

## **Pubs Code and Pubs Code Adjudicator: Statutory Review Response**

July 2019

**Name:**

Punch Taverns Limited

**Address:**

Jubilee House, Second Avenue, Centrum 100, Burton Upon Trent, Staffordshire, DE14  
2WF

**Respondent Type:**

Pub-owning business with 500 or more tied pubs in England & Wales

## About Punch

Punch operates a mixed pub estate of circa 1,300 leased, tenanted and retail community pubs with independent tenants and lessees on a range of pub agreements. At the heart of our business is a genuine shared interest in sustainable success in order to maximise potential for our pub businesses, our publicans operating the pubs and the consumers using the pubs. Established in 1997, we became one of the largest pub companies in the UK and have played a pivotal role in the evolution of the tied pub model. In 2017 the Punch business was acquired by Patron Capital and May Capital; this was coupled with the sale of 1,900 pubs to Heineken UK. Following this transition, a new leadership team and business strategy was created under the helm of new CEO, Clive Chesser.

With a tied pub estate of more than 500 pubs within England & Wales, Punch is a regulated Pub Owing Business (POB) by the passing of the Small Business Enterprise & Employment Act 2015 and the subsequent introduction of The Pubs Code etc Regulations 2016 (the Code) and The Pubs Code Adjudicator (PCA). With over 16,000 tied pubs in the UK we believe the benefits of the tied pub model, and the lower cost and lower risk entry point into the industry, help to create and maintain a very sustainable pub sector in the UK today. By operating a tied business model, we contribute to the success of pubs which are famous throughout the world.

- We continue to invest substantially with our tied pub tenants (TPTs) to create pubs that are central to the communities they serve. Under the ownership of Patron Capital and May Capital, we have commenced significant plans to invest over £85 million developing our tied pubs across a three-year period. Since the introduction of The Code we will have invested jointly with our TPTs in over 550 pubs at a value of circa £60 Million (on average in excess of £100,000 per pub)
- We invest heavily in our TPTs development. This year we have invested circa £750,000 in building and launching our development kitchen and state-of-the-art training academy which includes a fully operational training cellar, two fully operational bars, as well as coffee and merchandising training facilities.



- We deliver our market-leading training and Punch Progress training package at this new Academy. We pride ourselves on providing some of the sector's best induction training and continuing professional development. We have just launched a mobile-friendly training console and app with CPL Training. We have also been recognised with a National Innovation and Training Award (NITA) for our Art of the Possible Training programme. Last year we trained over 290 TPTs and their teams supporting them in continually developing and growing their businesses.

- We were the first pub company to launch an online ordering and information portal for our TPTs in 2011. We currently have 90% of our estate registered for online ordering via our award-winning Punch Buying Club which has just taken our 100,000th order and sold our 100 millionth pint of beer. Our portal also offers our TPTs access to food, non-consumables, printing, websites and social media platforms and online accounting information.
- We operate a mixed estate of leased, tenanted and retail businesses, enabling us to share learnings and best practice across all. We use this expertise to pass on support to our TPTs with items such as food menus and promotional campaigns.
- We have successfully launched and continue to develop a range of innovative retail pub concepts, including our Champs Sports Bars, Mighty Locals and Our Local concepts.
- Our dedicated in-house food team use their expertise and our Academy Training Kitchen to develop innovative and on-trend menus that are relevant to the pub customers they serve, and perfectly suited to our various retail concepts. The tried and tested results are then offered to our leased and tenanted pubs with discounted food and fully prepared menu packages.
- We provide a market-leading product range to our Publicans, including one of the broadest and most established cask beer ranges in the industry supplied from a wide portfolio of national and regional brewers. This is enhanced further through our partnership with the Small Independent Brewers Association (SIBA), providing scalable access to many small local brewers. In addition to our extensive range of beer and cider, our drinks team work with a large number of spirits, wine, and soft drinks companies to provide the most up to date products in a one stop shop to our TPTs.
- Our marketing support remains unparalleled including the world's largest pub team darts competition (The Punch Darts Classic) and the biggest national pub quiz. Every week we e-shot our TPTs with promotions, deals, advice and provide a quarterly magazine which supports marketing activity for their pubs and provides legal and business advice.
- We recruit TPTs through roadshows, open days and multi-layered online channels and we are seeing applicants increasing year on year. At the end of our last financial year we had received applications from 1,706 potential tenants, an uplift of over 35% since the year The Code was introduced.

All of the above support, and much more, is provided to anyone on a tied agreement with Punch. Historically these benefits have been known as 'SCORFA' (Special Commercial or Financial Advantages), but in plain English they are examples of the non-tangible assets provided by a pub company or family brewer to a TPT in running a pub in partnership with them.

With our experience outlined above and as one of the six qualifying pub companies operating under the Pubs Code, we believe we are ideally placed to provide comment on this consultation.

## Executive Summary of the Punch submission

Punch is of the opinion that The Code has the ability to work as drafted, subject to a few specific changes and the correct application of The Code via the PCA. New legislation takes time to develop and for areas of law to become settled. Punch is starting to see this clarity gradually develop with The Code, albeit some areas could definitely have been clarified more efficiently over the past three years.

The Code is an all-encompassing piece of legislation covering the entire relationship between a POB and a TPT. Crucially, the success of The Code should not be measured by the number of those wishing to depart from the tied model through MRO, but more so by the fact that the vast majority of those operating within it actively choose to remain within the tied model due to the significant benefits that this model provides to them versus a free of tie agreement. This point of view is clearly substantiated by the evidence within our own business and by the data collated by the BBPA across the six regulated POBs

We believe The Code as drafted, as was the case with the Voluntary Code, generally promotes and reinforces good business practices between a POB as landlord and TPTs. Through formalising requirements and expectations regarding provision of information, balancing negotiating power and access to a dispute resolution service, The Code helps to ensure that transparent and professional relationships exist.

Encouraging evidence that this is working well can be seen through the level of PCA referrals since July 2016. These amount to only 36 individual referrals from circa 10,000 TPTs covered under the Code. It is important to stress that the ability to make a referral stretches across the entire relationship between the POB and TPT. These referrals equate to less than 0.5% of the applicable population raising a dispute to the PCA since July 2016.

## Effectiveness of The Code

The Code provides the PCA sufficient and proper powers to enforce the Code effectively. As the PCA workload begins to reduce in regard to arbitration cases there is more of a focus on developing Guidance and understanding around the wider Code as well as exercising investigatory powers where necessary. This has been evidenced by the literature produced in regard to information leaflets, fact sheets and more latterly Statutory Guidance.

Pre-entry training requirements, business planning, visit records and rent justification were already taking place prior to The Code and this now has a defined threshold of minimum requirements. A prospective tenant looking to take on a tied pub has never been as well informed as they are under The Code. This can only help to improve business success and sustainability for all parties.

## Elements of The Code that require consideration

Punch has serious concerns that further regulation, or the incorrect application of the existing regulations, could lead to a detrimental impact on the viability of the tied leased and tenanted pub model which has been successfully in operation for over 200 years. The legislation as currently drafted can be made to work with the correct interpretation, application and guidance. The effectiveness of this can be improved through a small number of specific changes focused on increasing consistency and clarity. We outline our recommendations for this below:

- **Price Increase provisions:** Our recommendation would be for the comparison period to fall within the previous 52 weeks of an invoice being received, and not unintentionally create a 56-week price comparison window. This will alleviate the need for a 56-week review cycle which is problematic with business planning for both POBs and TPTs.

- **Extrinsic Price increases:** The Code does not allow for external or tax related price increases aside from Duty. Our recommendation would be for the exemption of extrinsic increases, as defined in Regulation 7(6) to be further applied to Regulations 3-6. This will remove the situation experienced with the recent Sugar Levy Tax and the POB exposure to external supplier increases. With the Sugar Tax, POBs were unable to fully pass on the price increase resulting in a dilution of the intended effects of the tax and a disproportionate burden on POBs. This area of the Code leaves POBs highly exposed to different risks and it is critical that it is addressed to reduce this unreasonable level of exposure.
- **MRO Clarification:** Punch believes clarity regarding MRO terms can be better achieved through accrediting common free of tie commercial lease terms or the MRO agreements/terms for each of the regulated companies. Accreditation would provide absolute clarity on the terms of an MRO agreement for all parties involved and would remove a significant time and cost element from the MRO process including that of the PCA. This would remove real or perceived areas of ambiguity and make life simpler for all parties.
- **Correct interpretation of compliant MRO terms:** Punch has serious concerns regarding apparent examples where standard commercial free of tie lease terms being proposed by POBs are deemed non-compliant due to the personal circumstances of the tied pub tenant. This is not the intention of the legislation, goes against open market principles and current property law.
- **Length of MRO agreement:** Punch believes that The Code provides absolute clarity on the requirements regarding MRO lease length through Regulation 30(2) stating that a compliant MRO proposal must be for an agreement term/length that is at least equivalent to the remaining tied agreement term/length. The PCA, through recent communications, has seemingly indicated that a test of reasonableness and commonality should apply when determining the length of MRO agreement on offer. Punch believes this approach is incorrect and beyond the remit of the PCA or intention of The Code. A POB's rights in dealings with its own assets should not be prejudiced and so determination of the lease or tenancy term on offer should be at the discretion of the POB subject to the statutory minimum afforded by Regulation 30(2).
- **Effectiveness of the PCA office:** All parties are seeking improved guidance and quicker consideration of Code matters. The outsourcing of arbitration cases to external arbitrators appears to be an area of the Code where the PCA has looked to try and free up their time. To ensure consistency in approach, we would recommend having a panel of individuals deciding such cases to whom such matters are familiar in nature and law. This should result in more efficient settling of the law. Further concern is raised in regard to the value for money being received under The Code. Figures provided via the BBPA indicate that the existing Voluntary Code and associated dispute channels runs at a cost of circa £18 per pub, however, under the statutory Code the cost is in excess of £100 per pub and continues to rise year on year. This is yet another burden on pub companies, and a disproportionate one for the six companies covered by The Code.
- **Investment Exemption:** Punch is concerned that the risk presented by MRO stifles some levels of investment with existing TPTs on tied leases due to the uncertainty over future income streams. The qualifying investment exemption currently results in polarised investment. To encourage more investment in tied pubs Punch recommends lowering the threshold for the qualifying investment option afforded under Regulation 56, which, subject to both the POB and TPT agreeing, can grant an exemption from MRO rights for an agreed period of time.

- **Timescale for arbitration referrals:** The timescale of 14 days for referral is too short and non-conducive to allowing meaningful negotiations to take place during the 56-day statutory negotiation window. Our recommendation is for the timescale for making referrals to be extended. It should be noted however that this has already been partly addressed through the introduction by the PCA of a three-month 'stay' period which has gone some way to resolving this concern.
- **Professionally Qualified Advisors:** We have concern in regard to the quality and motivation behind some of the advice being provided to TPTs regarding Code matters. To safeguard the advice given to TPTs in matters relating to The Code, the PCA should produce an advice note detailing the expected requirements for professional advisors. This advice note should assist a TPT in regard to the criteria they should consider when seeking advice on Code matters, such as recognised industry qualifications, accreditation from professional bodies and relevant indemnity insurance.

## Part A: The Pubs Code

### Question 1

**How well do you think the Pubs Code has operated between 21 July 2016 and 31 March 2019? What evidence do you have to support your view?**

The impact assessment conducted prior to The Code identified four areas to address, namely:

- a perceived imbalance of access to information,
- behavioural bias,
- a perceived imbalance to negotiating power, and
- the nature of the tie as a form of lock in.

The Code looked to address these areas by providing a legal framework regarding the provision of information, the introduction of the Market Rent Only (MRO) option and introduction of the Pubs Code Adjudicator as a dispute resolution channel.

#### ***Provision of information:***

The provisions introduced by the Code were largely evolving practices already present in the industry under the Voluntary Code of Practices. The Code has introduced a defined threshold of minimum requirements for provision of information from a POB to their TPTs. This acts to safeguard the ability for informed decisions to be made and addresses the perceived imbalance of information. A tenant looking to take on a tied pub has never been as well informed about the prospective business decisions as they are under the requirements set out by The Code.

In addition to the mandatory provision of information the Code also overlays a requirement for education and commercial awareness of the TPT. This includes the need for pre-entry training, consideration of professional advice and the requirement for sustainable business plans to be produced ensuring a complete commercial awareness required to run a tied pub business.

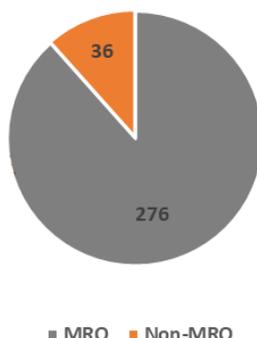
In our experience, from the original Voluntary Code and now The Code, the requirements regarding provision of information, and ensuring fully informed decisions are able to be made by both parties have continued to operate very well.

#### ***The introduction of the MRO option:***

The ability for a TPT to exercise their MRO right, and the improving clarity and understanding, operates well in helping to address the balance of negotiating power between POBs and TPTs.

The MRO option was something wholly new introduced by The Code. The drafting of the MRO provisions created differing interpretations, and it has clearly been a challenge for the PCA to provide clarity on a number of issues. MRO became the subject of referrals in accordance with the dispute resolution mechanism in The Code. The desire for clarity and consistency on this matter manifested itself through PCA referrals regarding MRO, as evidenced by 88% of referrals being submitted to the PCA up until 31<sup>st</sup> March 2019 focusing on MRO ([PCA arbitration data: January - March 2019](#)).

## PCA Accepted Referrals by Category up until 31/3/19



The process has been frustrating for all parties. However, we are of the opinion that, through access to arbitration awards, the clarity on disputed elements and a level of common understanding is starting to form. This is evidenced by the overall reduction in MRO related referral numbers, with only 12 MRO related referrals being made between 01/01/2019 and 31/03/2019.

Referrals for Arbitration (MRO related referrals only)				
	This Quarter 01/01/2019 to 31/03/2019	Last Quarter 01/10/2018 to 31/12/2018	Cumulative from 01/04/2018 to 31/03/2019	Cumulative from 21/07/2016 to 31/03/2019
Received	12	20	86	314
Accepted	14	16	84	276

Source: [PCA arbitration data: January - March 2019](#)

Despite initial frustrations, it is encouraging to see the more recent gradual emergence of clarity being formed around the fundamental points of differing interpretation within the first 3 years of the legislation. However, arguably this clarity could have been provided more efficiently through accreditation of commercial lease terms or POB MRO terms by the PCA as discussed further below.

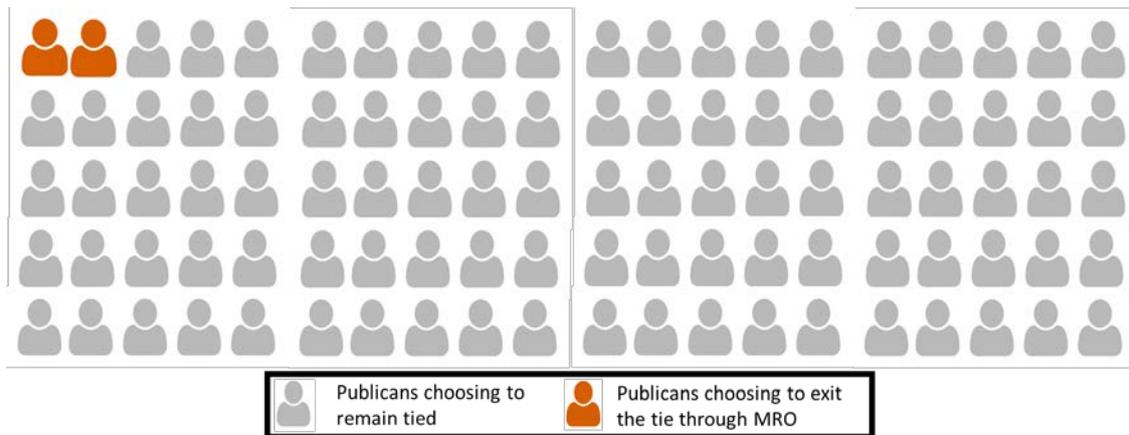
Further to the above, in looking to address the perceived imbalance of negotiating power, and the lock-in element of the tie, the MRO option does operate well. Our experience is that the majority of TPT's are not actually seeking to become free of tie tenants. To date, despite actively reminding our TPT's about the rights to explore MRO, only 20% of the Punch publicans with the opportunity to exercise their right to explore MRO have chosen to do so.



**1 In 5 tied publicans take the opportunity to explore MRO**

Further to this, only 10% of this population then ultimately progress onto a MRO agreement. This equates to 98% of the Punch estate actively choosing to remain with their tied agreement when given the option to consider MRO. What we do see is a MRO option being requested through

curiosity and negotiation tactics, and this is understandable. The measure of success of the MRO provision should definitely focus on the awareness of rights, not on the number of TPTs ultimately taking on a MRO agreement.



As a POB of some of the 16,300 tied pubs currently operating in the UK, we maintain that the benefits of the tied pub model are still very apparent to prospective TPTs. This is further evidenced by the PCA TPT survey of March 2018 stating that 7/10 TPT's have no firm intention to leave their existing tied agreement for the next 5 years. We have also experienced an increase in applicants for new tied agreements over the years since The Code was introduced.

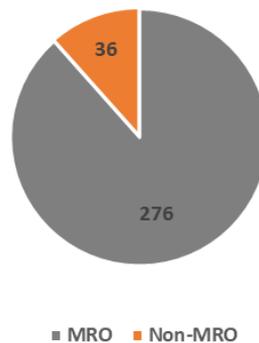
### ***Introduction of the Pubs Code Adjudicator as a dispute resolution channel:***

The introduction of the PCA as a dispute resolution method evolved and formalised pre-existing practice that existed through the Voluntary Code and the Pubs Independent Conciliation and Arbitration Service (PICAS). In regard to the process for raising disputes with the PCA, the Code provides clear definition and it is incumbent upon the PCA's office to operate this process effectively.

Where both clarity of understanding and consistency in application exist, such as the provisions concerning information and, latterly, through the evolution of MRO referral precedent, The Code has the ability to operate well. When considering evidence, it is important to state that whilst individual cases can be highly emotive matters, there should be consideration to the scale and quantification of the evidence presented.

The strongest evidence for the effectiveness of The Code in its entirety working well should be seen through the quantity of disputes being raised across the relationship between POBs and TPTs. This can be seen through the level of PCA referrals concerning non-MRO matters, accounting for only 12% of accepted referrals. This amounts to only 36 individual referrals since the commencement of the Code in July 2016. These referrals come from a total audience of circa 10,000 TPTs. Equating to less than 0.5% of the applicable population raising a dispute to the PCA regarding the entire relationship with their POB since July 2016.

## PCA Accepted Referrals by Category up until 31/3/19



The Code provides defined clarity on understanding in some areas (requirements for information etc) and refers to the market for definition in others (MRO terms). Our belief is that this is a healthy balance and now the key to success lies with ensuring there is consistency of application being implemented.

### Question 2

**To what extent do you think the Pubs Code is consistent with the principle of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants? What evidence do you have to support your view?**

We believe, as was the case with the Voluntary Code, that The Code as drafted represents good business practice between a POB as landlord and their TPTs. Through formalising requirements and expectations, The Code is conducive to ensuring transparent and professional relationships exist.

The Code evolved and formalised many existing practices and therefore much of the theory being applied was already working in practice. However, there is evidence with some areas of The Code where the theory has not fully translated, and subsequently unintended consequences have occurred, as discussed further in this submission.

### Question 3

**To what extent do you think the Pubs Code is consistent with the principle that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie. What evidence do you have to support your view?**

Through the protections afforded by The Code a TPT arguably enjoys far more privileges than a free of tie tenant does. Access to the required information prior to taking on an agreement is an example of information not usually provided on free of tie commercial open market transactions. Similarly, the requirement under The Code for the provision of information at rent reviews and the exclusion of upwards only rent review clauses are both privileges that are not available to a free of tie tenant.

The protections and privileges afforded under The Code to a TPT arguably place them in a position of contractual betterment than if they were not subject to a product of service tie. However, attempting to quantify the 'no worse off' principle has previously been a difficult task as very little information is collated in regard to the overall level of financial advantage or disadvantage between the tied and free of tie models. This leads to analysis focusing solely on the financial aspects of

beer prices and respective rent figures, often ignoring the wider SCORFA benefits provided under a tied agreement. The tied model brings a lot more than a differing financial arrangement. It is not as simple as adding or removing a product or service tie. The tied model provides a genuine shared interest and partnership (delivered via SCORFA) and greater flexibility of fixed and variable costs focused on achieving sustainable success for both the POB and a TPT.

Quantifying the benefits of the tied model has always been a subjective argument. As part of the Scottish Government Market Report, Punch were asked to cost these benefits (SCORFA) as if purchased on the open market. The same was asked of free of tie tenants who have to purchase them rather than have them provided by a POB. The result saw these benefits valued at a similar level by both POBs and free of tie tenants (£18,636 and £17,855 respectively), however, the perspective from TPTs saw the value attributed at only 20% of that figure. This would beg the question as to whether the true value of such benefits is not being fully understood within the tied market.

In addition to the above benefits, a TPT also has the ability under the Code, at specific junctures in the agreement, to explore a free of tie arrangement via MRO. This freedom to compare and contrast the two differing models ensures transparency and allows the TPT to make an informed decision as to which operating model is best for their business. To be wholly consistent with the 'no worse off' principle, the opportunity presented through MRO to explore a commercial free of tie arrangement should be the same agreement terms as if such an opportunity had occurred via the open market at the outset of the existing agreement (i.e. standard commercial free of tie terms common in the market). The Code attempts to replicate this scenario by ensuring that the length of agreement on offer is at least equivalent to the remaining term and the MRO terms presented are not uncommon to the market (Regulation 31(2)(c)). This approach ensures the terms being presented should be no worse off than those which would be proposed in a commercial free of tie open market transaction, retains a TPTs entitlement in regard to existing lease length, but also preserves the rights of the property owner under the Landlord and Tenant Act 1954 regarding options upon agreement expiry.

However, there is evidence to suggest that the implementation of the MRO process, and in particular the application of reasonableness, by the PCA could in effect be creating a two-tier free of tie market. It is our belief that the approach of the PCA in associating the personal circumstances of the TPT with a reasonable test of the proposed MRO terms goes beyond the intentions and scope of the Regulations. This approach might result in a TPT being presented an opportunity which would not normally be available in the open market through a free of tie commercial agreement. The unintended consequence being that those who achieve a free of tie arrangement via MRO may not only be in a 'no worse off' position, as per the intention of the Code, but also in a 'better off' position than if they were not subject to any product or service tie and had arrived at that opportunity via the open market. We are of the belief that this is not the intention of The Code.

#### **Question 4**

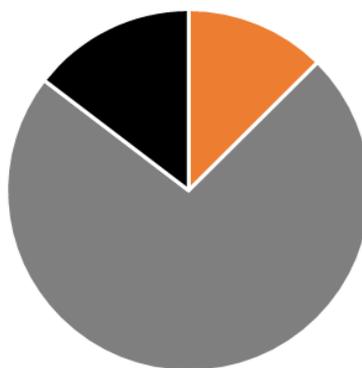
**What, if anything, do you think needs to change to make the Pubs Code operate more effectively and/or better support the principles?**

The Code acts as a safeguard to ensuring good business practice between a POB and the TPT. We do not believe that The Code requires significant changes. The Code is intended to protect and nurture the tied relationship between a POB and a TPT. We endorse the aim of the legislation to support a fair and lawful relationship.

MRO is a departure from the tied relationship. The success of the Code should definitely not be measured by the number of MRO agreements being taken up. MRO only forms a small part of the Regulations and reference to it should be weighted accordingly. In our experience, and evidenced

by circa 16,300 pubs operating under tied agreements, the vast majority of TPTs opt to operate within the tied model and do not wish to become commercial free of tie tenants. Evidence suggests that a MRO option is often being used as a comparison in order to understand the true value of a tied agreement. This is evidenced through the number of MRO requests which have resulted in the TPT ultimately choosing to remain tied. Punch has received 48 MRO requests that have been resolved with only 6 of these choosing to progress onto a free of tie MRO agreement; in contrast 35 of these have resulted in agreeing new tied agreement terms with the remaining 7 opting for neither option and leaving the pub.

## Outcomes from Resolved MRO Requests



■ Free of Tie (MRO) ■ Remained on Tied Terms ■ Mutually Agreed Exit

We believe that this data demonstrates that the tied relationship is working well, and that The Code is fundamentally achieving its core objectives. This should be recognised within this review.

As stated, The Code has the ability to work well and does not require significant changes aside from a few specific areas outlined below:

### 1. Significant Increase in Price (Regulations 3 – 6):

The objective behind these Regulations was to ensure that any annual price increases are within acceptable boundaries for fair and lawful dealing. However, the drafting has created the unintended consequence of a comparison window which extends to 13 months rather than 12.

This is best illustrated by an example:



Under the current Regulations, if a TPT receives an invoice on 10<sup>th</sup> March 2019, the comparison period for price increases would become 10<sup>h</sup> February 2018 until 10<sup>th</sup> March 2018. The comparison period could therefore capture an invoice set against pricing from the period 1<sup>st</sup> March 2017 until 28<sup>th</sup> February 2018. The only safeguard a POB has against this anomaly is to work to a revised 13 month/56-week pricing period rather than the traditional annual basis. This delays price changes and is problematic for both POBs and TPTs in business planning.

A solution to this would be for the comparison period to be 4 weeks starting on the anniversary of the invoice date rather than ending on this date. This, we believe, would achieve the same objective without creating the anomaly explained above.

The price increase Regulations also unnecessarily place the POB at risk of supplier price increases which they may not be able to fully pass on without breaching the price increase thresholds and creating a MRO trigger event for their entire estate. If the intention of The Code is to ensure fair and lawful dealing the Regulations concerning price increases should relate to increases governed or instigated by the POB and not those outside of the POB's control. However, as drafted this is not the case.

Regulation 7 makes a clear distinction between increases led by the POB and those that are extrinsic (outside the control of the POB). It is inconsistent drafting that Regulation 7 refers to extrinsic price increases and yet Regulations 3-6 do not.

An unintended consequence of this clause became apparent via the Sugar Levy tax introduced by the Government in 2018. Passing on the full price increase of the Sugar Levy would result in the POB being in breach of the Significant increase threshold under Regulation 5. This lack of exemption for extrinsic increases imposed a financial impact on POBs by forcing them into having to subsidise price increases intended for both the TPT, and ultimately the consumer, in tackling obesity. In the case of the Sugar Levy, this resulted in Punch having to absorb a significant element of price increases in order not to breach the price increase thresholds. This is clearly counteractive to the intentions of Government led obesity and health initiatives.

Our recommendation is for the exemption of extrinsic increases, as defined in Regulation 7(6) to be further applied to Regulations 3-6 in regard to the wider significant increase provisions.

## **2. Referrals made to the PCA due to a non-compliant MRO proposal (Regulations 32(4) & 35(1)):**

The Regulations provide that any referral regarding a perceived non-compliant MRO proposal must be made within the first 14 days of the negotiation period or from the date of receipt (if it relates to subsequent proposal within the negotiation period). This timescale is non-conducive to allowing meaningful negotiations to take place.

This tight timescale results in referrals being made to the PCA to reserve a position as a 'just in case' back stop. This has a direct effect and cost on the POBs under the Code via the Levy (being based partly on referral numbers) as well as to both the PCA and TPTs due to administration and advisors' costs respectively.

This is evidenced by referral cases accepted by the PCA which are then settled between parties. Since the commencement of the Code the current Punch estate has generated 15 referral cases to the PCA, 11 of which are now resolved. All 11 have been resolved through meaningful negotiations between Punch and our TPTs. This is an indication of The Code working well through parties adopting closer working practices.

We suggest that referral numbers would be reduced should the Code allow sufficient time for meaningful negotiations to take place prior to the deadline for referrals needing to be made. An early attempt to address this has been made by way of granting a mutually agreed initial stay period to explore early settlement, but this is only a discretionary option. Punch would welcome an extension to the negotiation period to 3 months with the right to referral being available throughout this period. This allows a TPT to make a referral but does not stifle the ability for negotiations to take place prior to having to submit a referral.

### 3. Improving clarity through access to Arbitration Awards

Punch advocates obtaining clarity for all parties on Code matters and we welcome the visibility of arbitration awards. We note that as of 31<sup>st</sup> March 2019 the PCA reported that 299 awards had been made but only 7 of these awards have been published.

Awards Issued			
	This Quarter 01/01/2019 to 31/03/2019	Last Quarter 01/10/2018 to 31/12/2018	Cumulative from 21/07/2016 to 31/03/2019
Awards issued	38	45	299

Source: PCA arbitration data: January - March 2019

All six of the regulated POBs have agreed to waiving confidentiality and providing consent for awards being published (subject to redaction of any commercially sensitive or personal information). This agreement was made to allow greater clarity for all parties. It would appear that this intention for improved clarity for all is being hampered by an unwillingness from the side of TPTs or their advisors.

Punch would support all awards being published as a standard output of arbitration and recommends that, subject to suitable redactions, the learnings from all awards are accessible. This would provide improved clarity and better interpretation.

### 4. Tied Pub Tenants Advisors/Representatives on Code matters:

The Code features a strong focus on ensuring a TPT is fully informed when considering decisions for their business. The Code in our opinion falls short by not ensuring any safeguards as to the quality or motivation of external advice a TPT may receive regarding Code matters. Punch advocates that our TPTs should obtain independent, professional and qualified advice from an accredited source to ensure such safeguards. Our recommendation would be for the PCA to provide an advice note detailing the expected requirements for professional advisors. This advice note should assist a TPT in regard to the criteria they should consider when seeking advice on Code matters, such as recognised industry qualifications, accreditation from professional bodies and relevant indemnity insurance.

### 5. The impact on investment in the tied Leased & Tenanted estate:

Punch has a strong desire to invest in TPTs and our leased and tenanted estate, committing to investing circa £80m across our estate over three years. However, an unintended consequence of the Code has been the stifling of investment into existing tied lease agreements within the leased and tenanted estate. This is a direct consequence due to the risk that the MRO option could lead to future income streams being uncertain, and consequently a return on investment is harder to quantify.

The Code goes some way to addressing this risk through Regulation 56 (the investment exception) however this could be improved further,

The impact of this clause has led to a polarising effect on investment with existing TPTs on tied leases – with investments below the exception threshold not being made due to the risk of MRO impacting the investment returns to the landlord. A commercial landlord will naturally invest money into more secure options when considering a return, therefore exposing TPTs on existing tied leases to an effectively all or nothing investment scenario. This could arguably damage the long-term future outlook for TPTs on existing tied lease agreements, devalue the

operating model and impact the sustainability of many pubs which currently have a viable future within their communities.

As can be seen from the below, despite Punch investing over circa £60 million in our estate over the last 3 years, the level of investment with existing publicans on tied leased agreements has only amounted to circa 4.1% of our total investment and yet this population represents circa 30% of our total estate.

	Total Last 3 Years	Proportion
<b>Total Amount Investment</b>	<b>£59,740,000</b>	<b>100%</b>
<b>Number of Pubs Invested in</b>	<b>637</b>	<b>100%</b>
<b>Amount investment with existing Publicans on tied leased agreements</b>	<b>£2,465,000</b>	<b>4.1%</b>
<b>Number of Pubs Invested in</b>	<b>24</b>	<b>3.8%</b>

A solution to this polarising effect would be to lower the threshold of the qualifying investment option (from 2 x rent), which can grant an exemption from MRO rights for up to 7 years. Lowering this threshold to apply to any level of investment from the landlord whilst retaining the requirement for the TPT to agree to this should open up the door to increased investment into the entire leased & tenanted estate where both parties see a mutual benefit in doing so, with further benefit to both consumers and local communities. Punch would advocate this change of Regulation 56 in order to encourage (through the removal of risk) increased investment with existing publicans operating tied lease agreements which The Code is designed to assist.

It should be noted that a further unintended consequence concerning long-term investment is the possibility that taking MRO might result in investment capital being harder to raise, as this would not likely be available via the POB and access to third party funding could be costly or unattainable to a free of tie tenant. This could lead to reducing the sustainability and future viability of the pub in the community it serves.

## Part B: The Pubs Code Adjudicator

### Question 5

#### **How effective do you think the Pubs Code Adjudicator has been between 2 May 2016 to 31 March 2019 in enforcing the Pubs Code?**

The Code is a complex piece of legislation which was introduced without a transitional period. We would like to acknowledge that the role of the PCA is a difficult one due to the complexity of the regulations, and some emotionally charged views within the sector. Without question the PCA has worked hard and attempted to deliver the best possible outcome within the capability of his office.

We are strongly of the belief that the Code as drafted affords the PCA sufficient and proper powers to enforce the Code effectively but that this ability has been hampered through a long-winded approach to resolving arbitrations. It is pleasing to see that as the PCA arbitration workload is beginning to reduce there is more of a focus on developing Guidance and understanding around the wider Code.

It is our belief that the approach of application adopted alongside the lack of transition period and initial resource hampered the PCA in exercising the powers of his office effectively. The volume of initial referrals, and the PCA's approach to resolving these, provided a distraction to effectively carrying out the wider duties of the role. As time has progressed, the effectiveness of the PCA has improved. This has been evidenced by the literature produced in regard to information leaflets, fact sheets and more latterly Statutory Guidance.

The PCA has developed a clear objective to raise awareness of the Code and to highlight best practice across the industry. However, Punch would caution that in doing so there remains a requirement for a better balance in regard to the cost benefit of such practices. For example, the recently published Beer Duty Waste Guidance has resulted in a further level of information being provided to the TPT, but we see little real benefit to either party from the required changes. This exercise required time-consuming systems changes and additional costs to implement as well as the financial resource expended via the PCA in conducting such an exercise.

The key to effectively exercising powers is to develop a common understanding through clarity and consistency. Punch feel that this has been an area which could have been approached differently, particularly in relation to MRO related matters.

The Code in its simplest form allows a TPT the opportunity, through MRO, to become a free of tie pub tenant on an open market free of tie rent. Within the industry there is common understanding as to common commercial free of tie lease terms as well as common terms of tied agreements available on the open market. It is also accepted that these differ due to the differing risk and reward profile and the differing levels of obligations, liabilities, initial investment, support and services that accompany each operating model. The legislation, as drafted, adopts an approach (regarding MRO proposals) based on simply an exclusion of 'uncommon terms' in free of tie agreements rather than simply opting to state that MRO should be on standard commercial free of tie lease terms. This has allowed differing interpretations to form and resulted in a lack of clarity as to what exactly a compliant MRO agreement should be; this was not the intention of The Code. The PCA has adopted a case by case approach to resolve these matters. Had the PCA taken the approach to publish or verify a clear position on these overarching principles at the outset of the Regulations this would have clarified the key issues at the heart of many costly and timely arbitrations.

Continued costly and time-consuming arbitration of issues is not in the interest of any party involved with The Code. Punch believes clarity regarding MRO terms can be achieved through the PCA accrediting common free of tie commercial lease terms or the MRO agreements/terms for each of the POBs. We would like to see Government assisting in tackling this matter through making it clear to the PCA that it expects this to be carried out. Presently the PCA does not believe that it is able to agree to this request. Accreditation would provide absolute clarity on the terms of an MRO agreement deemed as compliant for all parties involved and would remove a significant time and cost element from the MRO process.

A consistency in approach is required. As mentioned above in response to Question 3, there have been instances where the PCA has arguably adopted an approach which seemingly extends beyond the remit, or believed intention, of the Code. This has been evidenced in two areas to date which present significant concern regarding MRO terms and a potential infringement on a POB's wider rights as a commercial landlord.

First, the PCA's approach to considering a TPT's personal circumstance when considering the accessibility of MRO is, in our opinion, not in line with the legislation. Punch has concerns where standard commercial free of tie terms being proposed are deemed non-compliant due to the personal circumstances of the tied pub tenant. We are strongly of the belief that this is not the intention of the legislation and goes against practices common in the open market. The allowance of such personal circumstance being able to dictate what is to be deemed reasonable, and compliant commercial lease terms, seemingly contradicts the intention to provide balance and consistency. Further to this it is important to state that commercial leases and tenancies in themselves are drafted and interpreted on an objective basis using standard terms and not based on the personal characteristics or subjective criteria of a particular individual tenant. It would appear that the intention to view each case on the merits of the personal circumstances involved is the main reason for the PCA refusing to issue overarching principles or accrediting POB's MRO agreements or terms. Our belief is that this approach is not consistent with the intention of the legislation, goes against well engrained open market principles and current property law, and is inefficient in resolving the key recurring areas of disputes regarding MRO terms.

The tied pub industry has often been described as the low-cost entry route into the pub industry and key for bringing new entrants into the industry. Whilst MRO can offer the option to move across to a free of tie arrangement this should not be on terms that are significantly different than those available on the open market. This not only preserves clarity and understanding regarding expectations but also provides consistency to POBs in regard to portfolio management regarding standard lease terms.

The second instance relates to the PCA's recent considerations regarding the length of MRO lease terms being offered. This applies in the instance where a POB decides to offer a MRO proposal via way of a granting a new commercial free of tie lease. The Code provides absolute clarity on this matter through Regulation 30(2) stating that a compliant MRO proposal must be for an agreement term/length that is at least equivalent to the remaining tied agreement term/length. Punch believes the intention of this clause is to ensure that the tied pub tenants' rights to tenure are not diminished through taking the option of MRO. It is important to stress that at the expiry of a TPT's agreement; the landlord POB would have the right under s.30 of the Landlord & Tenant Act 1954 to explore differing intentions for their asset. This right to consider, and act upon, future intention is a well-established right to commercial property landlords.

The PCA, through recent communications, has seemingly indicated that, rather than applying the clarity as drafted within The Code, a test of reasonableness and commonality should apply when determining the length of MRO agreement on offer. Punch believe this approach is incorrect and not consistent with the remit of the PCA or intention of The Code. The MRO lease or tenancy does not arise via common methodology. A POB's rights in dealings with its own assets should not be

prejudiced. Determination of the lease or tenancy term on offer should be at the discretion of the POB subject to the maintaining at least the equivalent term of the existing lease in charge as clearly afforded in accordance with Regulation 30(2).

In addition to the above, the outsourcing of arbitration cases to external arbitrators presents a concern due to the potential impact on consistency. Prior to the Code the industry operated with the Pubs Independent Conciliation and Arbitration Service (PICAS) acting as a dispute resolution channel and this included a panel of arbitrators who ensured cases were decided upon by a collective mind. In comparison, the approach being adopted by the PCA appears to be individual external arbitrators. This presents the opportunity for subjective and disjointed decision making. Punch suggests that it would be better to have a panel of individuals deciding such cases to whom such matters are familiar in nature and law. This should result in clearer and more consistent settling of the law.

## **Question 6**

**Do you think the regulations relating to costs, fees and financial penalties should be amended? If so, how and why?**

Currently Punch has no reason to believe amendments are required to the The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016 although we would welcome greater transparency regarding the Levy payment justification and calculation. Punch has concerns regarding the value for money being received under The Code. Figures provided via the BBPA indicate that the existing Voluntary Code and associated dispute channels runs at a cost of circa £18 per pub, however, under the statutory Code the Levy cost alone is in excess of £100 per pub and continues to rise year on year.

## Part C: Pubs Code Regulations

### Question 7

There are two sets of regulations that relate to the Pubs Code: The Pubs Code etc Regulations 2016<sup>1</sup> and the Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016<sup>2</sup>.

You may have commented on some of these provisions in response to questions in parts A and B of this consultation<sup>3</sup>, but please provide any additional views on the regulations. If you think changes are needed to the regulations, please explain why and how you think they should be changed.

Punch is of the opinion that the Code as drafted does not require significant change. Our opinion is that the Code, subject to a few specific changes and the correct application of The Code via the PCA, provides the correct framework to effectively ensure that the two core principles are upheld, and that tied relationships are well governed. Our proposed changes in regard to the application of the Code by the PCA are detailed in Part B above. In addition, our proposed changes to the drafting of the Code are detailed above in Part A, but for clarity are repeated below:

**1. Significant Increase in Price (Regulations 3 – 6):**

*Our recommendation would be for amendments to address the unintended consequence of the drafting that results in annual price increases operating on a 56-week cycle. Punch recommends that the provisions are amended to address the potential overlap explained above in response to Question 4.*

*In addition, we further recommend amendments to exclude extrinsic price increases from within the definition of significant price increases. This would remove the unintended consequence experienced as a result of the Sugar Levy and the potential for any supplier increases that are not driven by the POB having to be absorbed in order not to breach the threshold test. This currently creates a potentially anti-competitive unintended consequence and has been counterproductive in achieving Government tax initiatives.*

**2. Referrals made to the PCA due to a non-compliant MRO proposal (Regulations 32(4) & 35(1)):**

*Our recommendation would be for amendments to address the insufficient negotiation time prior to a TPT having to apply for a referral on terms. This has resulted in the unintended consequence of referrals being lodged to reserve position which could be resolved through meaningful negotiations. This has the further impact on levy fees as well as administration time for all parties.*

**3. Improving clarity through access to Arbitration Awards**

*Punch understands that the PCA is currently obtaining consent from TPTs at the entry point for arbitration/referrals. As mentioned, all six of the POBs have confirmed their consent to waiving the confidentiality of awards subject to redaction of commercially sensitive or*

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<sup>1</sup> <https://www.legislation.gov.uk/ukxi/2016/790/contents/made>

<sup>2</sup> <https://www.legislation.gov.uk/ukxi/2016/802/contents/made>

<sup>3</sup> Some elements of the Regulations are covered by review provisions in the SBEE Act 2015, for example, Parts 2 to 10 of the Pubs Code etc Regulations 2016 make up the Pubs Code and must be reviewed under s.46 review provision in the SBEE Act. The review of the Adjudicator set out in s.65 of the SBEE Act states that the review may consider whether it would be desirable to amend regulations about costs, fees and financial penalties.

*personal information and the same should apply to TPTs and their advisors. Punch is concerned that at present there remains the possibility for the TPT population, or their advisors, to cherry pick awards for publication through refusing consent.*

**4. Tied Pub Tenants Advisors/Representatives on Code matters:**

*Punch advocates our TPTs obtaining independent, professional and qualified advice from an accredited source. To further the principle of fair and lawful dealing Punch would welcome the PCA producing an advice note detailing the expected requirements for professional advisors. This advice note should assist a TPT in regard to the criteria they should consider when seeking advice on Code matters, such as recognised industry qualifications, accreditation from professional bodies and relevant indemnity insurance.*

**5. The impact on investment with existing TPTs on tied leases:**

*Punch advocates the lowering of the threshold under Regulation 56 in order to encourage (through the removal of risk to future income streams) increased investment with existing publicans operating tied lease agreements which the Code is designed to assist. The amendment of the qualifying investment to be applicable for any level of investment, subject to parties agreeing regarding the waiving of rights, would encourage further investment and remove the current polarising effect that has been created. This will benefit not only the POB and TPT, but also consumers and local communities.*

## Part D: Impact Assessment and other information

### Question 8

The review will consider the key assumptions made in the Impact Assessments<sup>4</sup> which were published alongside the legislation and regulations. This will include wider impacts, non-monetised impacts or unintended consequences of the changes made. Specifically, we plan to consider any related impact on:

- costs to businesses and potential pub closures;
- redistribution of income from pub companies to tenants;
- changes in industry structure or ownership status; and
- wider industry trends such as employment and investment.

We welcome any evidence to support the analysis of these areas, or if there are any other elements of the Impact Assessments you think we should consider revisiting as part of this review.

Punch, through the BBPA, have supported the commissioning of an independent analysis regarding the impact of the Pubs Code via the economics consultancy firm Europe Economics. The report covers the rationale for the Code, an assessment of the tied pub model and a wider impact analysis.

A copy of this report can be obtained via the following link:

<https://beerandpub.com/policies/property-and-planning/statutory-code-and-pca/>

A summary of the key findings from this report are as follows:

#### ***Rationale for the Code:***

- Much of the original evidence was anecdotal and consisted of specific individual tenant experiences, with little objective consideration and testing to the true scale of the issues being presented. Further to this there was little in the way of comparison to other industries or sectors that operate in similar manners.
- There is a strong recommendation to consider the scale of issues being presented to understand if they represent intrinsically poor practice or are simply individual occurrences.
- The analysis revisits four key perceived failures identified in the original impact analysis:
  1. **Asymmetry of information:** Focused on improving communication and transparency. The report findings are that this area has improved since the Code's introduction.
  2. **Market power:** The report expresses concern that whilst MRO has helped to address the perceived imbalance of power between the POB and TPT, this needs to be handled carefully in order to not undermine the viability of the tied model.

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<sup>4</sup> <https://www.parliament.uk/documents/impact-assessments/IA15-002.pdf>  
<https://www.legislation.gov.uk/ukdsi/2016/9780111146330/impacts>  
<https://www.legislation.gov.uk/ukdsi/2016/9780111146323/impacts>

3. **Behavioural biases:** The report identifies differing motives for differing types of tenant as well as identifying the decision-making process as now being a rational process.
4. **The extent to which the tie unreasonably “locks-in” tenants to their agreements:** The report demonstrates no evidence of market failure due to the “lock-in” element of the tied relationship. The report also identifies that there have been no developments that would suggest market power of pub companies has increased since the Office for Fair Trading study in 2010, which found that the tied pub market did not result in any competition issues.

### ***The Tied Pub Model:***

- The report recognised the existence of asymmetric information on both sides and how the Code works, or can work, to address these.
- The report identifies the tied industry as the low-cost entry with a genuine shared interest in sustainable success. The report also recognises the associated support and services experienced in the tied industry. Comparisons are drawn to numerous franchise models.
- The report recognises the risk and reward nature of the tied relationship in regard to flexing the arrangement concerning fixed and variable costs.
- The report expresses concerns about the unilateral switching mechanism afforded through MRO as having the potential to undermine the viability of the tied relationship at the expense of the wider market.

### **Wider Impact Analysis**

- Awareness – The report indicates good awareness of the Code despite being in its infancy and that such awareness will improve as time progresses.
- The report highlights improvements required in regard to gaining confidence in the PCA and gaining extra clarity on key issues. Further to this the report raises concerns around the arbitration process regarding the impact of inconsistency and subjectivity in decision making.
- The report recognises the role that the tied model plays in low cost entry into the market and the assistance in retaining a continuing level of investment into the UK tenanted pub estate.
- The report highlights the short-term impact of MRO in improving negotiating power but raises concerns as to the long-term impact of this on the investment, quality and future outlook of the UK tied pub market.
- The report raises concern with the pace and delivery of the arbitration process, and subsequent awards, calling for greater clarity on compliant MRO terms.

In addition to the above, the report considers the tied relationship in conjunction with differing instances featuring vertical restraints and agency theory. Clear parallels are drawn between the operating models within the pub industry compared to other industries such as the mortgage market, insurance market, labour market and wider consumer goods (see page 28 of the report). It is apparent that the profile of a prospective tenant will likely drive their preference to the operating model they look for across the pub market. With those choosing the tied model opting for the lower cost and lower risk option (through overheads being split between fixed rent and variable product purchases). It is logical to assume that this mindset will naturally not result in large numbers

seeking to pursue a differing model via MRO, rather using this option to drive a better negotiating position on their preferred tied option. The comparison with other industries also shines a light on the no worse off principle and how there is a temptation for this to focus solely on the transparency of contract choice regarding rent and product prices when in truth a bigger picture should be considered. Drawing comparison from the mortgage market the report states:

*“Hence, whilst the consumer of the fixed mortgage deal will feel reassured when he sees interest rates rise (and compare his situation with the sufferings of the variable mortgage rate), they will feel the opposite when interest rates fall. Naturally, consumers will want to have the “best of both worlds”, a fixed rate when interest rates rise and a variable rate when they fall, but what consumers need to acknowledge is their long-run average deal and the fact that what the fixed rate does is to protect for any potential negative shock (and this comes at the expense of any potential positive fluctuations that might eventually occur).” (Page 29, Impact Analysis of the Pubs Code, Europe Economics, April 2019)*

The report also explores wider consideration of potential unintended consequences emanating from the introduction of the Code and the impact on viability this could have on the tied pub market. The unintended consequences mentioned present some serious areas of concern regarding the impact The Code could have on the long term investment and sustainability of the tied pub market. The report closes with a summary of findings and recommendations for next steps.

Punch advocates full consideration to the points covered in this independent analysis.

## Part E: Other comments

### Question 9

**Please add any points that you feel you have not been able to make in response to the earlier questions.**

The Code is still in its relative infancy as a piece of legislation. After 3 years, some areas of clarity and understanding are now starting to materialise.

Punch is of the opinion that the Code as drafted is able to work and that, inevitably new legislation takes time to develop and become settled. Punch acknowledge that this could have been achieved sooner through better clarity being provided by the PCA at the outset of the Code, particularly regarding MRO terms. Despite the approach adopted by the PCA, Punch is now seeing this development and settling beginning to emerge with the Code. Punch would urge the Government when considering this consultation to ensure a quantitative based approach is considered in regard to evidence and that the true scale of any concerns being raised is fully investigated. The Code, through the PCA, needs to strike a balance between upholding the principles it provides but also recognising the benefits of the tied pub model and ensuring that these are not undermined.

When considering the run rate of enquiries (from a potential audience of circa 10,000 pubs) received from the PCA shown below, and the fact that Punch experience only a circa 2% take up of the MRO option, there is no evidence to suggest that significant changes to the legislation are required. Subject to the correct application and a few specific changes, the Code is able to deliver on its stated objectives.

Enquiries				
Received by	This Quarter 01/01/2019 to 31/03/2019	Last Quarter 01/10/2018 to 31/12/2018	Cumulative from 01/04/2018 to 31/03/2019	Cumulative from 21/07/2016 to 31/03/2019
<b>Total</b>	<b>28</b>	<b>23</b>	<b>139</b>	<b>831</b>

Source: [PCA arbitration data: January - March 2019](#)

The Code, MRO provisions aside, is simply a framework for good business practice between Punch and our TPTs. Success of this relationship should definitely not be measured by the number of those wishing to depart from it via MRO, but more so by the fact that the vast majority of those operating within it are content in remaining within this model and the support which POB's provide. Punch has concerns that further regulation, or the incorrect application of the existing regulations as explored above, could lead to a detrimental impact on the viability of the tied leased and tenanted pub business model which has been operating successfully for over 200 years.

**Do you have any other comments that might aid the consultation process as a whole?**

Punch has no further comments on the consultation process. We are grateful for the opportunity to provide our point of view on the questions asked.