideally, the FMT should be reconciled to recent barrelage. In this way, a prospective publican can make a more informed decision. Furthermore, the Pub

Company landlord will have more accountability over the rental that is set and indirectly the sustainability of the pub being offered to the prospective publican.

Shortcoming 5: PEAT does not explain the balancing of risk and reward with the landlord Pub Company

What is the shortcoming?

The traditional tied pub model has some major shortcomings from a risk and reward perspective. Where a pub has growth prospects, and this growth materialises, risk and reward is shared between the Pub Company and the publican. However, if there is a decline in business, the Pub Company landlord retains reward but the risk, and the consequential losses associated with such risks, transfer to the publican. The reason is that the traditional tied pub model works fairly equitably where there is growth; it does not work when there is a decline in business.

The table below shows the disjunction between risk and reward in a declining beer market. The data used to prepare the table is based on the BBPA's Cost Guidelines and a price list of a large Pub Company, which is set out in the Column "Base Year".

The data in the table shows what happens in a pub if: -

- all costs, including rent, and beer selling prices increase by 4% annually after the base year, and
- beer volumes decline by 3% per annum after the base year.

The Publicans share of profit as a percentage of turnover decreases from 8% to 4% over a three year period. However, over the same period, wet and dry rental increase from £1,117 to £1,176. In other words, Pub Companies income increases marginally whereas the publicans earnings decline by nearly 50%.

Nature of Pub	Base Year	Base Year + 1	Base Year + 2	Base Year + 3
Publican earnings	£342	£291	£273	£173
Publican earnings as a percentage of turnover (excluding VAT)	8	7	6	4
Dry Rent	£342	£356	£370	£385
Estimated Wet Rent	£775	£780	£786	£791
Total Rent	£1,117	£1,136	£1,156	£1,176
Total Rent payable to Pub Company as a percentage of turnover (excluding VAT)	26%	26%	27%	27%

This is inequitable and unfair to the publican.

Why is it important that this shortcoming is addressed?

When a Pub Company landlord uses the RICS model for setting dry rent or includes an index linked rental increase in the agreement, PEAT should explain to the prospective publican how risk and reward is balanced. If there is decline in wet-sales that is not offset by increased food sales, there will be a significant decline in publican earnings. The proportion of rent paid to the Pub Company landlord does not decline in these circumstances. This should be made clear to all prospective publicans, although it may not be in the interests of Pub Company landlords to be so transparent.

The importance of this matter cannot be overstated due to the continuously declining beer volumes sold in pubs.

What should be done to rectify the shortcoming?

PEAT should explain this risk in the tied pub model thoroughly.

Shortcoming 6: PEAT does not indicate possible areas for negotiations with Pub Company landlords

What is the shortcoming?

Pub Companies often publically state that all terms and conditions of a tenancy or lease agreement are negotiable until finalised and included in the signed tenancy or lease agreement. That assertion is correct but unfortunately is not supported by a checklist of what is negotiable. Furthermore, Pub Company landlords may use standard industry practice to suppress negotiations; it is very difficult for an inexperienced prospective publican to negotiate against such an argument. For example, being told "this is standard industry practice" and "this is a standard clause in all our agreements that have never been questioned before" are difficult arguments to overcome to a prospective tenant that has never been in the pub business before.

This omission also undermines fairness referred to earlier in this research paper (see Shortcoming 1).

Why is it important that this shortcoming is addressed?

Negotiations are very difficult and it may be useful to seek independent advice from individuals or organisations that are critical or who have experience of the tied industry. PEAT needs to highlight this by identifying areas that could be negotiable. The following are examples of some of the areas that could be negotiable: -

- Actual rental levels relative to the nature of the business (wet-led versus food-led). If on-trade sales are declining, current and future rental levels may need to reflect these declines.
- Phase-in of monthly or annual rentals if the pub needs to be turned-around or the product offering refocused.
- Purchase or lease of fixtures and fittings. It may be more viable to lease the fixtures and fittings rather than purchase new fixtures and fittings. However, if the existing fixtures and fittings are relatively old, but in good working condition, it may be more appropriate to purchase the fixtures and fittings from the existing publican.
- Beer prices. A higher discount may be required to make the business sustainable if there is a competitive environment (particularly well-established freehouses or multi-site operators). In addition, unsustainable high beer prices may be the reason that the pub is available.
- Payment terms for beer purchases. It is ideal if beer purchased from the Pub Company is sold before the prospective publican has to make payment to the Pub Company or supplier.
- Further development of the pub which may include signage and internal redevelopment.

It is also important that prospective publicans are informed of reasons why a Pub Company may not be prepared to negotiate on these or any other factors. Reasons may include the following: -

- There may be a number of prospective publicans interested in the pub opportunity. Not all prospective publicans will necessarily negotiate. Just as a prospective publican will seek to maximise the economic benefit of the pub offering, so will the Pub Company. It must and should try maximising its financial return from the pub being offered. Therefore the Pub Company will not want to negotiate less favourable terms with one prospective publican if better terms can be obtained from other prospective tenants.
- A reluctance to change standard industry practices that it has always applied in the past.
- A reluctance to give more favourable terms to a prospective publican that may be able to compete more favourably with a publican in nearby owned pub.

What should be done to rectify the shortcoming?

PEAT should provide more information on factors to negotiate and indirectly reinforce the need for prospective publicans to seek professional advice.

Shortcoming 7: PEAT does not provide tailored information on purchasing a lease re-assignment

What is the shortcoming?

PEAT provides an explanation of the differences between a tenancy and a lease in very basic terms. Unfortunately it does not explain how leases are assigned and what a prospective publican taking on a re-assignment of a lease should consider. This is a startling omission.

Why is it important that this shortcoming is addressed?

Information on determining and negotiating premiums on lease re-assignments is not provided. There is no information available on recent trends on the premiums paid on lease re-assignments or on trends on re-assignments. Pub Companies, who are effectively a third party to lease re-assignments, may limit their involvement to protect their own commercial interests at the expense of the prospective publican purchasing a lease re-assignment.

There is a moral dilemma for the Pub Companies, which the IFC should address by providing guidance on what exactly is the role of the Pub Company in the re-assignment of a lease. Ensuring that the buyer of a re-assigned lease has the information to make an informed decision is the least that a Pub Company can do. A seller of a lease cannot and should not criticise Pub Companies for ensuring prospective buyers have sufficient information to make an informed decision.

What should be done to rectify the shortcoming?

PEAT should provide guidance to prospective buyers and sellers of leases to empower both parties to the transaction. Getting independent valuations by industry specialists and the importance of due diligences cannot be under-estimated and buyers of re-assigned leases should be categorically informed through PEAT that it is their right to have access to the accounting records of a seller of a lease. If access is not granted, the prospective buyer should withdraw from the transaction or indemnify the Pub Company with whom the lease is signed.

Shortcoming 8: PEAT overstates the importance of financial planning due to incomplete information

What is the shortcoming?

Financial planning is a very important business tool that assists prospective publicans assess the sustainability of the pub that they may contemplate taking over. Unfortunately, its importance is often overstated in PEAT and by Pub Company landlords because it does not necessarily identify unsustainable businesses. Like any plan, its creditability is dependent on the availability of reliable information. In most instances, the information available to prospective publicans is limited because it is incomplete and therefore insufficient to prepare robust and credible financial plans. Furthermore, business plans are done for a very short period (usually one year) and not for a minimum of 3 years.

Why is it important that this shortcoming is addressed?

The information provided to prospective publicans is often insufficient. Pub Company landlords often claim that they themselves have limited access to detailed financial information of existing tenants and lessees and there is merit in such an argument as they do not necessarily have access to the publicans' detailed financial information other than tied barrelages. However, Pub Companies have significant industry information and should be able to prepare a "realistic" shadow profit and loss account of the existing pub business far more accurately than a prospective publican that is new to the industry. Unfortunately, it is not in Pub Company landlords' interests to do so because: -

- a shadow profit and loss account may show that the pub is unsustainable and the Pub Company may not want this to be evident to a prospective tenant;
- it may prove that the rent is too high;
- the credibility of the rent assessment may become evident; and
- there could be a risk of misrepresentation to a prospective publican.

How a prospective publican is supposed to be able to prepare a realistic business plan without access to existing trading information is also not understood. Pub Companies will require prospective publicans to use a trade accountant to prepare or review the financial plan. Although a trade accountant will be of assistance, and will be able to help make the financial plan more realistic, the trade accountant is not able to identify or confirm pricing trends, footfall changes and growth prospects. The significance of their role is limited and should always be considered in that context.

Trade accountants will also be influenced by the rental and FMT assessment and may use this as a benchmark when preparing the financial plan. This, together with the limitations in their certification from a legal representation perspective, may lessen the robustness of the financial plan.

What should be done to rectify the shortcoming?

There is not much that can be done until the IFC is revised (Revision 6 of the IFC has partly addressed this shortcoming but its implementation by individual Pub Companies will need to be assessed). Only then can PEAT be amended to address the shortcomings referred to above.

Shortcoming 9: PEAT does not address the termination of a tenancy or lease from a valuation of fixtures & fittings perspective

What is the shortcoming?

PEAT does not explain the treatment of the valuation of fixtures and fittings when a prospective publican ends a tenancy or lease agreement. It appears that the basis of valuation on departure is liquidation value and not other valuations (for example, depreciated replacement cost) that are typically used in going-concern businesses.

Why is it important that this shortcoming is addressed?

If a prospective publican buys all the fixtures and fittings at the beginning of a tenancy or lease from the previous publican, maintains them in good working condition and then sells the same fixtures and fittings at the conclusion of the tenancy or lease, they should recover a substantial part of their initial outlay. The reason is that the fixtures and fittings were purchased at liquidation value and will be sold at liquidation value, if this method of valuation is used.

However, if a prospective publican purchases new fixtures and fittings from suppliers at cost during the period of their tenancy or lease, the prospective publican will not recover such investment if the liquidation value is used. The reason is that a new purchase of fixtures and fittings will lose most of its value after purchase. However, if a depreciated replacement value is used, a more realistic and appropriate recovery of the investment in fixtures and fittings will be made at the conclusion of the tenancy or lease agreement. Unfortunately, this is not explained in PEAT, mainly because the ending of a tenancy or lease is not addressed in the IFC.

What should be done to rectify the shortcoming?

PEAT should explain the procedures and processes at the conclusion of a tenancy or lease and the industry standard methods of valuation and the ramifications thereof. This information is just as important as other "pre-entry" information.

Shortcoming 10: PEAT does not explain churn rates

What is the shortcoming?

A Pub Company landlord should set out how often a pub being offered to a prospective tenant has changed tenant (referred to as the "churn rate") in the last 5 years, together with reasons where these are known by the Pub Company landlord. In particular, Pub Company landlords should indicate where a tenancy was ended prior to the duration of the agreement. In this way, prospective publicans can get an understanding of the churn rate which will assist them understand the challenges of the pub that will potentially be taken-over.

Unfortunately, this is not required in the IFC.

Why is it important that this shortcoming is addressed?

If the churn rate is disclosed, prospective publicans can get an understanding of how often there has been a change in publican. This will assist them understand the challenges of the pub that will potentially be taken-over.

What should be done to rectify the shortcoming?

There is not much that can be done until the IFC is revised. Only then can PEAT be amended to address the shortcomings referred to above.

Shortcoming 11: PEAT is outdated and does not reflect recent industry changes and investigations

What is the shortcoming?

There have been significant changes in the industry (Version 6 of the IFC has been recently released). There are new industry initiatives such as rent review mechanisms and other dispute resolution processes that have been introduced. There have also been a number of House of Commons' Select Committee hearings on the tied pub industry model. The omission of these and similar industry trends is not understood.

Why is it important that this shortcoming is addressed?

Prospective publicans should be updated with changes in the industry. PEAT is an important process that will provide information on the latest trends.

A critical piece of information will be where information on which Pub Companies have had PICA-Service matters raised will be obtained.

What should be done to rectify the shortcoming?

PEAT should be amended to address the shortcomings referred to above.

ANNEXURE E: FURTHER INFORMATION ON FINANCIAL MODEL TO SUPPORT SENSITIVITY ANALYSIS

A major criticism of the tied pub industry is that the sharing of risk and reward is no longer appropriate given the changes in the industry.

To prove this point, a financial model was used to illustrate financial impacts on publican earnings where beer volumes sold by pubs decline. The financial model developed was based on the BBPA's Cost Guidelines for 2011 and converted into sales quantities assuming a sales mix of 72% beer sales, 11% wine sales and 12% spirit sales based on a 2012 Enterprise Inns' price list (net of a £59.40 discount per barrel) that applied in the South-East of England. A wet-led £5,000 turnover a week community pub was used for the purposes of the financial model.

Beer volumes purchased from a Pub Company were assumed to decline by 3% per annum over a three year period (recent beer volume declines are much higher as explained further in this summary). RPI was assumed to be 4% over the extended three-year period which resulted in beer purchases, overhead costs and the pub increasing its beer selling prices by this rate.

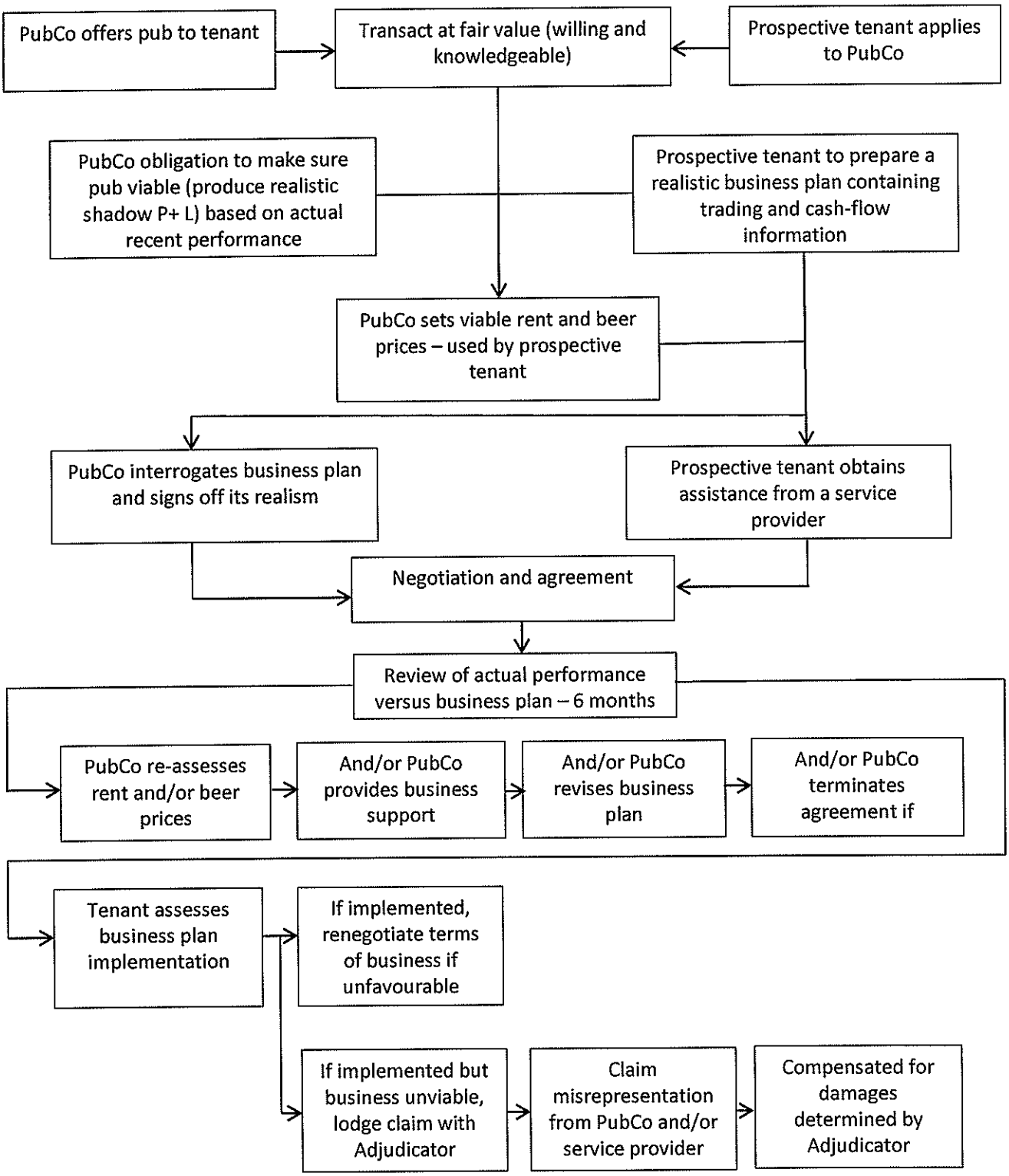
The table below illustrates the impact on the publican and the Pub Company as a result of these changes using the data of a small community wet-led pub. The original financial model is referred to as Base year and the subsequent three years as Base year+1, Base year+2 and Base year+3.

Table 8: Impact on Publican Earnings and Rent Payable when Beer Volumes Decline

Nature of Pub	Base Year	Base Year + 1	Base Year + 2	Base Year + 3
Publican earnings	£342	£291	£273	£173
Publican earnings as a percentage of turnover (excluding VAT)	8	7	6	4
Dry Rent	£342	£356	£370	£385
Estimated Wet Rent	£775	£780	£786	£791
Total Rent	£1,117	£1,136	£1,156	£1,176
Total Rent payable to Pub Company as a percentage of turnover (excluding VAT)	26%	26%	27%	27%

What this information shows is that a publican in a small wet-led pub will suffer a 49% loss in profits if beer volumes decline by 3% per annum whilst the total rental earned by the Pub Company will increase by approximately 1% over the extended three-year period. The sharing of risks and rewards is clearly not equitable as the tied publican's earnings fall whilst total pub rental income remains relatively static. In order for tied publicans to sustain their relatively low initial profitability, the price of a pint in a tied community wet-led pub in the South-East has to be increased by a higher rate than that of RPI, thereby putting upward pressure on beer prices in tied pubs.

ANNEXURE F: DIAGRAMTICAL ILLUSTRATION OF PROPOSED ALTERNATIVE MODEL



Define viability by using a defined minimum earnings that a tied publican should earn

ANNEXURE G: DIAGRAMTICAL ILLUSTRATION OF PROPOSED ALTERNATIVE MODEL (EXISTING TENANTS)