01 Submissions to BIS

Subject	**Submissions to BIS**
From	siclarke@[redacted]
To	[redacted]
Sent	[redacted]
Attachments	BROOKER...

Dear [redacted]
Following our chat earlier today it reminded me to review your submission to BIS in response to the public consultation.

Obviously, your opinion is your own and whether I agree or not you are entitled to it. I am however concerned that you have made some rather sweeping, and in my view misleading, statements about me and our circumstances at the Eagle. It may simply be that you were ill informed or not aware of the entire facts, either way it goes without saying that we should put the record straight in the event BIS intend lending any weight to your submission.

[redacted]

[redacted] I said we would, at the Eagle, because we are a real ale pub. I totally accept that licensees may consider their primary selling product or brand and consider the increased profitability they could achieve by acquiring particular brands as a guest. If I were an Irish Bar I might consider Guinness as my guest beer but the gap between tied and FOT price on Guinness may not be great and I might be better choosing my strongest selling ale or lager which has a wider price disparity therefore a higher latent value and overall profit. You have apparently sought to put words in my mouth here and misquoted me. Again I believe a clarification would be appropriate.

Regards.

Simon

(1a)

Brooker 1

CLAIM No. 7BS11690

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
SITTING AT WINCHESTER
BEFORE HIS HONOUR JUDGE IAIN HUGHES QC
SITTING AS A DEPUTY HIGH COURT JUDGE
Draft delivered: 24th August 2009
Handed down: 7th September 2009
BETWEEN:
(1) CHARLES BROOKER
(2) LESLIE BROOKER

Claimants

- and -
UNIQUE PUB PROPERTIES LTD

Defendant

JUDGMENT

Introduction

1. This is an unopposed renewal of a lease of a public house under Part II of the Landlord and Tenant Act 1954, as amended ("the Act"). All the terms of the new lease have been agreed, apart from the amount of rent.

2. The subject property is The White Horse at Hambrook, near Bristol ("the public house"). The claimants are the tenants who currently hold over under Part II of the Act. The commencement of the term of the previous five-year lease was 20th December 2001 and the same expired through effluxion of time. The passing rent of £16,000 per annum was set by Judge Weeks QC in an action between the present parties that was heard on 16th August 2001 in the Chancery Division sitting at Bristol.

3. The parties were represented before me by experienced counsel: Mr Anthony Verduyn for the claimants/tenants and Mr Mark Wonnacott for the defendant/landlord. I am grateful to both counsel for their assistance and for their helpful written and oral submissions.

4. At the request of both counsel, I heard the case sitting as a Deputy High Court Judge. This was because the central issue in the case was the proper methodology to use in cases where the rent of a public house has to be assessed under the Act.

The White Horse, Hambrook

5. Hambrook is a small village situated just outside Bristol on the B4058 road. This is a busy thoroughfare providing access from Bristol to the residential areas of Winterbourne, Frampton Cottrell, Coal Pitt Heath and Yate. The public house is situated on the edge of the village, a short distance from the centre. Within the village there is a small light industrial and office development. More extensive employment centres are located two miles away. There is one other public house in Hambrook: The Crown.

6. The public house stands detached in a prominent location. A two-storey building with a basement, it has a forecourt provided with tables and benches. Adjacent to the public house is its car park providing space for approximately 50 vehicles. There is also a beer garden adjoining a small river known as Bradley Brooke.

7. The main public bar provides seating for about 60 customers. A small flight of steps leads to a dining area which is part divided from the main bar by an open fireplace. The dining area

has 32 covers. The first floor has the tenants' private accommodation which includes a living/dining room and three bedrooms.

8. The lease provides that the only permitted use is as a public house and there is a covenant not to part with possession, under-let or assign the whole or any part of the property. The lease does not provide for periodic reviews of rent and the rent is not subject to indexation. Repairing obligations are divided between the parties. The landlord is to keep the foundations, structural timbers, roofs, main walls, drains and the surfaces of the car parks in good repair. The tenant is to keep the rest of the property in good repair.

9. The lease provides for insurance by the landlord at the tenant's expense and there is the usual proviso for re-entry. The landlord's consent is required for amusement machines and consent has been given on condition that one third of the takings is paid to the landlord by way of additional rent.

10. The lease includes a partial tie. There is a tie for beers including lagers, which are to be purchased at the landlord's tied price list from the landlord's nominated supplier. The tenant is permitted to offer for sale one draft cask conditioned beer which can be purchased from any source. This is known as the guest ale provision. There is no tie for low alcohol or alcohol free lagers and beers. Nor is there a tie or stocking obligation for other drinks including wines, spirits, minerals and cider.

11. The passing rent of the five-year term which ended in 2001 was £19,839. The present passing rent is £16,000. In his judgment, Judge Weeks determined a notional profit of £34,000 divisible between the landlord of the tenant. He noted that ordinarily this was shared equally between the parties but in the present case he found three reasons why a prudent tenant would negotiate for a more favourable division. First, the public house was burdened with a partial tie. Free houses were available on the market and the tenant could expect, other things being equal, to have made a greater profit from being able to buy beer on the open market and not at the tied prices even with a discount.

12. Secondly, the tie had the effect of creating a second level of profit for the landlord from the captive market for its associated company. In the trade this is often called the wet rent. Thirdly, the divisible profit was so low that one half did not, in the judgment of Judge Weeks, provide a suitable living wage or an adequate return to working tenants for their efforts, even allowing for the benefit of free accommodation. Accordingly Judge Weeks set a rent of £16,000 per annum, a reduction of £3,839 from the then passing rent.

13. The lease considered by Judge Weeks contained a minimum stocking obligation. The tenants were obliged to buy a minimum of 200 barrels per annum or pay compensation if their purchases fell short. That minimum stocking obligation has now been abandoned and it is agreed that the new lease will not contain any such obligation.

14. A new condition in the lease is a requirement for all tied beer lines to be fitted with monitors. This will provide the landlord with accurate flow readings for all the tied beers. It is intended to prevent the tenant from substituting tied beer with beer purchased from non-tied sources at a greater profit. This is now a standard requirement in all new leases granted by the landlord and there was no evidence before me that proved that the tenant had in fact been substituting beers in the past.

The Act

15. Rent is dealt with in section 34(1) of the Act, "Rent under new tenancy":

> "The rent payable under a tenancy granted by order of the court under this Part of this Act shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court to be that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor, there being disregarded:

(a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding;
(b) any goodwill attached to the holding by reason of carrying on thereat of the business of the tenant (whether by him or by a predecessor of his in that business);
(c) any effect on rent of an improvement to which this paragraph applies;
(d) in the case of a holding comprising licensed premises, any addition to its value attributable to the license, if it appears to the court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the license belongs to the tenant."

16. Both counsel are agreed that in the present case none of the statutory disregards in section 34(1) (a) to (d) has any effect on the calculations.

17. The Act requires the court to hold a mirror up to the open market at the date of decision. The question then for the court is: if the public house were available to be let in the open market, on the same terms as those contained in the new lease, how much rent would an incoming tenant be willing to pay?

18. The Act imports the requirement of reasonableness. The editors of the *Handbook of Rent Review* comment on this, at page 404:

> "the word "reasonable" is used in relation to what can be expected, not to the rent itself; the section calls for an objective assessment of what is obtainable in the market, not a.subjective assessment of whether the amount obtainable is reasonable, whether as between the parties or otherwise."

19. The editors of *Woodfall on Landlord & Tenant* make much the same point, at page 22/116, para. 22.148:

> "The rent which must be fixed by the court must be the market rent; not a 'fair and reasonable rent.' The rent thus fixed may, indeed, be one which the tenant cannot afford, but that does not enable the court to reduce the rent to one which he can afford."

20. This was confirmed by the Court of Appeal in the case of *Giannoukakis v. Saltfleet Ltd*, [1988] 17 EG 121. Dillon LJ said:

> " If you have long-established premises where the business has a fairly low profit element it may well be that a rent fixed in accordance with the formula of the Act will be more than the tenant can afford. Fortunately, it does not happen all that often, but I do not think there is anything in the Act which enables the rent is to be fixed at a lower rate because the tenant cannot afford a rent which the formula in the Act would produce."

21. The Act therefore requires an objective assessment of the market rent that would be offered by a hypothetical tenant for the agreed lease of the public house today. Although I am sympathetic to the position of Mr Brooker, who has operated the public house for many years, I cannot allow either that sympathy or the submission of Mr Verduyn, in his first skeleton: "The circumstances are such that, in the absence of a reduction in rent, the claimants will go out of business", to affect my judgement in this matter.

The market rent - methodology

22. The basic methodology for assessment is not disputed. Before making an offer for licensed premises, the hypothetical tenant would attempt to forecast the probable profit. To do this he would undertake the following calculations. First, calculate the anticipated turnover from sales of beer and cider, wines, spirits and minerals, food and retained income from gambling machines. Secondly, calculate the anticipated gross profit on turnover. Thirdly, deduct the likely expenses so as to produce the divisible balance (or notional profit). Finally, bid a particular proportion of that divisible balance as rent.

23. Although the experts do not agree on the detail of the assumptions that are made in performing this calculation, nevertheless the basic approach is common to both parties. I am satisfied that the only significant difference between the two experts in respect of the profit

forecast is the number of barrels of free of tie beer and cider which the hypothetical tenant would calculate would be purchased each year.

24. It is at this point that the methodology adopted by the experts for the two sides differs. For the landlord, Mr Taylor says that a number of different comprables provide a useful cross check on the assumptions made as to sales. These can include comparing rent with turnover and data from comparable public houses. However, as the existing tenant's accounts would not be available to the hypothetical tenant, the accounts produced in the action are of only limited relevance. Certainly, they cannot be used to support a detailed position that might be adopted by an incoming tenant.

25. Mr Jacobs, for the tenants, rejects entirely the use of comparables. Instead, he submits that a number of adjustments need to be made in order to work out the rent. First, an adjustment in order to satisfy what he terms "the prime principle" which is "that the tied tenants should not be financially worse off than if they were free of tie". Secondly, the application of a "value equation". This calculates the tied rent as the product of the orthodox free of tie rent, less 100 per cent of the extra profit which the landlord makes by letting the subject property tied.

26. The detail of Mr Jacobs' calculation of the tied rent is as follows:
    a. Calculate the free of tie divisible balance.
    b. 50 per cent of that figure is the free of tie open market rent.
    c. Perform the value equation, namely the tied rent equals the orthodox free of tie open market rent, minus 100 per cent of the extra profit that the landlord makes by letting the premises tied.

27. In short, Mr Jacobs calculates what he submits the rent should be, based on detailed principles of accountancy practice and arithmetic.

The evidence

28. I heard evidence from Mr Leslie Brooker who, with his wife, runs the public house. Mr Brooker seeks a reduction in the present passing rent. He produced certain sets of accounts, mostly of historical interest as they were somewhat out of date, and, during the hearing, a quantity of more recent delivery notes.
29. Mr Wonnacott attacked the credibility of Mr Brooker and suggested that neither his evidence as to beer and cider purchases nor his accounts could be relied upon. Without in terms accusing Mr Brooker of dishonesty, Mr Wonnacott submitted that his evidence was unreliable, that he had not produced his VAT accounts, nor his up-to-date profit and loss accounts. But Mr Wonnacott cannot have it both ways. If, as is the case, the tenants accounts are really of little relevance, then Mr Brooker should not be criticised for failing to produce the most up to date accounts, or for being late with his accounts, or for failing to set out the recent purchasing history of the public house in a clear and document-supported manner.

30. Mr Brooker presented as a cheerful, experienced public house tenant. I am satisfied that he will have done his best to maximise his profits over the years and that he strays no closer to the line than the average public house tenant. Just as I cannot allow sympathy for Mr Brooker to affect my judgment, so I do not propose to allow hints and nudges from Mr Wonnacott to affect my decision in the opposite direction.

31. I accept Mr Brooker's evidence that the public house was not a "cider pub." Mr Brooker did not try to maximise his cider sales by encouraging the type of clientele who drink that beverage; he described them as young and somewhat noisy. Given the existence of such establishments in the area, and the fact that the public house has a proper dining area, I do not consider it likely that a hypothetical tenant would prepare a bid on such a basis either.

32. Mr Arthur Jacobs FCCA is an accountant and produced two reports for the tenant. The first was dated 31st October 2008. A second report, dated 19th June 2009 was also filed. Mr Jacobs has had many years experience of working in an accounting capacity in the licensed trade,

indeed he has worked in that industry for nearly half a century. It was plain from his reports and his oral evidence that he feels very strongly that the wrong approach has been adopted when assessing rents for public houses under the Act. His method, he believes, allows both parties to observe their legal responsibilities and provides "fairness of income" to both. Mr Jacobs has compared his results against the tenant's profit and loss accounts for the period 1995 to 2006 "which have assisted me in checking the historical performance against my assessment of a profit assessment for the new period."

33. I regret that I did not find the evidence of Mr Jacobs to be particularly helpful and I am not prepared to adopt his methodology in resolving the issue before me. I found that his evidence lacked the qualities of objectivity and independence essential in an expert. It was also plain that Mr Jacobs was representing how he (no doubt sincerely) believed such rent reviews should be carried out, rather than how they are in fact carried out. My reasons are these.
34. First, as a matter of impression in the witness box, Mr Jacobs appeared disputatious and unwilling to answer all the questions put to him. For example, Mr Wonnacott put a reasonable proposition to him but Mr Jacobs responded: "I cannot give you an answer. You are making an unrealistic assumption". Mr Jacobs simply refused to answer a perfectly proper question and instead argued more broadly around the point.
35. Secondly, Mr Jacobs presented as partisan and freely admitted that his complaint was that the market was dictated by valuers: "Yes it is. I complain that valuers say that the market rate rules." Given the terms of the Act that was an unfortunate and damaging admission. Mr Jacobs acts almost exclusively for tenants. Mr Wonnacott suggested that Mr Jacobs' position was that:

> "Mr Taylor is talking about what actually happens in the market, but your point is that what happens is unfair and illegal, because the rents so assessed are too high? Mr Jacobs: That is a fairly reasonable assumption."

36. Thirdly, Mr Jacobs' reports contained some broad assertions plainly outside his expertise. These reduced still further the confidence I had in Mr Jacobs as an independent expert, understanding that his primary duty was to the court, rather than to the tenant he was representing. I have in mind his comment as to the effect of the Human Rights Act, which upon investigation was revealed as something he read in a trade journal and the effect on public houses of the Disability Discrimination Act, comments which were generalised and irrelevant to the public house. Mr Jacobs admitted that he was unqualified to express any opinion on the workings of the Disability Discrimination Act.
37. Fourthly, I consider that Mr Jacobs allowance for cleaning and other losses, of more than one pint in ten, to be unsupportably high. If accurate, such losses would make many licensed premises uneconomic. The figure was, I conclude, exaggerated to support an established conclusion.
38. Finally, I am satisfied that the method adopted by Mr Jacobs is not representative of the approach generally adopted in the market. In 2007 the RICS published Valuation Information Paper No. 2 titled "The Capital and Rental Valuation of Restaurants, Bars, Public Houses and Nightclubs in England, Wales and Scotland." These papers not only provide information for members but they also outline current practice. They are also relevant to professional competence. Paragraph 7.1 provides:

> "The primary method used in preparing a rental valuation for licensed properties is the analysis of comparable transactions by reference to trading potential and the adoption of the profits test method of valuation. This is based upon the fair maintainable trade, whereby the fair maintainable operating profit reflects the hypothetical reasonably efficient operator's direct costs of running the business, and the provision of the trade furnishings and equipment, stock and working capital. The resultant sum (the divisible balance) is apportioned between landlord and tenant to reflect the risks and desirability of owning the property and operating the business. It is essential, however, that the end result is compared to comparable transactions wherever available."

39. This is the method adopted by Mr Taylor. Paragraph 7.8 is as follows:

> "There has been some suggestion that the reward available to the supplier of tied products should be reflected in some way in the rent assessment. This is not correct. Estimated rental values of each particular premises arise only from market

evidence and analysis relating to the maintainable income stream derived from the operation of the business in the hands of a reasonably efficient operator."

40. "Reward" in this context means the wet rent. This paragraph explicitly rejects Mr Jacobs' methodology. I am not prepared to prefer the approach advocated by Mr Jacobs over the present usual practice amongst professional valuers.
41. The landlord's expert was Mr Peter Taylor ARICS. Mr Taylor prepared reports dated 1st December 2008, a report in response to that of Mr Jacobs dated 12th May 2009 and an updated version dated 31st July 2009.
42. Mr Taylor presented as a better witness than Mr Jacobs. Mr Taylor appeared reasonable and was prepared to consider areas where his opinion might need modification or be in error. Although I prefer Mr Taylor's methodology to that of Mr Jacobs I do not accept all of the former's assumptions uncritically and I have had regard to those parts of Mr Jacobs' reports that discuss the profit forecast.
43. Mr Jacobs and Mr Taylor met and prepared a written statement of agreed facts. This simply set out the facts relating to the public house. There was no attempt to grapple with the technical areas of agreement and disagreement between the experts. As an aide memoir to the locus and physical characteristics of the public house, it was useful. As a joint statement identifying the areas of agreement and disagreement, relevant to the issues between the parties, it was useless. This may have been because of the gulf between the methodology of the two experts. Even so, it was unhelpful.

The total gross profit

44. The hypothetical incoming tenant would have access to the actual tied beer figures for the public house and, I infer, for other public houses in the wider area owned by the landlord. However the previous tenant's figures and accounts would not be available. This means that the hypothetical tenant would have to make a series of assumptions about the sales of free of tie beer and cider.

45. There is no dispute about the tied figures for the public house. For 2008 the barrelage was 140 and for 2009 the agreed figure is 133. Ordinarily the hypothetical tenant will try to maximise his profit by purchasing the best selling cask ale out of tie and all of the cider out of tie, pricing them accordingly. However, the hypothetical tenant of a country pub will also have regard to local conditions and local demand. Mr Brooker told me that he switched to a local brewery in April 2008 to meet local demand and a hypothetical tenant would have to balance the need to maximise profits with the requirement not to alienate existing trade, especially with a competitor in the village. The effect of this cannot be calculated, it is simply a factor to bear in mind.

46. In his first report, Mr Taylor adopted a figure of 35 barrels of guest ale and 35 barrels of guest cider. In his second report Mr Taylor altered those figures to 33.5 barrels each. By contrast, Mr Jacobs gave a total of 20 barrels in his first report and 15 for guest cider and 12 for guest ale in his second, a total of 27.

47. I am not prepared to apply the figures calculated by Mr Jacobs for the reasons I have already explained. I do not accept that the hypothetical tenant would proceed with the calculations set out by Mr Jacobs in his reports.

48. Mr Taylor arrived at his figures by the assumption that in pursuit of maximum profits, the hypothetical tenant would expect to sell one-third of his ale and cider from non-tied products because profits would be greater from those products. Mr Taylor's assumption was that the hypothetical tenant would sell one pint of free of tie beer or cider for every two pints of tied beer. I do not accept that such a formula should be anything more than a general starting point. It is not based on comparators or statistics.

49. There was much discussion of cross-checks involving detailed calculations based on the evidence of Mr Brooker and from delivery notes produced late in the day by him. This data would not be known to the hypothetical tenant and if reliance is placed on such matters in the

present case, there is a risk of falling into error and fixing a rent that it is reasonable for Mr Brooker to pay based on his own historical data.

50. Both experts agreed that in the past five years there has been a reduction in public house beer sales in the UK of about 20 per cent. This is properly regarded as a long term trend and predated the present economic circumstances. The hypothetical tenant would be well aware of this fact. Mr Taylor acknowledged that beer sales are in decline and so reduced his 2008 figure of 210 barrels to 200 for 2009, a reduction of just under five per cent. I am satisfied that the hypothetical tenant, considering this decline, would adopt a more pessimistic stance. The bid would be for a lease for the next five years without a break clause. A bid calculated on past figures would have to reflect the probability that beer sales would continue to decline. Whilst it would be wrong to pitch a bid at the barrelage figures that might obtain at the end of the lease, figures fixed according to the landlord's data obtained before the start of the same would probably only get worse.

51. The hypothetical tenant would, in the words of Mr Wonnacott in a different context, exercise "commercial common sense" and give himself room for more profit on beer in the early years of the lease, to reflect the probability of falling sales and therefore declining profits in the later years. The hypothetical tenant would strive to avoid the possibility of a bid that led to a loss in the final years of the lease.

52. The hypothetical tenant would, in my view, start with the known barrelage of 133 and then make assumptions as to guest ale and ciders. The assumptions would include the starting point of one pint of free of tie sold for every two pints of tied beer sold. This would then have to be adjusted to reflect the fact of declining beer sales.

53. I have concluded that the hypothetical tenant would reduce Mr Taylor's 2008 figure of 210 barrels by ten percent, rather than Mr Taylor's five per cent. This gives a figure for 2009 of 189 barrels. After allowing for 133 tied barrels, guest ales and ciders would be 28.5 barrels per annum each. Guest ale and ciders would therefore represent about 30 per cent of total sales, a reasonable figure in the circumstances and not out of line with the data provided by Mr Taylor.

54. I accept the analysis of Mr Wonnacott as to the other elements of the profit calculation. There is little material difference overall between the two experts and in attempting to assess the bid of the hypothetical tenant, it is sensible to take the average of each figure.

55. Applying my free of tie barrel figures of 28.5 for ale and cider to the draft calculation prepared by Mr Wonnacott for 2008 gives a gross profit figure for each item of £10,358.

56. Applying the same barrel figures to the draft calculation for 2009 gives a gross profit figure of £10,138 for each item. The total gross profit for 2009 is therefore £135,679.

57. I accept Mr Wonnacott's calculation of the anticipated expenses and return on capital. The mid point between the two experts is £84,181.

58. The total gross profit for 2009 is therefore £135,679. Expenses of £84,181 are deducted, leaving a divisible balance of £51,498, which I carry forward as £51,500.

59. The cider and beer cross-checks presented by Mr Wonnacott both depended on a detailed analysis of the evidence of Mr Brooker and his experience of running the public house, his accounts and documents. For the reasons I have explained I do not find this helpful. The cross-check against turnover was unhelpful because the data used by Mr Taylor generally came from larger public houses operating under different terms of business. All of this evidence pre-dated the current economic crisis and the public house smoking ban.

60. The only cross-checks that might have been of real assistance would be evidence of comparable lease transactions. Such data could be discovered by the hypothetical tenant. Mr

Wonnacott relied on just two comparable transactions. The other properties involved agreements made prior to the present economic downturn and provided little or no guide to the present level of rents and lease terms. They do, of course, provide important data in respect of what has happened to those public houses in the recession and I discuss this evidence in due course.

61. The evidence of recent, actual transactions in the market was confined to The Swan at Yate and the King George VI at Filton.

62. The Swan was let on a full tie basis for a 15 year lease on 26th March 2009 at a commencement annual rent of £18,000, to be increased to £26,000 per annum from 1st August 2009. The lease provisions differ from the public house (which is a five year lease with no periodic reviews or annual indexation): for the Swan rent review is up or down to open market rent with an adjustment to annual RPI between. In a time of recession this might result in a rent reduction. Another difference is that the public house lease does not permit alienation but the Swan lease provides for assignment as a whole after two years. In addition the Swan gave the tenant a six month "cooling off" provision. These are significant provisions. I was told that the cooling off period had been three months but because of recent trading conditions it had been extended to six months for all new lettings. Support was also provided by the landlord by an additional discount of £150 per barrel on all volume above 181 barrels per annum.

63. Mr Brooker told me, and I accept, that the Swan's trade has hitherto been that of a cider pub. Under the new tenant this may no longer be the case but it means that data cannot easily be compared. The previous tenant of the Swan surrendered the lease and the premises were completely refurbished by the landlord. Importantly, the provisions of the new lease mean that the lease is saleable and the tenant of the Swan may therefore build up a stake in the property. That is not the case with the public house.

64. The barrelage figures demonstrate little growth between 2005, 2006 and 2007. In 2008 volume fell significantly. The data to date for 2009 does not suggest any real increase on that poor figure for this year. The Swan illustrates a new tenant of an, at best, lacklustre public house being actively supported by the landlord with a variety of measures: a substantial initial rent reduction, a break clause, a two year escape route, incentive discounts, a stake in the business and rent adjustable to the open market, downwards if necessary. I conclude that the Swan is not very helpful as a comparable.

65. The King George VI at Filton is included because of the date of the new lease, 19th March 2009. However, I am satisfied that it is so dissimilar to the public house in terms of location and style of business that its value as a comparable is severely limited. The King George VI is located on a prime corner site in Filton, a thriving suburb of Bristol and its barrelage figures comfortably exceed that of the public house. Important centres of commerce and higher education are close at hand. This fully tied public house also offers accommodation and a restaurant and overall is a larger establishment located in a town, rather than a village. It is not a country pub.

66. However, the terms of the new lease reveal the state of the market. The annual rent is £32,000 but the lease is only for three years, not five. There are no rent reviews save for an annual RPI adjustment and the landlord repairs and decorates, save only for internal cleaning and decorations. The tenant can serve a six months break notice at any time. Support has been given by the landlord with a discount of £100 per barrel on all beer and cider.

67. It follows that there is not much comparable evidence and what there is would not greatly assist a hypothetical tenant, save to make him cautious about bidding for a five year lease with a prohibition on alienation. The comparable evidence provides no evidential basis for me to adjust the figure of £51,500 as the divisible balance.

The hypothetical tenant's bid

68. I have assessed the divisible balance as £51,500. Mr Taylor suggests that the open market rent that would be bid by the hypothetical tenant would be one half of the divisible balance.

69. In his first report Mr Taylor explained his reasoning when calculating the hypothetical tenant's bid:

> "The divisible balance is generally divided fairly equally between rent and tenants retained income. There may be reason to deviate from this position where the retained income is particularly low or conversely, particularly high. A tenant may make a higher bid in a situation where he is free of tie and is able to secure discounts. In this particular instance I see no reason to deviate from the norm and have therefore adopted a 50 per cent bid."

70. Mr Taylor continued with the 50 per cent division in his later reports, without further comment. Mr Taylor agreed, when giving evidence, that in his reports he did not address or take account of a number of major factors affecting risk and confidence in the market. I am satisfied that a hypothetical tenant would do so.

71. I must assess the rent for which the public house might reasonably be expected to be let in the open market as at 7th August 2009. Mr Taylor agreed that before making an offer, a hypothetical tenant would carefully take into consideration the following facts and matters. I note that the categories are not self-contained and elements of one merge with another.

72. First, the effect of the unprecedented economic crisis. The reality is that no one knows for how long the present economic situation will continue, nor the extent to which the UK economy will be adversely affected. Unemployment is high and rising which will adversely affect demand for non-essentials such as eating and drinking in public houses. A general election is less than a year away, higher taxes on alcohol are being discussed and it is plain that difficult economic decisions for the government lie ahead; all facts which contribute to an unusual level of uncertainty. The hypothetical tenant is bidding the rent for a five year term and in the present unusual circumstances, that period is cloaked in uncertainty. Mr Taylor agreed that a hypothetical tenant would bear in mind that trading data for previous years (such as barrelage figures and evidence from comprables) were obtained in better economic circumstances.

73. Secondly, the present restrictions on the availability of ready, inexpensive capital. Even when available, the present cost of risk capital does not, at present, resemble the Bank of England base rate, or any figure close to it. A hypothetical tenant will require working capital in order to purchase stock, fixtures and fittings, undertake improvements and attend to such matters of repair as are provided for in the lease. It does not matter whether the hypothetical tenant is assumed to have adequate capital resources or would be obliged to borrow. If the former, the use of such capital would have an opportunity cost to the tenant which would have to be taken into consideration, such cost including the need to replenish such capital on the open market. If the latter, the exposure to the present state of the capital markets is direct.

74. I was a little surprised to hear Mr Taylor suggest that the unemployed, with their redundancy payments, might step into the void created by the credit crunch. On this point Mr Taylor fell below his usual standards of objectivity. Mr Robert May, the landlord's national rent controller, confirmed that the days of the enthusiastic amateur publican were over.

75. Thirdly, the market-depressing effect of the steady news of public house closures. Mr Taylor agreed that about 50 a week were now closing. Mr May, to his credit, did not try to avoid this issue in his evidence. In his first statement (24th February 2009) he wrote:

> "Pub trading has never in my memory been more difficult than it has been the last six months."

When questioned about the period from February to August this year, Mr May said:

> "Pub trading has been more difficult. If anything, I would say that the next six months were even more difficult. I have had to deal with a lot of distress in my

job. We require the delivery of a professionally assisted business plan and this practice will be enforced for all new lessees and assignments. We do not want naive tenants. We may however offer to train them."

76. Mr Wonnacott suggested that if the market generated over-optimistic bids, then that would represent a true reflection of the market for present purposes, even if such bids would end in business failure and surrender prior to expiry of the term. That submission may be correct when economic circumstances are favourable but it is certainly not the present position. There is no such optimism in the market at present. I am also satisfied that this landlord does not want a rapid turnover of tenants, all of whom were allowed to make over-optimistic bids. Changing tenants is bad for trade (in respect of both the public house and the wet rent) and also costs the landlord in terms of early refurbishment, management time and voids or a manager's salary.

77. The present unhappy state of the market is well illustrated by data from the evidence of Mr May and Mr Taylor. Partly in response to inaccurate comments by Mr Jacobs, both reviewed a number of public houses in the area. Mr May sought to lighten somewhat the picture of unremitting doom presented by Mr Jacobs, Mr Taylor sought to identify some comparable properties.

78. Although Mr Jacobs' deep pessimism was, I find, exaggerated, it is nevertheless clear that the position is much worse than anyone can remember. 18 public houses were identified in all. Of these, the following twelve may properly be said to have been, or in, economic distress:
    a. Wheatsheaf at Winterbourne. A freehold free house, the owner seems to be in financial difficulties and the freehold is for sale.
    b. Green Dragon at Downend. Closed and boarded up.
    c. White Lion at Yate. Open but not thriving.
    d. Western Coach House at Frampton Cottrell. Closed and site converted to housing.
    e. George & Dragon at Winterbourne. Recently re-opened after a low-cost investment.
    f. Royal Oak at Winterbourne. Changed to a curry house.
    g. Golden Lion at Brampton. Changed to a curry house.
    h. Downend Tavern at Downend. Lease is on market for sale.
    i. King George VI at Filton. Support being given of £100 per barrel discount on all beer, cider and flavoured alcoholic beverages.
    j. Cross Hands at Fishponds. Lease surrendered on 20th July 2009 and public house closed.
    k. Crown at Hambrook. Support being given of £100 per barrel for three months.
    l. Foresters at Downend. Support being given with a rent reduction and additional discounts on beer.

79. The hypothetical tenant would make reasonable enquiries to determine the state of the market before calculating the bid for the lease of the public house. Such enquiries would reveal most, if not all, of the above information.

80. A further illustration of this depression in the trade is provided by the landlord's own proposals as to what the rent should be. In January 2008, in its Acknowledgement of Service, the landlord suggested that the new rent should be £39,000 per annum. Mr Taylor told me he had not calculated this figure. By December 2008, in his first report, Mr Taylor assessed the rent as "in the order of £34-35,000 per annum." In July 2009, in his second report, Mr Taylor had amended his figure to £30,800. On the landlord's own figures, the rent had fallen by approximately 20 per cent over a period of 18 months. In reality, given that the severe economic turbulence commenced only a year ago, the fall has been even more acute.

81. Fourthly, the smoking ban. This came into effect in mid-2007 and it is now clear that it is permanent. It was generally accepted during the hearing that this has had an adverse effect on the licensed trade. Committed smokers are now more likely to buy discounted alcohol from supermarkets to consume at home, untroubled by anti-smoking legislation. Designated

outside smoking areas are unpopular save in fine weather. I should also note the counter-argument that some customers, hitherto repelled by smoke-filled bars, might now be inclined to visit public houses more often. Overall however, I am satisfied that the smoking ban would be regarded as a negative factor by the hypothetical tenant.

82. Finally, the hypothetical tenant would have regard to the fact that free houses are available on the market and the tenant could expect, other things being equal, to make a much greater profit from being able to buy beer on the open market and not at the nominated suppliers prices. The fact of the partial tie provides a second level of profit for the landlord and this wet rent provides the tenant with an additional margin for negotiation.

83. A positive counterweight to the above is that the hypothetical tenant would also take account of the fact that free accommodation was provided at the public house. I remain satisfied that the market for leases of public houses is, at present, very much a buyer's market and that this would be reflected in the hypothetical tenants bid.

84. These six factors are not susceptible to calculation and quantification. I am satisfied that at present they would have a significant adverse effect on the confidence of a prospective tenant and would encourage caution in any bid.

85. It is important not to allow double counting to creep into the assessment. If the hypothetical tenant had used the existence of the above factors to depress the barrelage estimates then it would be wrong to apply the same factors all over again when assessing the figure for the bid. In my assessment leading to the divisible balance I have only taken account of the agreed long term decline in beer sales, and none of the six factors identified here.

86. Taking all these matters into consideration I conclude that the hypothetical tenant would bid a rent of £18,000 for the lease of the public house. This is 35 per cent of the divisible balance of £51,000.

87. I do not consider that the landlord would accept a bid from a tenant for less than this. However I am satisfied that a bid in the region of 35 per cent for this lease would be regarded as a sensible compromise in the present highly unusual circumstances. This figure is only just below the bottom of the typical range (albeit for fully-tied houses) identified by the European Commission in the *Scottish & Newcastle* case in 1999 (para. 68), in very different economic times. Whilst the data covers the recession of the early 1990's that was far less serious than the present depression:

> "The contractual rent negotiated by the parties is not automatically determined on the basis of 50% of the divisible balance. Resulting from open competition on the market the parties negotiate a rent typically between 40% and 60% of the divisible balance.".

Interim rent

88. The new rent of £18,000 is to be inserted into the new lease, which will commence three months after the final disposal of these proceedings: see section 64 of the Act. However, there is also a claim for an interim rent under section 24A of the Act. The interim rent is the rent which will be payable, with retrospective effect, for the period from 27th December 2007 until the commencement of the new lease.

89. Section 24C(2) of the Act provides:

> "Subject to the following provisions of this section, the rent payable under and at the commencement of the new tenancy shall also be the interim rent."

90. Section 24(C)(3)(a) provides an exception to this if the interim rent under that subsection differs substantially from the relevant rent. The relevant rent is the rent which the court would have set, as the market rent, if the new tenancy had commenced on 27th December 2007 (section 24(C)(4)).

91. These provisions have nothing to do with the passing rent. The interim rent will be the new rent unless there is a "substantial difference" between the rental value at 27th December 2007 and the new rent of £18,000. I have to decide whether there is a "substantial difference" between the two. No guidance is given in the Act.

92. If I find that the market has risen substantially since 27th December 2007, I could adjust the interim rent downwards. On the other hand, if I find that the market has fallen substantially since that date then I can adjust the interim rent upwards.

93. Mr Wonnacott suggested that a difference of more than ten per cent should be regarded as substantial. I disagree. In the event, the new rent has been set at about 12.5 per cent above the passing rent but I doubt that Mr Wonnacott would regard that increase as substantial.

94. The evidence relating to an assessment of an interim rent as at 27th December 2007 was sparse. I was provided with the Seventh Report of the House of Commons Business and Enterprise Committee for the 2008-09 session, dated 21st April 2009. A table at paragraph 29 illustrates the dramatic rise in the rate of public house closures during 2007. Evidence before the committee, including evidence from the landlord, suggested the blame lay variously with increasing costs for small businesses through new legislation such as licensing reform, gambling laws, the smoking ban, fire regulations, employment legislation, supermarket strategies and policy on alcohol taxation.

95. I note that at the very end of 2007 the effect of the smoking ban, introduced in mid-2007, and the accelerating rate of closures of public houses were both well known within the licensed trade. However, I am conscious that I did not receive detailed submissions from either party on this issue because obviously neither could address me on the basis of the new rent.

96. I therefore direct that the parties, if the outstanding issues cannot be agreed, are to provide written skeleton arguments limited to the issues of the interim rent claim and costs. Such skeletons are to be filed by Monday 28th September 2009. The matter should then be re-listed before me, in consultation with counsels' clerks, as soon as possible, with a time estimate of half a day.

(2)

NWSL - PUB COMPANIES - WILLOTT

NB RESPONSE NEEDS SLIGHT REMARK RE PUBLICATION OF LE PROPOSALS AS WAS IN A DIFFERENT ASPECT OF IT.

CCP

Campaign for Real Ale
230 Hatfield Road
St Albans
Hertfordshire
AL1 4LW

CAMPAIGN FOR REAL ALE

Telephone: 01727 867201
Fax: 01727 867670
Email: camra@camra.org.uk
www.camra.org.uk

Jenny Willott MP
Parliamentary Under Secretary of State for
Employment Relations & Consumer Affairs
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

6th January 2014

Dear Jenny,

Pub Company Reform

Congratulations on your recent appointment to this role.

CAMRA is seriously concerned about delay to proposals for a Statutory Code and Adjudicator to regulate the large pub companies. In December Jo Swinson MP published consultation responses but failed to announce what steps the Government will take. This is despite a clear commitment that a decision would be made by the end of 2013.

We urge you to, without further delay, announce whether or not the Government will stick to its pledge to introduce a Code and Adjudicator.

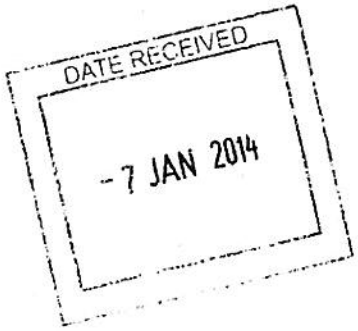
Without Government intervention, the large pub companies will continue to force good licensees out of business and sell hundreds of valued and profitable pubs for redevelopment. Unfair practices and abuse of the relationship between pub companies and their licensees is already contributing to the closure of 26 pubs every week. Under the current inequitable business model, licensees cannot afford to invest in improving their business. Publicans tied to big pub companies can pay at least 50% more for beer than free of tie publicans, as well as paying above market rents.

CAMRA is further concerned by misleading reports following the publication of research by London Economics into the Government's proposals that suggest London Economics has found that reform may cause up to 1,600 pubs to close. In fact, the report acknowledges that the outcome of reform is highly uncertain, and that its key finding is not the impact on pub numbers, but rather the high number of pubs that appear to be at the margin of viability. We believe that reform will help tip the balance for these pubs and help them survive.

The solution to a decade of this abuse is a Statutory Code, Adjudicator and an option for licensees to pay a market rent only giving them freedom to buy beer at open market prices. Please act now and ensure our valued community pubs are provided with a fair and sustainable business model.

Yours sincerely,

Mike Benner
CAMRA Chief Executive


DATE RECEIVED
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for Business
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Our ref: 2014/00296

Mike Benner
Chief Executive
Campaign for Real Ale
230 Hatfield Road
St Albans
AL1 4JW

27th January 2014

Dear Mr. Benner,

Thank you for your letter of 6 January about the Government's consultation on establishing a statutory Code of Practice and an independent Adjudicator to govern the relationship between pub companies and their tenants, and for your message of congratulations on my appointment as the Minister for Employment Relations and Consumer Affairs.

As you are aware, we had intended to publish our response to the consultation before the end of 2013, and I understand that you and others who are affected by the proposals need clarity from us. We promised Government intervention to address the unfairness in the relationship between pub companies and tenants and this remains our commitment. We also said that intervention would be proportionate and targeted. That is why we are taking the time to process, evaluate and assess the staggering response to the consultation, including the views which CAMRA and its members shared with us. We will decide on the next steps very soon.

Yours sincerely,

Jenny Willott

JENNY WILLOTT MP

Jenny Willott MP
Minister for Employment Relations and Consumer Affairs

03 [redacted] - without prejudice

From: siclarke@[redacted]
Sent: 19 December 2013 12:11
To: [redacted]
Subject: Re: [redacted]

Without Prejudice

Dear [redacted]

I refer to your email of yesterday.
I have not applied my 'favoured' method of rent assessment, rather I have applied the method I understood was agreed by the RICS working group [redacted] resulting in the revised RICS guidance and that is proposed by Government in the Public Consultation. I appreciate, after the event [redacted] have chosen to interpret what was agreed differently. To date, primarily due to the Trade Related Valuations Group - TRVG [redacted] blocking any clarification, this dispute of interpretation remains despite being highlighted by BISCOM and BIS to the RICS.

[redacted]

04 FW: GOVERNMENT CONSULTATION ON PUB COMPANIES AND TENANTS - RESPONSE TO OFT SUBMISSION DATED 14TH JUNE 2013

From: siclarke@[redacted]
Sent: 12 January 2014 11:11
Cc: [redacted]; McLynchy Julie (CCP); Cable MPST
Subject: GOVERNMENT CONSULTATION ON PUB COMPANIES AND TENANTS - RESPONSE TO OFT SUBMISSION DATED 14TH JUNE 2013

FYI report sent to OFT following their response to the Government Consultation.

Please see OFT submission response and summary attached outlining fundamental flaws in their understanding and submission. Any consideration of weight to be applied to the OFT report should be done so in the light of the attached.

Simon Clarke

OFT_BIS_c...

OFT_BIS_c...

-----Original Message-----
From: siclarke <siclarke@[redacted]
To: enquiries <enquiries@oft.gsi.gov.uk.>
Sent: Sun, 12 Jan 2014 11:08
Subject: GOVERNMENT CONSULTATION ON PUB COMPANIES AND TENANTS - RESPONSE TO OFT SUBMISSION DATED 14TH JUNE 2013

Dear Sirs

I write to your enquiries address as no contact details were attached to the published OFT response to the Governments public consultation. I will send a hard copy in the post.

Please find attached a response to your submission which we believe is misrepresentation of the circumstances and demonstrates some serious and concerning misunderstandings in the OFT's interpretation of the tied pub sector.

We would suggest the OFT may benefit from evidence submitted by Fair Pint Campaign and other like organisations before responding.

Yours faithfully

SIMON CLARKE
[redacted]

This email was received from the INTERNET.

Communications via the GSi may be automatically logged, monitored and/or recorded for legal purposes.

(4a)

THE FAIR PINT CAMPAIGN
PO BOX 3380, LONDON, SW1H 0ZB

The Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX

10th January 2014

Dear Sirs

RE : GOVERNMENT CONSULTATION ON PUB COMPANIES AND TENANTS
OFT SUBMISSION DATED 14TH JUNE 2013

1. Fair Pint Campaign is the voice of tied tenants and tenants calling for an end to the exploitation of publicans through the tie. We are working to protect the UK pub industry and to ensure a fair deal for both publicans and consumers. We wholly endorse the Government proposals in respect of a statutory code.

2. We have recently had the opportunity of reviewing the OFT submission to BIS in response to the public consultation, dated 14th June 2013, and consider there are some fundamental flaws in your understanding of how the tied pub sector currently operates and indeed the proposals that have been tabled to rectify the behaviour of some pub owning companies and the rent setting process.

3. <u>OFT powers</u>

4. The OFT submission makes references to the CAMRA super complaint of 2009 and your subsequent findings of 2010. It is no secret we consider the OFT findings were wrong as too much weight was placed on hearsay evidence produced and submitted by the pub companies and their mouth piece the BBPA. The OFT did identify back in 2010, as outlined at para 9 of the submission to BIS, that *"...any strategy by a pub company which compromises the competitive position of its tenants would not be sustainable, as this would be expected to result in sales and margin losses for the tenant and, in turn, for the pub company."* The evidence of the following 4 years proven this to be exactly the strategy adopted by many pub companies and the effects are exactly as the OFT expected.

5. Regardless of the latter, the OFT findings were almost 4 years ago and in our view much more evidence is now available and there have been some significant changes, not least the revocation of the Land Agreement Exclusion Order of 2011.

6. The OFT powers of investigation are now stronger than in 2009/10. The revocation of the Land Agreements Exclusion brings all commercial property transactions within the ambit of Chapter I of the Competition Act. The OFT draft guidance identifies as most likely to be anti competitive an agreement which restricts the commercial freedom of a trading partner such as a distributor or

supplier, for example, beer ties on a pub, as a types of land agreement likely to fall within the prohibition.

7. Clearly, in 2009/10 the OFT would not have considered this amendment to the Competition Act 1998. The revocation of Land Agreement Exclusion Order enables the OFT to now consider beer tie agreements in the context of leases. We consider that a tied agreement will be regarded as having an appreciable effect on competition as the pubcos and brewers, operating tied agreements, are competitors operating a network of similar agreements and their aggregate share is more than 5% of the relevant market.

8. We appreciate there are four exemptions from the prohibition but we consider these do not all apply in the instance of tied agreements. The OFT may not have considered product prices and rent levels payable to landlords, and the rent assessment process justify intervention however in the light of the revocation there appears to be clear justification for intervention now.

OFT policy concerns regarding a principle that 'a tied tenant should be no worse off than a free of tie tenant' and the Government proposed method of 'balancing risk and reward' between pub companies and tenants

9. In relation to the tied tenant being no worse off then the OFT position before was that they could not interfere in commercial agreements yet now the OFT seek to interfere on behalf of the pubcos. The OFT concerns raised seem duplicitous at best and therefore lacking in objectivity. We would however take this opportunity to highlight what appear to be quite fundamental misunderstandings and flaws in the three concerns listed in the OFT public consultation response submission.

10. The OFT set out in section 15, the three observations in response to a principle that 'a tied tenant should be no worse off than a free of tie tenant' and the Government proposed method of 'balancing risk and reward' between pub companies and tenants.

11. Observation 1

> First, in our 2010 report, we did not find any evidence that rents were set in the pub industry in a way that would systematically operate to the detriment of tied tenants. Rather, we found that, having taken into account the various aspects of pub rents,[5] there was no clear difference in the overall rent levels paid by tied tenants as compared to those that were free-of-tie. Given these findings, the extent of the rental adjustments envisaged in the consultation may not be necessary to achieve the Government's aim of ensuring a similar position as between the level of overall rent paid by tied and free-of-tie tenants.

12. The OFT state quite clearly that in their opinion, in 2010, they believed the equilibrium intended by the 'no worse off' principle was achieved. It follows that the

OFT conclusion reached, *"...that the rental adjustment envisaged in consultation may not be necessary to achieve the Government's aim of ensuring a similar position as between the level of overall rent paid by the tied and free of tie tenants."* suggests that the effect of such a method of balancing risk and reward poses no immediate threat of significant rent adjustments and therefore, if the OFT are correct, the implementation of such a method of balancing risk and reward would NOT result in a noticeable threat to the pub companies rental income stream. In the light of the above we fail to see how this OFT 'observation' could be construed as a 'concern'.

13. Observation 2

> Second, the rent agreed between a pub company and a tenant is the outcome of a commercial negotiation between a pub company and a tenant. The OFT considers that where a market is considered to be competitive, interventions involving price regulation should be contemplated only in exceptional circumstances given the potential for such interventions to distort markets and have a negative impact on productivity.

14. The OFT state that they consider *"... where a market is considered to be competitive, interventions involving price regulation should be contemplated only in exceptional circumstances..."* this is a baffling statement as no one is suggesting price regulation and indeed the Government proposal makes no mention of it. IN addition, the commercial negotiation is agreed on the understanding that high product prices will be balanced by a lower rent and benefits. This is not expressed in the contract as it was understood that European and domestic competition law required it.

15. Observation 3

> Third, the ultimate impact of the 'no worse off' principle will depend upon the detail set out in the statutory code and the adjudicator's interpretation of it. We are concerned that, in the event that adjustments are made systematically[6] to tied pub rents to ensure consistency with the rent payable by a hypothetical free of tie rent, such an approach has the potential to result in significant rental adjustments.[7] If this is the case, this could result in a market distortion that may lead to consumer detriment. In particular, to the extent that the proposed changes to rent calculations mean that pub companies decide that running a tied outlet is no longer its most profitable option, they may choose to adopt an alternative business model (for example running a 'managed' pub or a free of tie leased pub)[8] or consider selling or closing the pub. To the extent that pub companies are incentivised to adopt a business model that is less efficient than they would have otherwise adopted, this has the potential to increase supply costs and result in higher prices to consumers.

16. This OFT observation seems totally contradictory to the OFT statements in the first observation. In the first observation the OFT state that "...***that the rental adjustment envisaged in consultation may not be necessary to achieve the Government's aim*** *of ensuring a similar position as between the level of overall rent paid by the tied and free of tie tenants." ("including wet and dry rents and any relevant benefits provided by the pub company to the tenant" - from OFT footnote 5).* If the OFT statement in the first observation 1 is correct then how can the statement in the third observation, that ***"...such an approach has the potential to result in significant rental adjustments."***, hold true ?

17. Either the 'no worse off principle' and Government proposals will result in significant rent adjustments or they will not - it can not be both.

18. The final part of the third observation demonstrates a clear lack of understanding of the contractual relationship between landlord and tenant and the pub companies income streams. Proposed changes to rent calculations may mean that pub companies decide that running a tied outlet is no longer its most profitable option, the legislation placed on Rachmann no doubt led him to a similar conclusion. The pub company may *like* to adopt an alternative business model but running their pubs as managed houses is only an acceptable option if the potential level of sales is considerably higher than the national average, and, if they chose to operate a free of tie leased estate of pubs, this would lose the pub company the additional income stream they derive from the discounts achieved from their bulk buying power, which they do not achieve at the tenants expense. Even if the tenant is no worse off than if they were free of tie, the most profitable approach for a pubco is to maintain a tied leased estate enabling them to profit from the discounts achieved from bulk purchasing but restraining them from the Cartel like behaviour many consider they currently demonstrate.

19. In this third observation, the OFT demonstrate another clear misunderstanding of the pub environment. A pub company can not simply close a pub. There is a contractual relationship between pub company and tenant under which the tenant is protected from eviction under the provisions of the Landlord and Tenant Act 1954. In order to 'close' a pub the pub company must first obtain vacant possession. The most efficient business model that the pub companies can adopt is one that strips the vast majority of a pubs profits out of the business leaving the operator (the tenant) with a derisory earning and trapped in an abusive relationship. The most efficient business model for the production of clothes, for example, might be sweat shops but we in the UK seek to restrain and discourage such behaviour. The whole purpose of the Government proposals for intervention is to restrain the efficiency of a business model that relies on manipulation and abusive relationships and encourage a business model that allows all, including consumers, a fair share of the resulting benefits, something that is not in existence presently.

<u>OFT policy concerns regarding a mandatory Market Rent Only (free of tie) option</u>

20. The OFT observations in regard to the mandatory Market Rent Only (free of tie) option are also misrepresentative of the circumstances that prevail.

21. Observation 1

> First, we note that the second and third advantages referred to at paragraph 5.36 of the consultation document do not appear to be focussed on fairness to tenants, but relate to access to retail outlets by microbrewers and consumer choice in pubs. We would note that our own recent work in this sector found that large non-brewing pub companies already source beer/drinks from a wide variety of suppliers and that there is already a great deal of fragmentation at the brewing level of the supply chain.

22. The OFT state that in recent work they *"...found that large non brewing pub companies already source beer/drinks from a wide variety of suppliers and that there is already a great deal of fragmentation at the brewing level of the supply chain."* There are estimated to be around 1,000 brewers now in the UK. Most pubco tenants have access to a selection of micro brewers beers but these are a fraction of the brewers that exist. The 30 small family brewers have an effective monopoly on access to the tied pubs, however, there is one route to the tied pub market for micro brewers through the pubcos and Small Independent Brewers Association (SIBA) scheme. This scheme forces micro brewers to increase their prices if they want access, effectively, in some cases, almost doubling the price they would otherwise sell to free of tie operators. As a consequence of the latter, micro brewers beers are priced even higher than the small family brewers prices, on the large pub companies price lists, effectively deterring tenants from purchase as the necessary uplift in price to the consumer becomes unattractive. This undermines the tenants willingness to supply the micro brewers products but enables the pubcos and larger brewers the opportunity to control and in some cases eliminate competition in respect of a substantial part of the products (beer) in question under a veil compliance with the request to offer a wide variety of suppliers products.

23. Observation 2

> Second, we also note that such a proposal would be likely to result in pub companies losing some of the economies of scale that are currently achieved through centralised purchasing (as described in our 2010 report) which could in turn could result in higher beer prices for tied lessees, which may be passed on to consumers.

The OFT state that the pubcos may lose some economies of scale if the market rent only option were taken by their tenants. The OFT seem to be under some impression (presumably from information provided by the pubcos and/or BBPA) that these economies of scale find their way to tenants and in turn are passed on to the consumer. This simply does not happen. Any tenant can get better beer prices by simply ringing the brewer. Any financial benefit on other essential services or products that might attract a discount due to central purchasing or bulk ordering, e.g. insurance, utilities etc, are just as easily price matched by a free of tie sole trader as the financial benefit achieved by the pubco central purchasing is rarely passed on. Indeed we are aware that in practically all instances it is cheaper for a free of tie trader to

acquire any product or service than to acquire the same product or service as a tied tenant. If products and services were genuinely cheaper through the pub company, due to the benefits of central purchasing, then a tenant would *choose* to acquire them from the pub company not be *forced* to acquire them by mandatory lease provisions. The pubco's make a profit from these services and seek to force the tenant to acquire them. We remain shocked that the OFT have not failed to recognise this and instead still seem content to take the word of the pub companies and their representatives.

24. Pub companies acquire beer at considerable discount, below the price to a sole free of tie operator, yet in many cases the price to their tenants is approaching double the free of tie open market price. If central purchasing, of say building insurance, led to cheaper insurance and it were contractually shared with the tenant, then it would be quantified and included in any rent assessment as a SCORFA. A tenant considering the market rent only option would have to evaluate whether a free of tie agreement may mean the loss of such a SCORFA, in this example insurance discount, and whether this warranted taking the option. That is the point of a MRO option - it is a choice allowing a tenant to evaluate their circumstances and ensure their agreement is compliant with the original intention of the parties and competition law requirements.

25. The OFT conclusion that loss of pubco central purchasing would lead to higher prices to tied tenants, which may in turn be passed on to consumers, is precisely why the MRO option needs to be in conjunction with, NOT instead of, the principle that a 'tied tenant should be no worse off than if they were free of tie'. MRO and 'no worse off' principle working together deter pub companies inappropriately increasing prices of other products and services.

26. Observation 3

> Finally, removing the supply tie (and, to a lesser extent, requiring a pub company to offer a guest-beer provision) would significantly alter the nature of the contract that had been agreed between the pub company and the tenant. There are many other industries where exclusive purchasing obligations are commonly used as a form of distribution of goods and/or services and may fall within the scope of the European Commission Block Exemption Regulation for Vertical Agreements and Concerted Practices[9] (subject to certain market share thresholds). Requiring pub companies to offer a free of tie option and alter legal contracts (where they do not breach competition laws) would also set an unhelpful precedent for other industries and give rise to uncertainty for businesses that use this distribution method.

27. No one is asking for removal of the supply tie, tenants are asking for the supply tie agreements to be operated fairly or risk having this part of the agreement severed from the agreement, apply to the same remedies to unfairness as those applied to anti competitive restrictive contract provisions under the Competition Act 1998. To this end tenant organisations have collectively agreed to the BISCOM compromise of a Market Rent Only (free of tie) option. If the supply tie in an

agreement is operated fairly it will prevail if not it runs the risk of being nullified. A tenant choosing to take the option and go free of tie, should not be significantly altering the nature of the contract that had been agreed, all other terms and conditions would remain in tact.

The supply tie is simply a provision within a wider agreement capable of being severed from the document if it is shown to be operated unfairly. Indeed all tied agreements contain provisions to accommodate the eventuality of supply tie removal should it occur.

28. The agreement the tenant understood they were signing up to, as sold to them by the pub companies, was that, as a tied tenant/tenant, the higher price paid for tied products would be offset by a lower 'countervailing' rent and benefits (SCORFA's). Free of tie rent was supposed to equal the tied rent plus profit on tied products and SCORFA. If the nature of the contract is significantly altered as a result of a tenant taking the Market Rent Only (free of tie) option it is only because the original balance, and the original understanding of the pubco offer, has not been honoured and maintained - hence the Government objective to rebalance risk and reward.

29. As the OFT acknowledged, at the beginning of their submission, that their comments were in relation to competition and consumer aspects or implications of Government policies. The proposed intervention is not on competition grounds but on the grounds of fairness and the relationship between landlord and tenant in the pub sector.

30. Leaving aside the issues of fairness, which the Government is seeking to address through its statutory code proposals, the OFT have made comment on the Government proposals in respect to the implications on competition and we would like to concentrate on these comments on a purely competition basis.

31. Our following competition related statements have no impact on the Governments efforts currently in operation to seek to deliver fairness and circumstances where a tied tenant is no worse off than if they were free of tie. We acknowledge these are two different issues and should be treated accordingly.

32. We would like to draw the OFT's attention to the original European Commission block exemption which was based on the concept that higher product prices would be offset by countervailing benefits, one of which of course was a lower rent. Since the OFT's response to CAMRA's super complaint in 2009/10 legislation has been amended with the revocation of the Land Agreement Exclusion Order in 2011.

33. Following the revocation of the Land Exclusion Agreement Order we now have circumstances where land agreements (including tied leases) are not exempt from the Competition Act 1998 and businesses need to review their property transactions to consider whether they may infringe on the Act.

34. A supply tie provision is anti competitive as :

- it has as its object or effect the prevention, restriction or distortion of competition :
- its effect on competition and trade within the UK is 'appreciable' : and
- it does not qualify for exemption on the basis that its benefits outweigh its anti competitive effect.

35. Supply tie provisions are agreements which restrict the commercial freedom of a trading partner, for example, a distributor or supplier and are therefore likely to be prohibited restrictions (OFT definition).

36. An agreement is exempt from the prohibition if **ALL** of the following apply :

- the agreement contributes to improving production or distribution, or to promoting technical or economic progress
- it allows customers a fair share of the resulting benefits
- it does not impose restrictions beyond those indispensable to achieving those objectives: and
- it does not afford the parties the possibility of eliminating competition of a substantial part of the products in question

37. Supply tie provisions should not be exempt from the prohibition as they do not offer **all four** conditions of prohibition, indeed they appear to offer none, and the aggregate market share of the competing parties operating supply tied agreements, 'a network of similar agreements', is well over 5% of the relevant market.

38. The effect of the revocation of the Land Agreements Exclusion Order in 2011 means that where before a supply tie provision was exempt from OFT powers under the Competition Act 1998 they now are not.

39. For the above reasons we believe the OFT need to consider their duties and should review the impact of the changes to the Competition Act 1998 in relation to the CAMRA super complaint and competition circumstances that have changed and now prevail.

40. In respect of the submission to BIS responding to the public consultation, we consider the OFT may benefit from a meeting with Fair Pint Campaign which would perhaps clarify what appear to be clear misunderstandings of the both the Government proposals, circumstances of tied tenants and tenants and legislation seeking to offer protection in tied commercial agreements. The OFT need to consider evidence from pubcos in the light of evidence from tenants.

Yours faithfully

SIMON CLARKE
FAIR PINT CAMPAIGN
email @[redacted]

(4b)

THE FAIR PINT CAMPAIGN
PO BOX 3380, LONDON, SW1H 0ZB

GOVERNMENT CONSULTATION ON PUB COMPANIES AND TENANTS
RESPONSE TO OFT SUBMISSION DATED 14TH JUNE 2013

Fair Pint Campaign consider there are some fundamental flaws in the OFT's understanding of how the tied pub sector currently operates and the Government proposals to deliver fairness and circumstances where a tied tenant would be no worse off than if they were free of tie.

The OFT have said in the past that they do not consider the *artificial* market environment of a supply tie of beer to tied tenants raises any competition issues, they are now suggesting that the tenants choice to stay in the artificial environment or step outside it, in to an *open* market, would have competition issues.

COMPETITION

Despite the proposed intervention being on the grounds of the relationship between landlord and tenant, and not competition, the OFT do raise an important competition issue. Their previous conclusions in respect of the beer supply tie were established in 2010, since then legislation has changed requiring that Land Agreements (of which the supply tie would be one) need to be competitive and now fall under the Competition Act 1998. Anti competitive land agreements, or provisions within them, are now prohibited restrictions.

Fair Pint Campaign believe some supply ties would now be considered prohibited restrictions, and do not comply with the criteria for exemption, and the OFT should be reconsidering their previous findings in the light of these changes.

OFT CONCERNS TO THE PUBLIC CONSULTATION

The OFT stated in their submission they did not believe there would be a significant rental adjustment to rectify the perceived imbalance rendering the tied tenant no worse off than if they were free of tie. They then raise concern that the implementation of the "no worse off" principle may lead to significant rental adjustments. These two statements are contradictory and show a conflicting understanding of the 'no worse off' principle.

The OFT demonstrate a clear misunderstanding of the circumstances that prevail. To close a pub it must be vacated. Most tenants have a degree of protection from eviction by legislation. It is tied terms that circumvent that protection. The Government proposals would make it much harder to evict a tied tenant and offer them the similar protection to that enjoyed by practically all other commercial tenants in the UK.

The OFT also expressly indicate their understanding that price regulation is being proposed - IT IS NOT.

There are around 1,000 brewers in the UK and despite some large non brewing pub companies allowing sourcing from a small handful of them the vast majority are restrained from participating in around 40% of the UK's pubs. The OFT, even in their latest work, have failed to recognise this fact.

Contrary to the OFT understanding, the benefits of central purchasing by large pub companies are NOT passed on to the tenants and in turn the consumer does NOT benefit. If products and services were genuinely cheaper through the pub company, due to the benefits of central purchasing, then a tenant would choose to acquire them from the pub company not be forced to acquire them by mandatory lease provisions.

The original contractual nature of agreement between landlord and tenant is that the higher tied product prices would be fairly balanced by benefits (special commercial or financial advantages - SCORFA). The pub companies have altered the nature of the contract between the parties by undermining the balance taking too much in rent whilst over charging on tied product prices and offering little if any other countervailing benefits. The intention of Government intervention is to redress that balance and restore the 'fair' nature of the contract between the parties NOT to alter it as the OFT have concluded.

The OFT have demonstrated an incredibly naive perception of how the pub sector operates and the failings within it and seemingly relied almost entirely (again) on the information submitted to them by the pub companies and their representatives.

For more information please contact.

SIMON CLARKE
FAIR PINT CAMPAIGN
email @[redacted]

05 FW: Government Consultation on Pub Companies and Tenants - Response to OFT submission dated 14 June 2013

From: siclarke@[redacted]
Sent: 26 March 2014 09:50
To: [redacted]; McLynchy Julie (CCP)
Subject: Fwd: Government Consultation on Pub Companies and Tenants - Response to OFT submission dated 14 June 2013

Dear [redacted] and Julie

I think I may have forgotten to send this through to you and for the sake of completes and transparency it seems only right I do given my previous submissions in this regard.

What is interesting is that the OFT seem to concede that there may have been some changes which were not considered in their previous reports (the revocations of the Land Agreement Exclusion Order being one). Furthermore they have confirmed that despite this possibility they will not be reviewing again due to insufficient resources.

I will come back to you shortly with a more detailed response outlining why I believe the recent changes in competition law are so significant.

Regards.

Simon

S_Clarke_...

-----Original Message-----

From: [redacted]

To: 'siclarke@[redacted]
Sent: Fri, 14 Mar 2014 17:10
Subject: Government Consultation on Pub Companies and Tenants - Response to OFT submission dated 14 June 2013

Dear Mr Clarke

Thank you for your email dated 12 January, and its enclosed report, sent to our Enquiries Unit. I have been asked to reply, and attach a formal response. I apologise for the delay in getting back to you on this.

Yours sincerely,

[redacted]
Office of Fair Trading
Fleetbank House | 2-6 Salisbury Square | London | EC4Y 8JX | [redacted]| www.oft.gov.uk

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OFFICE OF FAIR TRADING

Mr Simon Clarke
Fair Pint Campaign

[REDACTED]

Our ref
Date 14 March 2014

Direct line [REDACTED]
Email [REDACTED] k

Dear Mr Clarke

Re: Government Consultation on Pub Companies and Tenants – Response to OFT Submission dated 14 June 2013

Thank you for your email of 12 January 2014, and the enclosed response dated 10 January, addressed to our Enquiries Unit. I have been asked to reply, and apologise for the delay in coming back to you on this.

Your response to the OFT's submission dated 14 June 2013 on the government's pubco consultation makes a number of points. Overall, as you note in paragraph 2 of your response, you consider that the OFT's consultation response shows some fundamental flaws in our understanding of how the tied pub sector currently operates and of the proposals that have been tabled to rectify the behaviour of some pub owning companies and the rent setting process.

We note the points you have made. For example, we accept that there will have been some changes to the market, including competitive conditions, in the period since we made our report. We do not accept, however, that the concerns we raised in the response to the consultation were 'duplicitous', nor that they lacked objectivity (as suggested in paragraph 9 of your response).

We are not, however, in a position to respond to your points in detail. Our current position is that given BIS is currently considering how best to respond to the consultation on regulating the market, we do not propose to undertake a fresh review of our own at this time. This would require considerable resources that are not currently at our disposal.

Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX
Switchboard: (020) 7211 8000
www.oft.gov.uk

Going forward, you will know that the OFT and the Competition Commission are due to be replaced on 1 April 2014 by a single regulatory body, the Competition and Markets Commission (CMA). We do not yet know what the CMA will set itself in terms of investigative priorities. But if the CMA was provided with compelling evidence that consumers in a particular market, such as the pubco market, were being adversely affected by a lack of competition in that market, that evidence would be carefully considered.

Yours sincerely,

[REDACTED]

– Goods and Consumer Group