The Pubs Code and Pubs Code Adjudicator: A Government Consultation: Delivering No Worse Off

Prepared for: Department for Business, Innovation & Skills
Prepared by: B&HLA
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EXECUTIVE SUMMARY

This document details the views of Brighton & Hove Licensees Association (B&HLA) in relation to both parts one and two of the governments consolation into the Pubs Code and a pub code adjudicator.

We have reviewed the consultation documents and have responded to both the questions raised within the the documents and also on the wider position as viewed by our Association to be pertinent to the consultation process.

It is the view of the Association that the statutory code and adjudicator are both essential in re-balancing the landlord-tenant relationship within the pub industry and that access to a Market Rent Option is key to ensuring that this re-balancing is in line with the title of the consultation document “delivering no worse off”.

PART ONE

1. RENT ASSESSMENTS

1.1. The principle that the tied pic tenant should not be worse off than a free of tie tenant is one that we fundamentally agree with. That free of tie tenant referred to being one that rents their pub on a fair and open market rental basis. This should not be by reference solely to one pub owning business's own free of tie tenants, or indeed solely pubco in general free of tie tenants, doing so would perpetuate the current imbalance.

1.2. We support the right of the tenant to request for a rent assessment in the circumstances noted in the consultation document:

1.2.1. where no rent assessment has been concluded under the tenancy agreement for at least five years; or

1.2.2. where there has been a significant increase in the price at which tied products or services are supplied under the tied agreement; or

1.2.3. where an event has had a significant impact on the tenant's expected trade.

1.3. We agree with the consultation document that a rent review should start a minimum of six months before the due date or following a request from a tenant under the terms noted in 1.2.

1.4. We agree that the pub owning business must provide the tenant with a rent review proposal within a set time frame, though we do believe that 14 days may be too short a time-scale and would be happy with a three week, 15 working days time-frame to allow for a more thorough proposal to be drawn up by the pub owning business.

2. DELIVERING "NO WORSE OFF"

2.1. We agree with the need to deliver on the principle of the tied tenant being no worse off than the fee of tie tenant. That free of tie tenant referred to being one that rents their pub on a fair and open market rental basis. This should not be by reference solely to one pub owning business's own free of tie tenants, or indeed solely pubco in general free of tie tenants, doing so would perpetuate the current imbalance.

2.2. It is our view that the Market Rent Only (MRO) option is the cornerstone to ensuring the principle of "no worse off" is met. It is both the mechanic to deliver no worse off and the policeman to ensure it is a principle that is adhered to.

2.3. We strongly support the requirement of the pub owning business providing a parallel rent assessment (PRA) to their tenants during the rent review process. This not only ensures the pub owning business is benchmarking their own tied offer, but it ensures the tenant (who from experience we know not to be time and resource rich) have all the required information to make an informed decision with regard to their rent.

2.4. Whilst we agree that the MRO option alone delivers on the commitment to being no worse off we do believe that the PRA enables all sides to have the required information to make an informed decision, allowing both parties to move forward. We fail to see the arguments in opposition to a PRA put up by either side. Firstly that of the pub owning business, that a formulaic approach brings an unwarranted intervention into the commercial process, when the rental assessment being one of Fair Maintainable Trade (FMT) being formulaic itself and the only difference we can see between the rent proposal and the PRA being the application of a different gross profit margin % on sales and the valuation of the SCORFA (commercial benefits the pub owning business adds to the tenant), indeed valuing the SCORFA may well be a sensible option for the pub owning business to do, ensuring the tenant realises the benefits they bring. We also fail to see the opposition of some of the tied tenants groups that it may well overwhelm the adjudicator. In our view the PRA (if produced correctly) arms the tenant with the necessary information to make an informed decision, surely this will lead to less cases being brought to the adjudicator's attention.

2.5. We disagree that producing a PRA is a complex procedure. As we have noted in 2.4 it simply requires a change in gross profit margin% achievable and the factoring in of SCORFA. This is not a difficult process.

3. MARKET RENT ONLY OPTION

3.1. We agree that one of the triggers for the right of the tenant to request an MRO will be upon renewal of a lease that is protected under the Landlord and Tenant Act (LTA) 1954. We have concerns that pub owning businesses will seek to provide opted out tenancies as a means to avoid MRO requests and feel that renewals of opted out tenancies should carry the same rights of the tenant and that the request for an MRO should be made following a rent proposal from the pub owning business, this measure to ensure that the MRO request doesn't lead to opposition to any renewal, the pub owning business having already signalled its intention with a new rent proposal. It also ensures the pub owning business doesn't have a long-term tenant on a rolling tenancy that has no access to an MRO.

3.2. We fundamentally disagree with the consultation documents proposal that the right to request an MRO is only triggered when the rent proposed by the pub owning business is higher than the existing. This singularly fails to deliver the principle of “no worse off”. Indeed this may well penalise some of the pubs most in need of re-balancing. Where the rent is already too high the tenant will have no right to MRO and will continue to pay too high a rent simply on the basis of the pub owning business keeping their rents the same. It is the very need to re-balance that has brought us to this place, to deny a tenant the right to request an MRO purely because their rent hasn’t risen at review penalises those who are most in need and ensures the failure of the governments intention of delivering “no worse off”.

3.3. The time limit of 14 days from receipt of the rent proposal from the pub owning business to request an MRO is not long enough. We have been consistent in this noting in 1.4 that 14 days was too short a time-frame for the pub owning business and the same can be said for the tenant. We would suggest a four week, 20 working days time period, this being five days longer than that afforded to the pub owning business as the tenant will usually have far less resource available to them. If a tenant is on holiday it doesn’t get picked up, if the pub owning business representative is away their workload will be passed on.

3.4. We agree that a significant increase in price should be a trigger for a tenant to request an MRO. This provides a protection most necessary when the tenant has no negotiating power of the prices they are charged in a tied market.

3.5. We agree with the consultation documents requirement that certainty and transparency is needed when looking at what denotes a significant increase in price however we disagree with their definitions.

3.6. With regard to beer we fail to see why there should be any tolerance at all over and above any increase to the wholesale market price as set by the brewer. It is our contention that the wholesale market price is already an arbitrary concept that is subject to little or no downward market pressure and to allow for any tolerance over and above this will leave tenants in serious risk of being priced out of the market with no option and no alternative. The industry is already seeing above inflationary increases to the wholesale price, and when one factors in this is applied to the duty element as well as the cost of production and distribution, we can see how the wholesale price can escalate out of proportion already (our assessment has already noted that over the past 20 years the cost to the tenant is around 40p per pint more than if inflation had solely been responsible for wholesale price increases when applied to only production and distribution). Our view is that anything over the wholesale price would be considered significant, and that being as long as the wholesale price only rises by inflation, this will ensure the pub owning business applies downward pressure on the brewer’s wholesale price to the benefit of its tenants in the same way it would apply downward pressure on the price it actually pays to the brewer.

3.7. With regard to other tired products we need to have some definition here. Wines, spirits, minerals etc should be categorised in the same way as beer if they are tied for.

3.8. We agree that a definition of “significant" needs also to be applied to other tied products price increases. However again we disagree with the proposed definition. The approach taken in the consultation document is both unworkable and confusing. It is also a licence to print money for the pub owning business. allowing increase of 30% and 40% is un-justifiable in our opinion. Whilst we appreciate and support the right of the pub owing business to pass on increases that are beyond their control there needs to be some check and balance in place here. Simply allowing for up to a 40% increase without this being considered significant and so giving no redress to the tenant is not delivering on the commitment to provide “no worse off” indeed we believe it will exacerbate the problem. A far simpler method would be for the pub owning business to justify each rise that is above the current rate of inflation. As they are paying the extra cost they will be in a position to prove their cost has risen significantly above the rate of inflation and by how much and so be within their rights to pass this on. Again this ensures the pub owning business exerts as much downward pressure on price as it can when negotiating and so benefitting their tenants.

3.9. We believe the time frame involved should be one year and not 6 months as proposed in the consultation document. This is in line with annual beer price rises and indexation rises.

3.10. We agree with the tenants right to request an MRO where there has been an event which has a significant impact on the level of trade that – in the absence of that event - they could reasonably have expected; and where the impact is beyond their control; and where it could not have been foreseen.

3.11. We believe the tenants rights should be from the time of the impact and not from the date they provide the pub owning business with a written analysis of the forecast impact. Clearly we wouldn’t want people sitting down writing analysis rather than dealing with the consequences of such an event as a flood. The onus would be on the tenant to prove the date of the significant event.

3.12. We believe that a definition of significant event is necessary however don’t fully agree with the consultation’s proposals. Our definition would be:

3.12.1. Brings about a permanent change to trading conditions, and not simply the result of normal variations in trading conditions. We don’t believe this needs be to evidenced by a year’s worth of trading forecasting to illustrate the significant impact on trade as this length of time may see the demise of the business. We don’t think a time frame is appropriate here as by definition the event is known and it will be clear whether it is short or long-term.

3.12.2. Is not capable of prevention or remedy by any other means – for example, there will be no significant impact where the risk was an insurable one; where the pub-owning business is required or able to undertake physical repairs to the property (as long as these repairs are not

considered investment that would then impede the rights of the tenant to request an MRO at review or renewal); or where the pub-owning business is prepared to agree a reduction in the tied rent to alleviate the impact on trade;

3.12.3. Does not relate to the personal circumstances of the tenant;

3.13. We disagree with the definition that a request can only be made if it is specific to the tenants pub. This is clearly a bizarre situation that enables the pub owning business to avoid any MRO request simply because it has a number of pubs in an area or in a specific circumstance and in so doing fails to deliver the principle of “no worse off”, by its very nature it will penalise urban pubs.

3.14. We also disagree with the definition that it shouldn’t result in an increase of the expected trade over the following 12 months. Firstly this would be impossible to police as it would require disclosure from the tenant following MRO option being taken and consequently the divulging of commercially sensitive material and secondly penalises good business and hard work.

4. MRO-COMPLIANT AGREEMENTS

4.1. We agree with the consultation that any agreement needs to be MRO complaint and the use of a standard commercial agreement as the model for this. Further to this we agree that the imposition of any tie other than buildings insurance should be seen as unreasonable.

4.2. We do believe that any MRO-compliant tenancy should provide for a five yearly open market review. This ensures both tenant and pub owning business are safeguarded from any fluctuations in the market.

5. MRO-PROCEDURE

5.1. We agree with the six month maximum timetable for an MRO procedure.

5.2. It is our view that some consideration needs to be given when a tenant requests an MRO and the pub owning business and tenant cannot agree on terms of the MRO, this then going to the adjudicator at the end of the rent review procedure. It will be self evident that the tenant has opted for an MRO feeling that they are worse off under the tie. However during any adjudication process it is likely the tenant will remain worse off until an agreement be made. It is our view that the arbitrator should have

the power to compensate the tenant if they feel the pub owning business delayed any agreement or caused the adjudicator to be involved by setting too high a bar in the previous negotiations with their tenant. In these circumstances it should not be the tenant who remains worse off and should be compensated. We don't see the need for this to be applied in reverse as the pub owning business will still be receiving the previous rent and terms until any adjudication is made.

5.3. We believe the tenant only being afforded 7 days to notify the pub owning business of their intention to refer any matter to an adjudicator is far too short when considering the resource and time available to the tenant. It is our belief this needs to be 21 days as a minimum

5.4. We also believe 21 days should be allowed to the tenant to provide the assessor with evidence. This for the same reasons as given in 5.3

6. WAIVER FROM MRO IN RETURN FOR SIGNIFICANT INVESTMENT

6.1. It is in the interest of both tenant and pub owning business to allow for an MRO waiver in return for a significant investment however we believe this is an area that needs serious consideration with significant being exactly that. This must not be an avenue available to pub owning businesses to deny their tenants a request to go for an MRO following any investment that isn't considerable. This must also be subject to control to ensure a waiver isn't indefinite and that the tenant is in receipt of all information regarding how the waiver results in a return on the investment for the pub owning business in both wet and dry rent. To this ends we believe each waiver should be entered into by genuine mutual agreement for an investment that as a minimum requires planning permission and that a timescale should be applied to the waiver after which the tenant would be again free to make a request for MRO.

6.2. We see the simplest way of policing any mutually agreed waiver to allow for a return of investment of five years during which no further rent review can take place. This which would then allow for an MRO request when the investment has provided a return for the investors and a new rent can be set with the availability for an MRO to the tenant should they feel the new rent levels don't deliver the no worse off principle. It should not be ignored that any investment should still provide a greater return for both tenant and pub owning business long after the waiver period and consequently we see no reason for return periods in excess of five years.

6.3. With regard to what we would consider significant we see two easy options either a multiple of the dry rent with a minimum of three times the annual dry rent, or an amount equal to the one and a half times the combined wet and dry rent as evidenced by the pub owning business. Both methods are

pub specific and consequently avoid any sliding scale indicator which we believe would be messy in the extreme. A known example being the average dry tied rent of a pub in England and Wales being £27,000 so a minimum investment of £81,000 would be needed to be considered significant.

PART TWO

7. MARKET RENT ONLY OPTION AND PARALLEL RENT ASSESSMENTS

7.1. We support the requirement of a PRA alongside an MRO request. This allows for greater transparency and informed negotiations.

7.2. As it is proposed that prospective tenants do not have the right to an MRO initially it is all the more important that the trigger point of upwards only rent review is not adopted. This ensures fairer dealing with the pub owning business who are not incentivised to artificially inflate the initial rent in an attempt to avoid an MRO request at a later review date.

8. AVAILABILITY OF THE MARKET RENT ONLY OPTION AT RENT ASSESSMENT

8.1. It is our view that the removal of the condition that there must be a proposal for a rent increase at rent assessment before a tenant may exercise the MRO option is essential. Firstly, and in our opinion most obviously, if the condition remains then the very basis of the consultation, that of delivering “no worse off” is fundamentally undermined. If a tenant is worse off at the rent review process and their rent is not increased they will still be worse off and no re-balancing has occurred.

8.2. Further to 8.1. we believe that the failure to remove the condition will penalise those who are already worst off. Those whose rents were set too high in the first instance may have to endure years of hardship before they get the opportunity to rebalance their agreements. It is the case that rents that are already too high may well be subject to indexation which clearly will exacerbate the problem (a percentage increase applied to an already too large a rent will maintain that rent at too high a level) an ensure the pub owning business never has to offer an MRO to their tenant. Again this condition ensures the failure in delivering the key principle of “no worse off”.

8.3. It is our view that the removal of this condition is at the very heart of ensuring the fair system and availability of MRO to ensure the principle of “no worse off “ is delivered. Failure to remove it and the whole process falls down it is that fundamental.

9. THE PUBS CODE

9.1. We fully support the Pub Code making clear what information should be provided and when.

9.2. Whilst we fully appreciate the desire to avoid time wasting we are not entirely convinced of the need to have a formal inspection of a property before it being mandatory to provide specified information to a prospective tenant. It is our view that written (or emailed) confirmation of interest in the pub to the pub owning business or their agent should be sufficient.

9.3. We agree that a pub-owning business may not require a prospective tenant to submit a business plan if the tenant is a qualified person to whom it has provided the specified information.

9.4. Whilst agreeing that the need for certain contractual and formal or informal negotiations affecting the tied rent may not need a formal rent assessment we are not convinced that one of these should be a catch all category “periodic general business reviews” which seems rather ambiguous and non-specific.

9.5. We also believe that a 14 days notice period of any changes in the circumstances mentioned in 8.19 of the consultation document is too short a time frame and would recommend 20 working days as a minimum.

9.6. We are strongly of the opinion that the pub owning business should be required to provide a full Schedule 2 rent proposal in the circumstances notes in consultation document 8.19. This allows for transparency and the tenant to be fully availed of the reasons behind the rent change.

9.7. The one exception to 9.6 would be a change as a consequence of annual indexation rises where we don’t consider the provision of a full schedule is required.

10. CONTRACTUAL INCONSISTENCIES WITH THE CODE

10.1. We agree with the terms listed that would constitute fundamental breaches of the code and would therefore be void, namely;

10.1.1. have the effect of preventing, inhibiting or penalising a tied tenant for relying on the Code's protections; or for asking its pub-owning business to comply with its Code obligations; or

10.1.2. would allow only the pub-owning business and not the tenant to initiate a rent assessment; or

10.1.3. restrict rent review proposals at rent assessments to being upwards only; or

10.1.4. purport to penalise the tenant based on the reading of a flow monitoring device without any additional evidence.

10.2. The same is true for terms that seek to sidestep arbitration.

11. EXTENSION OF CODE PROTECTIONS

1. We remain unconvinced of the limitations imposed under section 69 on tenants ability to have protection of the code and to request an MRO as a consequence of a change of ownership. The principle of being no worse off shouldn't be limited to tenants only of substantial pub owning businesses. We are aware of abuse of the tie and an imbalance of power within companies of all shapes and sizes and where the pub owning business isn't a brewer we see no requirement for the pub owner to be exempt and consequently allow for their tenant to be worse off than if free of tie. Where this occurs as a consequence of a change of ownership simply exacerbates the issue, as a tenant also invests time, money and effort into a premises and does so with the initial knowledge that they have the protection afforded to them of the Code and MRO. To arbitrarily remove this without agreement of the tenant who then has the risk of becoming worse off than if free of tie over time undermines the principle.

12. EXEMPTIONS FROM THE PUBS CODE

12.1. The exemption for genuine franchises is welcomed, however the franchise must be a genuine one and one recognised by the British Franchise Association and all the criteria as laid out in "Table 1 – Key characteristics of a genuine pub franchise with rationale" are met . This cannot be used as a smokescreen to avoid the code and MRO.

12.2. We agree that the Pubs Code information requirements that are indirectly related to rent such as the signposting to sources of benchmark information and the provision of historical trade information should apply to genuine pub franchise agreements.

12.3. We agree with the maximum exemption term of 12 months for tenancy at will agreements.

12.4. We do believe it is appropriate that a tenant entering into a tenancy at will or short-term agreement with a pub-owning business should have completed pre-entry awareness training prior to being offered the agreement or be qualified to be allowed a waiver.

13. ENFORCING THE PUBS CODE

13.1. We support the discretionary powers afforded to the Adjudicator. This is a common-sense approach and allows for a case by case basis to be adopted.

13.2. We believe the fee of £200 to be fair and proportionate and costs awarded against a tenant to be limited to £2,000 to be equally fair with the exceptions as outlined in the consultation document such as a vexatious referral.

13.3. The maximum fine of 1% penalty for breaches by a pub owning business seems is proportionate, however we would recommend this is set against a groups global turnover and not limited to the UK. Whilst most may currently be owned within the UK this may not always be the case and it takes away any incentive to move offshore to limit liability and exposure.