



Federation of Small Businesses
The UK's Leading Business Organisation

Rt Hon Anna Soubry MP
Minister for Small Business, Industry & Enterprise
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24th November 2015

Dear Anna,

**FSB response to BIS consultation - Pubs Code and Pubs Code Adjudicator:
Delivering 'No Worse Off', A Government Consultation – Part 1**

I write to express serious concern that the Government's proposals to introduce a statutory Pubs Code does not honour the agreement reached during the passage of the Small Business, Enterprise and Employment (SBE) Act 2015. It is clear from the consultation that the principal tenets which underpinned the agreement appear to have been lost. If so, this is an unacceptable position. It is imperative that the Government reassesses this proposal and give reassurances that it will deliver on what was clearly promised to the tenanted publican community. Indeed, how the Government chooses to proceed will be taken by the small business community as a litmus test on its commitment to deliver for small, not large, businesses more widely.

The FSB has around 3,000 publican members and has long campaigned for a fairer playing field for tied publicans. We produced a seminal and independent survey of tied publicans nearly two years ago, enclosed for your ease of reference. For the first time, this research shone a light on the problems tied publicans experience when tied to a pub company, and the reforms that were needed.

Our research showed that almost 90 per cent of tied publicans believe they are forced to pay significantly more for beer than they would pay if they bought it on the open market. Our evidence showed that self-regulation of the industry is not working; and we therefore welcomed the Government's original commitment to introduce a statutory Pubs Code Adjudicator, in addition to the House of Commons' later decision to back a genuine Market Rent Only (MRO) option. This proposal was later amended in the House of Lords, with the Government promising that the commitment to provide a genuine MRO option would remain.

However, we believe the proposal for the MRO option laid out in your name in the recently published consultation document is not in keeping with the agreement that was presented to both Houses of Parliament. The FSB now calls on the Government to address what we see as two fundamental breaches of the agreement:

1. **Conditions placed on the trigger for the MRO option** - The agreement reached during the passage of the SBEE Act proposed that the trigger for a MRO option would be when a tenant's lease came up for renewal - **not** any artificial figure or one that can be manipulated by either party involved (the pub company or the publican). *As such, under no circumstance was it agreed that any conditions should be attached to the tenant's right to request an MRO offer as part of their rent renewal process.* The feature proposed under point 8.12 of the consultation should therefore be removed.

The proposed condition that the MRO option could only be triggered 'so long as the rent proposed by the pub-owning business is higher than the existing rent that the tenant is paying', clearly places the power to trigger the MRO option in the hands of the pub company. As agreed during the passage of the SBEE Act, the Government needs to address the existing asymmetric power-dynamic between pub companies and their tenants. This does not achieve that objective. Furthermore, and fundamentally, this condition effectively implies that existing rents are fair. As our research showed all too clearly, this is not the view expressed by the majority of tied tenants.

2. **The Parallel Rent Assessment (PRA)** - In our engagement over the SBEE Act, we argued that a PRA would be required to enable publicans to make a well-informed decision about whether to accept a MRO option, ensuring that tied tenants should be no worse off than a free-of-tie tenant. Crucially, the PRA was envisaged to be an integral component of the MRO option decision-making process.

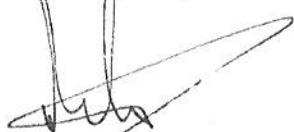
In light of this, the FSB is far from convinced by the arguments presented in point 7.10, in particular- that tenants will have all the information and transparency they need to make a well-informed decision. This is not, as some have suggested, an interference in the market and therefore unnecessary regulation. In instances where markets are clearly imperfect as in this case, such an intervention is fully justified.

The FSB believes the consultation can only be meaningful if these major points are addressed, and these agreed points of principle are fully reflected throughout. Additionally, we have concerns over the current consultation process. Primarily, those centre on the consultation being presented in two separate parts with different timeframes for responses. We cannot see any merit to this approach and, conversely, it hinders our ability to properly assess the proposal; the consultation is, in effect, asking for feedback without providing all of the necessary information. A good example of this is highlighted in point 7.12, which informs us that the detailed proposals for, essentially, the alternative to including PRA will be set out in the second part of this consultation.

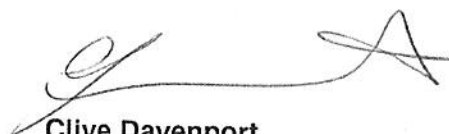
Given the FSB's views on this matter and the unequivocal evidence provided by our research, we believe the Government needs to withdraw the current consultation and redraft it to produce one coherent consultation document which addresses the above points. It is paramount that the consultation delivers a statutory Pubs Code which genuinely rebalances power fairly between pub companies and their tenants and ensures that a tied tenant should be no worse off than a free-of-tie tenant. This we believe is what was agreed in March, and would be deeply disappointed if the Government's position did not work in full faith towards that position.

We are ready to work with your officials on this issue and look forward to your response.

Kind regards,



Mike Cherry AIMMM FRSA
Policy Director



Clive Davenport
Portfolio Chairman, Enterprise
and Innovation

cc: The Rt Hon Sajid Javid MP, Secretary of State for Business, Innovation and Skills and President of the Board of Trade

18 January 2016

Dear Anna,

FSB submission to Department for Business, Innovation and Skills consultation on Pubs Code and Pubs Code Adjudicator, Part 2

I write to respond to Part 2 of BIS' consultation on Pubs Code and Pubs Code Adjudicator. The Federation of Small Businesses (FSB) welcomes the opportunity to respond to this consultation.

This letter follows on from FSB's previous response to Part 1 of the consultation, where we expressed serious concern that the Government's proposals to introduce a statutory Pubs Code did not honour the agreement reached during the passage of the Small Business, Enterprise and Employment (SБEE) Act 2015.

Since submitting our initial response, back in November 2015, we have worked closely with the BIS team responsible for this consultation and your office. The engagement has been meaningful and we feel that the government has since then listened to the concerns of the tied-tenant publican community; this is evident by the questions presented in this second part of the consultation. We hope that there is now a clear intention to honour the letter and spirit of the Parliament's decision which received Royal Assent in March 2015.

In FSB's submission to Part 1 of the consultation we presented two fundamental issues which we asked the government to address as a matter of urgency. The first was the condition placed on the trigger for the MRO option and the second concerned the inclusion of a Parallel Rent Assessment (PRA) or the principles behind including such a mechanism.

In light of the proposals presented in Part 2 of the consultation, we are satisfied that both of these issues have now been meaningfully considered by the government. We welcome the opportunity to provide further comment on these two particular issues and the questions which pertain to them:

1. The MRO option

Q.4 (Part 2): What would be the effect of removing from the draft Pubs Code Regulations the condition that there must be a proposal for an increase in the rent at rent assessment before a tenant may exercise the MRO option?

FSB strongly believes that the effect, of removing from the draft Pubs Code Regulations the condition that there must be a proposal for an increase in the rent at rent assessment before a tenant may exercise the MRO option, would be to ensure, without hesitation, that the overarching principles of the Code are met. As stated in paragraph 6.1 of the consultation, these dual principles are:

- (i) Fair and lawful dealing by pub-owning businesses in relation to their tied tenants and
- (ii) That tied pub tenants should not be worse off than a free-of-tie tenant.

Removing this condition will leave the draft Pubs Code upholding the agreement reached between the tied-tenant publican community and parliament during the passage of the Small Business, Enterprise and Employment (SBEE) Act 2015. Importantly, this will ensure that the MRO option is a neutral mechanism, which can only be triggered based on a time or situation mutually agreed from the outset, in this case at rent assessment; the trigger to exercise the MRO option cannot be controlled by either party.

Further, removing the condition means removing the potential for the MRO option to be manipulated by either party to suit their vested interests. The government acknowledges that there have been longstanding concerns in the industry about the unfairness in the relationship between large pub-owning businesses and their tied tenants. FSB's research evidences how current conditions make it more likely that large pub companies abuse the imbalance in the relationship for their own advantage.¹ In this context it is reasonable to expect that this condition will, in practice, mean some pub companies may decide not to increase a tenants rent for the explicit purpose of preventing the tenant from exercising the MRO option, and in doing so maintain this asymmetric power relationship.

There may also be instances where a pub company decides not to increase a tenants rent with no intention of preventing the tenant from exercising the MRO option but nevertheless the condition prevents the MRO option being triggered. Either way, this condition would place an arbitrary barrier preventing certain tenants from exercising an option which other tenants can access. Such instances would contradict the principles driving the draft Pub Codes Regulations.

Q.5 (Part 2): It would be particularly helpful to receive evidence of the percentage of rent reviews that have resulted in a freezing or reduction of the rent over the last three years; of the prevalence of annual indexation provisions and other inter-rent review arrangements in tenancy agreements; the typical increase in the amount payable by the tenant that they result in; and the way in which these are exercised by the pub-owning business under the terms of the tenancy.

Fundamentally, FSB does not agree that any conditions should be placed on the trigger and, for the reasons stated above and with no reasons provided to the contrary, this should be a self-evidencing reason in itself. It is not clear as to why the assumption in paragraph 7.4 – that the amount payable could be expected to rise at each rent review – upon which the condition was based, should warrant placing a condition on triggering the MRO option. Even if this assumption was accurate, we cannot see how it would justify placing such a condition. As it stands though, this assumption is flawed for a couple of key reasons.

Firstly, it is not a foregone conclusion that the amount payable will rise at each rent review scheduled in the tenancy. FSB's research² indicated that an increasing number of publicans tied to large pub companies were able to secure a reduction in dry rent during rent review; 24% of surveyed members reported that in their last rent review their rent was reduced.³

Secondly, the assumption of an expected rise at each rent review is based on the assumption

¹ FSB response to consultation on Pub Companies and Tenants, June 2013

² FSB survey of members for FSB response to consultation on Pub Companies and Tenants, June 2013.

³ Sample base of 63 publicans tied to pub companies, including 27% of surveyed members who stated the question was 'Not applicable, no rent review since beginning of the lease'.

that the current levels of rent are fair and consistently calculated. The calculation of 'fair maintainable trade' (FMT) is used to project the trade the pub is to achieve and is used to calculate the dry rent for a pub. FSB's research highlighted a real problem of pub-owning companies using inflated FMTs.⁴ When asked 'Does the FMT used by your pub company or brewery to calculate your rent reflect the level of trade your pub actually achieves?' 75% of respondents stated that the pub's annual trade is lower than the FMT.

Inflated FMTs in some cases may be the result of the pub companies being genuinely over-optimistic. But ultimately large pub companies who are under pressure to increase revenues from dry rent have a strong incentive to inflate FMTs. For the publican inflated FMTs not only result in above market rate dry rents and lower than expected income, it also means that the effort and skill invested to increase trade is not fairly rewarded. Anecdotal evidence would suggest that if a publican manages to increase trade and exceed their FMT large pub companies simply increase the FMT or the dry rent.

Q12 (Part 1): Do you agree with the distinction drawn between an MRO compliant agreement that arises from a request for MRO at renewal and an MRO compliant agreement that arises from a request for MRO during the course of the tenancy?

No, FSB believes that the distinction drawn in paragraph 9.11, part 1 of the consultation, would seriously undermine the overarching principle that tied pub tenants should not be worse off than a free-of-tie tenant. In effect, the provision described in paragraph 9.11, creates a situation where security of tenure can be traded off with exercising a MRO option; this runs contrary to the point made in paragraph 9.5 to "ensure that a tenant enjoys no less – but also no more – protection or security of tenure under their new MRO agreement than they previously had under their old tied agreement".

We propose that a tenant faced with the option of exercising a MRO option, during the course of the tenancy, should be entitled to the same terms, regarding length of tenancy, in their new MRO agreement as in their unexpired tied agreement. One way of realising this could be to revise the provision in 9.11 to read "In these circumstances, to be MRO-Compliant the new agreement must be for a minimum of five years or the remaining term of the existing tied tenancy, whichever is greater; for a maximum of 15 years; and must continue any protections under Part II of the LTA that were enjoyed under the tied agreement."

2. Parallel Rent Assessment

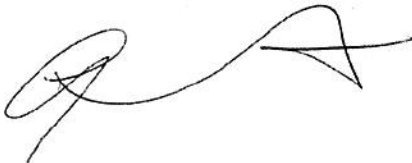
Q.1 (Part 2): We believe the stated MRO procedure, that will give tenants a free-of-tie rent offer alongside a tied rent review proposal, will enable tenants to make an informed judgment as to whether they will be no worse off by remaining tied and fulfils the objectives of a Parallel Rent Assessment. If you believe that this does not achieve the goal, please give your reasons why.

FSB believes that the stated MRO procedure achieves the goal of enabling tenants to make an informed judgement as to whether they will be no worse off by remaining tied, fulfilling the objectives of a Parallel Rent Assessment.

⁴ FSB response to consultation on Pub Companies and Tenants, June 2013

We trust that you will find our comments helpful and that they will be taken into consideration.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Clive Davenport', written in a cursive style.

Clive Davenport

Chair of the Enterprise and Innovation Policy Unit
Federation of Small Businesses