Pubs Code and Pubs Code Adjudicator: statutory review

Star Pubs & Bars (part of HEINEKEN UK) response to the Department for Business, Energy and Industrial Strategy (BEIS)

We are happy for our response to be published in full.

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About Star Pubs & Bars (part of HEINEKEN UK)

Headquartered in Edinburgh, HEINEKEN UK is the UK's leading pub, cider and beer business and employs around 2,300 people. We own around 2,700 pubs through our pubs business, Star Pubs & Bars. The vast majority of our pubs are leased out to small businesses and entrepreneurs with a supply agreement. Around 120 operate on our 'Just Add Talent' model (a low cost of entry managed operator agreement).

In 2018 Star Pubs & Bars won the Publican Award for Best Tenanted & Leased Pub Company (500+ pubs). Our ambition is to Build Britain's Best Pub Company – by attracting and retaining the best operators, investing to create great pubs at the heart of their communities and by providing licensees with market leading insight and support.

HEINEKEN UK's unrivalled portfolio of beer and cider brands includes Foster's, Heineken®, Strongbow, Desperados, Kronenbourg1664, John Smith's, Bulmers, Amstel, Birra Moretti and Old Mout, and is backed by a full range of craft and speciality brands.

Since the acquisition of Scottish & Newcastle in 2008, HEINEKEN has invested consistently and significantly in the UK. Over the past three years we have invested more than £100 million in our UK brewing operations (located in Hereford, Ledbury, Manchester, Tadcaster and Edinburgh). Over the last decade we've also been growing our pub estate, investing £190 million in our pubs since 2014.[1] Since the introduction of the Pubs Code Legislation in 2016, we've also trebled the size of our pub estate through the acquisition of 1,900 pubs from Punch Taverns.

[1] That investment figure in pubs excludes our recent acquisition of 1,900 pubs from Punch Taverns (a further £1.3 billion inward investment).

PART A: THE PUBS CODE

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?

Star Pubs & Bars are committed to the Pubs Code, both in word and spirit. Working with the best pub operators is at the very heart of our business model and we have a good relationship with the vast majority of our licensees. Overall we believe the Code has been working adequately since its introduction, but that there are significant opportunities for it to work better.

At the outset, we would point out that for the majority of our licensees, the Code has affected our day to day ways of working and relationship in ways many of them would not be aware of (such as additional discipline in terms of documenting business meetings).

As with any new system, it takes time to adjust and implement new processes. The Code impacts the majority of our colleagues across a range of different job roles, as well as most of our processes and interactions with licensees (this is very different to the Groceries Code which affects a relatively narrow group of Buyers within a retail organisation). It has been complex to implement because all parties had to adapt extremely quickly to the legislation being introduced - there was no transition period.

Taking the positives first, we believe the Code has given licensees more options, put rigour into processes and created higher levels of transparency. There is evidence to suggest the Code has been operating well in the following areas since 2016:

Better recruitment – there is better recruitment and on-boarding of licensees with improved transparency on all sides. The Code gives confidence that all parties operate to the highest of standards during the recruitment process.

As stated in our PCA annual compliance report[2], we offered 204 new leases with a supply agreement in the first PCA reporting period (July 2016 – March 2018). Each one of those applicants went through a rigorous recruitment process before they were offered an agreement with us. This included online application forms, an initial interview by our recruitment team, second stage interviews with a Business Development Manager (BDM), a visit to the pub as well as completing a business plan (and taking professional advice on that plan). We advise all potential lessees to complete appropriate industry training, such as from the British Institute for Innkeeping (BII). We also mandate that potential licensees attend our own Innside Knowledge course - a bespoke 5 day entry-level training course. In 2018 we trained 164 people from 138 pubs. While Star Pubs & Bars had these measures in place before the Code came into effect (and were signatories to the preceding voluntary Code), the legislation formalises and standardises this process across industry and between all parties - there is greater transparency on all sides.

This process has resulted in better informed licensees running pubs. The market continues to evolve, and we know that more and more people are running pubs as a business rather than a lifestyle choice.

[2] 'Pubs Code Regulation 43 Compliance Report Framework for Pub Owning Businesses: Star Pubs & Bars', Star Pubs and Bars, July 2018 (https://www.starpubs.co.uk/sites/default/files/misc_docs/PCAComplianceReportSPB.pdf)

This is backed up by the evidence – according to the Licensee Index (a thorough, independent, market survey of over 1,500 licensees by KAM Media)[3] – 18% of our licensees are now multiple operators (as at May 2019; and up from 16% in October 2018). That also puts Star Pubs & Bars above the big six average (14%). In addition, the data shows that the primary motivation for running a pub across all pub companies is 'running a profitable business' – the second biggest factor is to be at the centre of the community.

Better understanding of risk and reward – the Code creates a framework and licensees are using their right to request an MRO offer as a tool to negotiate a deal that works for them, which may be tied or free of tie. Many of our licensees are looking more broadly at the relative risk and reward of different models and are able to choose between the benefit of the tied model with its SCORFA benefits (special commercial or financial advantages) and higher risk & reward models such as longer free of tie agreements. As Europe Economics found in their thorough analysis of the impact of the Code[4], the MRO option may be being used by licensees and their advisers as a tool solely to negotiate an improved tied offer. We have also experienced this in many of our own cases.

The operational success of the Code must not be judged by the number of MRO agreements that have been granted. MRO is simply one element of many there to ensure that licensees get a fair deal – it absolutely does not mean that an MRO deal is the best option for licensees or something that every licensee would wish to take up. That a number of licensees are looking at MRO and choosing the lower cost, lower risk, high support of continuing their lease with a supply agreement proves that the legislation is working - as it means that licensees are able to see that they are no worse off and are choosing to remain on their supply agreement with us. MRO provides us with the opportunity to explain the benefits of the model and provide tenants with a choice.

We have examples across our estate to back this point up. For example, our licensee at the [Redacted] reviewed his MRO offer and decided he would remain on his lease with a supply agreement. They told us: *"I think MRO is good price wise and can work if you're a multiple operator with the right infrastructure in place. However, if you're on your own, you can feel a bit isolated. You soon realise that there are lots of things you don't get when you're a free trader. The support I get from by BDM is massive. There's also the training, the extras like garden umbrellas and the outside bar, which Star organised within six weeks.*

"When you're on your own you don't have access to insight on what's on trend as quickly, what you need to do legally, the health & safety paperwork and licensing information. So, it's great to have an umbrella organisation like Star do a lot of that work and feed through information in advance. I saw that if you're MRO you'd need to spend five days a week in the office, as opposed to one and a half days. I believe customers want to see landlords front of house, especially if you're a family operation like ours. If you're tied to the office, you lose a feel for the business. So that wasn't for me."

More flexible agreements in the market – the Code is driving a more flexible suite of agreements in the market. Licensees are looking more broadly at the relative risk and reward of different models. As outlined above, they are therefore able to choose between the SCORFA benefits of the leased &

[3] 'The Licensee Index 2018/19 Wave 2', KAM Media, May 2019
[4] 'Impact Analysis of the Statutory Code of Practice', Europe Economics, March 2019

tenanted model (special commercial or financial advantages) and the higher 'Risk & Reward' of commercial free of tie agreements.

Improved governance – there is more consistency, rigour and discipline in terms of ways of working, and greater clarity of expectations on all sides. There have been improvements in internal processes which has led to, and will continue to lead to, better services for licensees. For example, BDMs now have to produce business review sheets to document interactions and meetings with licensees which have to be provided within 14 days (although in many cases we send these the following day or sooner). The review sheet states that if the licensee does not agree with any aspect of the record they should respond to the BDM within 7 days of receiving it. Whilst we completed business review sheets prior to the Code coming into force, the legislation has certainly standardised this process and made it more robust.[5]

Good awareness of the Code – over the last three years, and as the legislation has bedded down, we know that more and more of our licensees are aware of the Pubs Code. This is backed up clearly by a number of pieces of evidence:

- We polled 500 Star Pubs & Bars licensees at our October 2018 regional licensee forums[6] – less than 1% thought the Pubs Code as was an issue for their business (business rates, retaining staff and other issues were more important). Licensees also told us they wanted more information about the Code from their BDM (39%) – over emails (20%), website (18%) and directly from the PCA (9%). 14% of respondents told us they either didn't want any more information or weren't interested in the Code. Nevertheless, we have listened and acted on these results – in Q1 2019, all our BDMs were sent PCA leaflets to distribute and raised the Pubs Code as part of the spring call cycle with licensees.
- Licensee Index[7] data suggests that Star Pubs & Bars ranks second out of the big six for Code awareness (7.6), but that we could be better at signposting sources/information regarding the Pubs Code. Between October 2018 and April 2019, Star Pubs & Bars improved in terms of signposting information on the Code to licensees (moving from 5.7 to 5.9 out of ten). The data also found both awareness and signposting by pub companies has improved considerably over the last 6 months.
- According to the PCA's Tied Tenant Survey Report[8], 72% of respondents claimed to be "quite" or "very" aware of the new regulation. This means that over one quarter (28%) of surveyed tenants declared themselves "unaware to some extent" of the regulation. However, this survey was conducted only 18 months after the Code's introduction.
- Finally, Europe Economics[9] also found there was good awareness of the Code considering the legislation is less than 3 years old. It also found awareness will increase as more licensees approach contractual trigger points.

[5] 'Pubs Code Regulation 43, Compliance Report Framework for Pub Owning Businesses: Star Pubs & Bars', Star Pubs & Bars, July 2018 (https://www.starpubs.co.uk/sites/default/files/misc_docs/PCAComplianceReportSPB.pdf)
[6] 'Star Pubs & Bars Regional Licensee Forums', Star Pubs & Bars, October 2018 (over 500 licensees were asked to vote at 9 regional events on interactive voting buttons)
[7] 'The Licensee Index 2018/19 Wave 2', KAM Media, May 2019
[8] 'Tied Tenant Survey: Report', Pubs Code Adjudicator, 2018. The survey received responses from 388 tenants, and conducted more in-depth follow-up interviews with a sub-sample of 27 respondents.
[9] 'Impact Analysis of the Statutory Code of Practice', Europe Economics, March 2019

More transparency – there is greater transparency about the process and all parties can learn from the publication of arbitration awards. Star Pubs & Bars was one of the first pub companies to call for the publication of arbitration awards to help bring greater transparency, openness and clarity for pub companies. All 6 pub-owning businesses made a voluntary industry pledge and agreed to a series of principles regarding publication in April 2018[10]. Arbitration awards are now made available on the PCA's website which has helped increase understanding on all sides on what to expect.

We have, however, been disappointed that we have been unable to reach agreement with the PCA on the redactions to arbitration awards that we believe are necessary, prior to publication on the PCA's website, to protect what we deem to be commercially sensitive information. This issue is particularly acute where the arbitrator determines it appropriate to include granular detail of parties' negotiations in the award or its appendices, which we believe is of commercial prejudice in terms of publicising our commercial strategy.

In one particular case where such information was included, this left us in the unfortunate position of having to choose between withholding our consent for publication (which is our legal right), and upholding the voluntary commitment we made to Government to support publication (even where we feel the terms of that commitment have not been upheld by the PCA). In that case, having been given a very short deadline by the PCA to give our final consent we reluctantly agreed to publication in that particular case. However, going forward we very much hope that a more reasonable position will be taken that appropriately balances the need for transparency against the need to respect commercial confidentiality.

Quicker resolution of cases – now that the Code has been in place for over three years, the evidence certainly suggests that the historical backlog of cases is being dealt with, although this is still work in progress. The PCA and pub companies are seeing fewer complaints and inquiries in and this is backed up by the PCA's own data. In the first two months of the Code coming into force (July and August 2016) there were over 219 complaints into the PCA's office. This levelled off in the same two months in the following years – there were only 23 complaints in July/August 2017 and 30 in July/August 2018.[11]

While we see these positive aspects to the Code, we are increasingly concerned that the PCA is creating confusion for all parties with a subjective and inconsistent approach to decisions and interpretation of key elements of the Code, which undermines what is often otherwise a positive commercial relationship. There are areas where the Code could be working significantly better:

Subjective approach to decisions and lack of clarity on an MRO compliant agreement - our hope was that the Code and the PCA would provide a clear, unambiguous framework that would support open and transparent discussions between pub companies and licensees. Having engaged with the PCA in an open way, disclosing a copy of our standard MRO agreement repeatedly, we expected that the PCA would provide clear feedback, suggest changes and ultimately tell us if there were particular clauses or provisions which are unlikely to be non-compliant – therefore avoiding the need for any licensees

[10] 'Agreement reached on pubs code confidentiality', Morning Advertiser, 25 September 2018

[11] 'Pubs Code Adjudicator: Parliamentary Written question – 250428', Department for Business, Energy and Industrial Strategy, May 2019 (https://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/commons/2019-05-02/250428)

to dispute or refer to adjudication. This would provide certainty to pub companies and to licensees, speed up the process, reduce conflict, and allow the PCA to focus on the more complex cases. Unfortunately to date our efforts to seek to have the PCA streamline matters in this manner have not been viewed constructively by the PCA.

Not only has the PCA refused to do this, the adjudicator's office has created even greater confusion. The PCA states that when considering whether an MRO agreement is compliant, the decision will be based on a subjective view of what is reasonable for the individual pub and licensee including their personal circumstances and the terms of their existing tied lease. This is leading to a bizarre situation where the PCA can find standard MRO terms acceptable for one pub, but not for another pub, which has led to uncertainty, unpredictability and delay.

This subjective approach has created a situation where it may be impossible as matters currently stand for a pub-owning business to issue an MRO-compliant tenancy at the outset, with the associated costs (principally borne by the pub-owning business) and delay in respect of the arbitral process creating a negative experience for all concerned.

The PCA is asking pub companies on a case by case basis to justify to granular levels as to what are common terms in the market, and what is reasonable for the licensee given their individual circumstances. It means that rather than taking an objective view on whether the MRO offer is in line with commercial agreements available in the market (i.e. fulfilling the test of whether a licensee is no worse off than if free of tie), the PCA can require changes which deliver a more advantageous agreement than would be available to other licensees seeking a commercial free of tie agreement.

Not only does this approach create confusion, significant cost and complexity for all parties, it is also a false reading of the legislation. This approach is quite different to the wording of the Code, which requires (i) that agreements do not contain uncommon terms and (ii) the objective and logical interpretation of the reasonableness test relating to terms in the context of the market for free of tie pubs – which implies a more objective and market-driven approach. As noted above, an increasing number of our licensees are multiple site operators and may anticipate a similar, if not identical, approach being adopted in negotiations in relation to multiple pubs. We have seen this approach from advisors, who consider in many instances that the same commercial concessions reached through negotiation should apply to all of their clients.

The Act states that a tied licensee should be no worse off than a free of tie licensee. It does not state that a tied licensee, who chooses to go down the MRO route, should be no worse off (or better off) than when they were tied.

A subjective pub by pub approach may be viewed as attractive. However, for the reasons described above it leads to confusion, uncertainty and conflict and will mean more cases will go to arbitration – this is clearly demonstrated in the number of cases referred to the PCA. It makes it extremely difficult for pub companies to manage their estate and support licensees when individual agreements can vary significantly. Over time it creates an uneven playing field where some licensees benefit from preferential treatment not available to existing tied or other commercial free of tie licensees. We believe this could be easily resolved if the PCA were to accredit each of the pub companies' standard MRO agreements as being compliant.

We believe that the PCA should now be in a position to understand the types of terms which are commonly debated between the parties. If the PCA could produce some approved short form clauses and explanatory notes, this would assist parties in agreeing these terms and prevent the same issues being raised (and determined) time and again. As a result, only the truly contentious/complex issues will come before the PCA, which should streamline the adjudication process and reduce time and cost.

By way of example, the Property Standardisation Group[12] was formed by four Scottish law firms in 2001 to produce agreed forms of documents for Scottish commercial property transactions. These documents are frequently used in commercial property transactions to reduce time spent negotiating the more straightforward or trivial clauses, thus allowing parties' representatives to focus on the more substantive issues of the contract.

Unrealistic expectations of some licensees are exacerbated by unqualified and unaudited advisers – the legislative framework and MRO process is complex and technical, and we always recommend that our licensees take independent advice on what the best option is for them. Some licensees are not being well advised as to realistic outcomes from the arbitral process and there are a group of advisers who have a modus operandi of simply deferring cases to the PCA – also known as 'protective deferrals'. This is stopping pub companies from taking the time to negotiate with licensees, is distorting the numbers and ultimately adding to the PCA's workload. As at June 2019, over a third of our 28 cases with the PCA are being advised by two Pubs Code campaigners alone.

Meanwhile, there are activist advisers who are on the record as opposing the principle of the leased & tenanted model – this is unhelpful and stops us from having meaningful conversations with licensees. We want our licensees to make balanced and informed decisions and are concerned activists and unaccredited advisers are not acting in their best interests. Ultimately we want the best outcome for licensees and believe the PCA should work with tenant organisations to develop a list of suitable and recommended advisors, or alternatively an accreditation system (pub companies would simply be accused of bias if we were to help develop this list).

Even if the PCA felt unable to develop a list of authorised advisers, there should, at the very least, be far better signposting from the PCA about where licensees can get advice from experienced professional bodies governed by codes of practice. As an example, and by way of comparison, where an individual is signing a bank guarantee there is a requirement to take independent legal advice from a solicitor. Another example is where a lease is being "contracted" out of the Landlord and Tenant Act 1954, licensees need to be separately advised of the consequences, with the documents to be signed before an independent solicitor or notary public. We firmly believe that licensees should have better protection against unaccredited advisers and more support in knowing they are getting good counsel.

Blurred lines between regulator and arbitrator – this issue is a concern which we outline in further detail in our response to Question 5c.

Overall, we believe there have been some positives since the introduction of the Code, but that there are a number of changes which should be made to make the legislation work more effectively – we outline these in more detail in our response to Question 4.

[12] http://www.psglegal.co.uk/

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 that the Code is consistent with this principle. The transparency for incoming and existing licensees at rent review and renewals mean that all licensees have absolute clarity on what is being offered. There are clear timetables for decision making points and the obligations on us as a pub company to deliver these.

The principle of fair and lawful dealing was considered by Government to "*be understood as requiring the Pub Company to conduct its relationships with Tenants in good faith, without distinction between formal or informal arrangements and without duress*".[13] We believe the MRO option goes further, in allowing licensees to move to a different agreement at certain trigger points and giving licensees additional negotiating power. The PCA and arbitration routes ensure that a licensee has further recourse if there are any issues, including those in relation to rents and lease terms, that cannot be resolved amicably. These structures are funded by us and other pub companies at significant cost.

The legislation (section 42(3) of the 2015 Act) is clear in providing that the Secretary of State must seek to ensure that the Pubs Code is in line with the principles of fair and lawful dealing and that tied tenants should be no worse off than if they were not bound by any product or service tie. We consider this to be a clear signpost for the Secretary of State alone to apply in the creation and maintenance of the Code and these are not principles for the PCA (or any other arbitrator) to apply in assessing the reasonableness of any particular lease term.

Despite the above, we are aware of cases where the PCA has applied the reasonableness, "fair and lawful dealing" and "no worse off" tests to the pub-owning businesses choice of MRO vehicle and in one case, required that the pub-owning business provide a revised response in the form of a deed of variation. The issue of the choice of lease vehicle (and the PCA's interventionist approach in this regard) has been recurrent in multiple referrals. The PCA's Advice Note of March 2018 states: *"If the pub owning business proposes a <u>new tenancy</u> for the MRO proposal without good reason, and this disadvantages the TPT (Tied Pub Tenant), then the tenancy can be noncompliant for containing unreasonable terms or conditions."*[14]

This approach to new tenancy contradicts the statement made by Baroness Wheatcroft during a debate in the House of Lords, which indicates that the legislative intention was for MRO to be achieved by way of new lease: "*We need to spell out that if a tenant opts for a market rent only deal, there should be a completely new agreement between the tenant and the landlord, and that should take in everything, from investment to the length of lease—it is a new lease, effectively. We should spell out that there is freedom to renegotiate there.*"[15]

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[13] 'Pub Companies and Tenants: A Government Consultation', Department for Business, Innovation and Skills, 22 April 2018 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/363475/13-718-pub-companies-and-tenants-consultation.pdf)

[14] 'PCA Advice Note: MRO Compliant Proposals', Pubs Code Adjudicator, March 2018 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685133/2018_03_02_PCA_Advice_Note_MRO_Compliant_Proposals_11.05.pdf)

[15] House of Lords Debate, 28 January 2015, Hansard Col GC108, (http://www.publications.parliament.uk/pa/ld201415/ldhansrd/text/150128-gc0001.htm#15012858000194)

Even if the MRO tenancy can be achieved by way of either vehicle, this is not something which the legislation intends to be subject to the determination and direction of the PCA. While the terms and conditions of an MRO tenancy must be reasonable, this reasonableness requirement does not extend to the vehicle used to deliver the MRO tenancy. If the choice of vehicle is subject to a reasonableness test (which we refute), it is for the licensee to show that it is unreasonable. The onus should not be on the pub-owning business to show that the vehicle is reasonable.

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?

There are huge numbers of pubs on the open market across the UK– whether it be free trade, leased & tenanted or managed pubs[16]. In no other market are there so many different options. There are many budding entrepreneurs out there who have the talent and a vision for how they could build a successful business - but the costs, risks and lack of access to expertise acts as a barrier to entry. Many would struggle to afford the cost of purchasing a free trade pub outright. That is why they choose a leased & tenanted pub.

The leased & tenanted model allows licensees access to their own pub business for a comparatively small investment, while benefitting from our economies of scale. There is choice in the market. Licensees could choose a free trade pub (and work with a bank) but others would rather work with us. Licensees are not forced to be 'tied' – they choose to rent a pub with us with a supply agreement. We provide training, support and expertise to help licensees to grow their business and in many ways our licensees are 'better off' by working with us, their pub company.

As we have outlined in our response to Question 1, the operational success of the Code must not be judged by the number of MRO agreements that have been granted. MRO is one element of many to ensure that licensees could be sure that they were getting a fair deal – it absolutely does not mean that the MRO deal would be the best option for licensees or something that every licensee would wish to take up.

That a number of licensees are looking at MRO and choosing the lower cost, lower risk, high support of continuing their supply agreement proves that the legislation is working - as it means that licensees are able to see that they are no worse off and are choosing to remain with us. MRO provides us with the opportunity to explain the benefits of the leased & tenanted model. That includes:

> i) Investment – we have invested over £190m in our pubs since 2014 which includes over 630 major pub refurbishments. In 2019 we are on track to spend £50 million on our pubs – within that around 150 pubs will receive a transformational refurbishment of over £250,000. It is not just about our financial investment support - when making our investments, licensees get the benefit, expertise and skills from our teams of investment managers and third party contractors and suppliers. For each refurbishment project, we also appoint an Investment Support Coach – an experienced trainer who works with licensees during the project. They help deliver the business plan, reviewing marketing offers, pre-opening training for the team,

[16] There are over 50,000 pubs in the UK, BBPA data, November 2016 (http://beerandpub.com/wp-content/uploads/2018/03/Pub-numbers-non-members.xlsx)

marketing and merchandising advice, agreeing post project objectives and generally providing honest, independent feedback on the refurbishment plans.

ii) Business help, insight and support – our licensees have guidance and support from their local BDMs to help them grow their businesses. This includes providing advice on the business plan during the bi-monthly call-cycle, retail marketing and product support, to informal advice and simply being on the end of the telephone for an opinion. Our BDMs also host events and forums for groups of licensees at a local level where licensees receive market insight on current trends, category support from third party suppliers and retailing tips, plus ideas and opportunities to help them grow their businesses. Our scale allows us to bring together licensees to network and engage with each other – we know they value these events and the network we help provide. In fact, we arrange these events in direct response to feedback from our licensees who tell us they want more opportunities to network with each other. We hosted licensees from 536 pubs at our 9 regional licensee forum events led by our Regional Operations Directors in October 2018. We then hosted a further 40 licensees at our National Licensee Forum in Amsterdam bringing operators together to share best practice, hear the latest industry trends, and to network. In addition to our regional and national events, in 2019 we will host approximately 1,200 – 1,500 licensees at local BDM events in pubs as well.

iii) Training – we support our pubs with training. In the first half of 2019 alone we have hosted 20 one day Passion for Quality workshops (covering all aspects of cellar and bar management, such as how to get the best out of cask ales) averaging 14 people from 8 pubs on each day, with plans for another 20 workshops planned in Q2. We also provide access (and negotiate a discount for licensees to) the CPL eLearning platform[17]. With over 40 modules on the platform, to date over 11,700 modules have been completed by our licensees. We have committed to funding 100 apprenticeships across our estate in 2019 and have already had 60 enquiries in the first two months of the scheme. We launched our online 'Business Breakfasts' last year – available publicly on Facebook, these cover subjects such as Making Tax Digital, Cleaning Beer Nozzles and Social Media Photography – and in the first half of this year these 2 minute videos have had 60,000 views.

iv) Promotional deals – we negotiate deals with larger suppliers e.g. Sky to give licensees access to the best deals and to help them reduce their costs (for example, our deal with waste management company BIFFA to reduce pub waste management costs, saves our licensees an estimated £1,000 each per year).

v) Retail marketing support – we provide our licensees with regular hints and tips on how to maximise retailing events throughout the year, from busier trading periods (such as Halloween, big sporting fixtures and Christmas) to slower months (such as January 'bounce back' initiatives). Examples include support through our weekly Sunday Night email, bi-weekly Pub Life email, bi-monthly Discover Star Magazine, annual retail marketing calendar, and online point of sale support (where licensees can order and tailor their own point of sale support). In addition, we provide activation ideas and promotions through our beer and cider brands as well as through third parties. We also have an accessible 'support library' with ten

[17] CPL provide digital learning and team engagement tools for food and drink focused businesses across retail, manufacturing and hospitality (https://www.cplonline.co.uk/about/)

modules of marketing advice – from hints and tips on how to hold a successful event, to how to maximise PR and advertising.

vi) Legal, compliance and property – we provide licensing support, conduct age verification visits, and support with general compliance and advice. We also conduct 'mystery shopper visits' at each of our pubs, which allows our BDMs to have positive conversations with the licensee on how to improve and grow their business.

None of these areas of support outlined above would be provided by commercial landlords. We are confident that the leased & tenanted model has its benefits. We are firm believers that when the model is run transparently and collaboratively it offers significant benefits to licensees and has a role to play in the broader pub ecology alongside managed and free trade pubs.

It is also true that many licensees do not realise the true value of these benefits - and that is backed up by the evidence. A report published by the Scottish Government in 2016[18], found that many licensees (tied and partially tied) undervalued their SCORFA benefits, and many lacked an understanding of these potential benefits available to them.

The Code also seeks to meet the principle of a tied tenant being 'no worse off' through the MRO option. This clearly provides a mechanic, whereby at certain trigger points, the licensee can consider their current or a new tied deal versus an MRO-agreement – before deciding whether or not they are indeed worse off with a tied agreement.

Europe Economics[19] found that the MRO option may also be being used by licensees and their advisers as a tool solely to negotiate an improved tied offer, and that this could have detrimental effects on the tied pub market (insofar as it could lead to lower overall investment in leased & tenanted pubs). It also claims there is a need to take caution in estimating the 'transfer of value' and how much better off licensees are. This is because it is difficult to quantify the intangible benefits – which are unique to each pub, and unique to the experience and skill of the licensee.

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

As outlined in our response to Question 1, we think the Code is working adequately and major changes are not needed to the legislation. It is important that Government and all stakeholders recognise the benefits of the leased & tenanted model – any changes to the Code should not undermine the viability of this business model. However, we do think there are a number of areas which should be changed to help bring greater transparency and simplification to the system:

1) Clarity on what an MRO compliant lease looks like – the PCA should be able to accredit pub company agreements and provide clear guidance on what form of agreement is compliant. As outlined above, at the moment the PCA is taking a very subjective approach to decisions at a pub by pub level which is adding complexity and cost. A simple framework, based on a standard non tied pub lease

[18] 'Research on the pub sector in Scotland phase 1: scoping study', Scottish Government, Economic Development Directorate, 6 December 2016 (https://www gov.scot/publications/research-pub-sector-scotland-phase-1-scoping-study/pages/5/)
[19] 'Impact Analysis of the Statutory Code of Practice', Europe Economics, March 2019

used in the investment market, would avoid the need for time consuming PCA referrals and fees to advisers on both sides.

2) Clarity on whether the PCA is able to determine lease length – as outlined in section 5(c) below we have concerns with the way in which the PCA has determined specific lease lengths in decisions. We are appealing an arbitration award on this issue, and we hope our appeal will help bring greater clarity on this point as we believe it was never the intention of the Code to set commercial terms. In respect of the length of terms to be offered in MRO leases it is contended that intervention by the PCA or an arbitrator requiring a pub-owning business to go above and beyond the agreed lease term has potential to disrupt the market.

3) The PCA should develop a list of independently audited & registered advisers – so licensees know they are getting good counsel, and to stop unqualified advisers. The PCA should work with the BII to develop a list – the BII is well established having been set up 40 years ago and has a national network of 8,000 members.

4) Technical changes to legislation – we believe that there are a number of smaller technical changes to the legislation which could be made to help ease and simplify the process, such as:

(a) extend timescale for discussions on the MRO lease content (14 days) and subsequent negotiations (56 days) as the current time is insufficient for quality negotiations resulting in premature referrals to PCA. We believe extending the 14 day period to 28 days would provide a more meaningful timeframe.

(b) for annual prices the comparison period should be 4 weeks starting on the 12 month anniversary, not ending on the 12 month anniversary. Currently, a price increase of 13 months after the previous could be counted as a single "annual" price rise in terms of a trigger event which is not the intention.

(c) existing tenants with a good business model should be given the option to 'fast track' their application for a new agreement (i.e. rather than having to produce a detailed business plan for a second time which is adding delays and costs to all parties).

(d) we would welcome further clarity and engagement with the PCA on changes to how and when Rent Assessments Proposals are concluded, and also their interaction with contractual tied rent reviews.

(e) allow the introduction of a new MRO lease during the currency of an arbitration. The PCA encourages both parties to continue to communicate and negotiate while an MRO referral is ongoing. As a result, parties are often able to reach agreement on certain elements of the MRO lease and some cases, this results in the pub-owning business issuing a new MRO lease to the licensee while the referral is still ongoing. In this situation, the PCA has two options when determining the dispute: (1) find that the legacy MRO lease as issued was non-compliant; or (2) recognise the pragmatism of the negotiations that have taken place and issue an award (based on the up to date lease as opposed to the terms of any legacy lease, acknowledging that terms of the legacy lease are no longer in dispute).

To date there has not been a consistency of approach and we have seen instances where both parties have been content to proceed on the basis of the new lease but the PCA considers it

necessary to deal with the legacy lease before proceeding. We think the second approach outlined above would be more efficient and appropriate, and it would avoid the PCA incurring needless time considering matters which are no longer at issue. In addition, the PCA could make an adverse finding on a point no longer in dispute, which could potentially damage the pub-owning businesses reputation needlessly, given that the clause has since been agreed/modified/removed. Neither party should be penalised for narrowing down the scope of the dispute mid-referral.

5) Consider excluding arbitral awards under the Code from the statutory right of appeal - the statutory appeals process arising under the Pubs Code requires any appeal to be referred to the High Court under the Arbitration Act 1996. This is an adversarial process which involves the licensee (as both Claimant to the initial arbitration and Respondent to the High Court appeal) and is often unnecessary where the grievance subject to appeal concerns the PCA or alternative arbitrator's determination in the referral. It also exposes the licensee to expenses and further strains the relationship with the pub-owning business.

In the eyes of licensees this may be unexpected and, insofar as we are aware, this is not set out as a potential consequence or risk in seeking to exercise the MRO option. In one instance, this has been viewed by a licensee as effectively expecting that licensee to defend the decision of the PCA in proceedings where the PCA may not apply to become a party.

We believe that it would be appropriate to consider an alternative method of review of arbitral awards rather than solely providing the statutory right of appeal under the Arbitration Act 1996. In this regard, it would be helpful to consider whether such decisions could be subject to challenge by a pub-owning business by way of a review procedure undertaken by a third party decision maker, with submissions from the arbitrator and pub owning business (and with participation from the licensee being optional).

Judicial review may offer such a remedy, albeit only insofar as a court considers any award to possess the necessary "public" element to attract such a remedy. While the matter is untested in the context of an arbitral award under the Pubs Code, the availability of such remedy may be limited if a court considers such an arbitration to be a private law dispute between the parties, notwithstanding the PCA (or an alternative arbitrator appointed thereby) exercising a statutory function.

The benefit of a third party procedure over an appeal under the Arbitration Act 1996 (or any uncertainty over judicial review) is that the pub-owning business (or, if launched by a licensee, that licensee) would be the principal party to the proceedings with the arbitrator as respondent. Any involvement on the part of the licensee (or pub-owning business where proceedings are launched by a licensee) would be discretionary.

6) Protect our right to brand stocking – legislation must continue to recognise that brewers who own pubs (as HEINEKEN does) should have a right to ensure that their own products are stocked, and direct competitor brands can be reasonably restricted. We outline our views on this issue in Section 9 below.

7) The political focus must be on helping all pubs (leased & tenanted or otherwise) on serious measures facing them – business rates, beer duty, and need for fairer & balanced system of regulation. It is important to remember that the Pubs Code does not apply to all licensees in E&W – of 48,350 pubs in the UK in 2017, only 16,300 of those (34%) are leased & tenanted. Within that, even a smaller

number are covered by the Code (an estimated 6,000 of those 16,300 pubs are owned by pub-owning businesses with less than 500 pubs and are therefore not covered by the Code).[20]

[20] BBPA Figures, Response to the Statutory Review of the Pubs Code, July 2019.

PART B: THE PUBS CODE ADJUDICATOR

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?

As we outlined in our response to Question 1, the PCA's office took time to set up and there was a historical backlog of cases to get through. It took time for the office of the PCA to be established, in part due to the lack of legislative implementation period. These delays did lead to an initial frustration with the PCA on all sides. However, it is also clear from that evidence that the historical backlog of cases is now being dealt with and the operational process has become quicker and clearer over time as more cases have moved through the system.

It was unhelpful that the PCA was opposed by campaigners even before he commenced his duties by the small group of very vocal lobbyists in this area. The appointment of a Deputy Pubs Code Adjudicator helped in terms of speeding up the number of cases reviewed. We firmly believe that there are benefits of having a balance of expertise in the adjudicator's office in terms of legal as well as commercial and property experience.

[Redacted] attends meetings twice a year with the PCA to discuss Pubs Code issues that affect our business, while [Redacted] attends the quarterly CCO meetings with officers from the other five pub-owning businesses. While it often takes some time for the PCA to send through the minutes and actions of those meetings, in our dealings with the PCA's office we consider that they have been holding pub companies to account and have generally performed in a satisfactory manner. However, there is scope for significant improvement, and engagement could be more constructive.

The PCA often takes a long time to come back on our correspondence on arbitration cases, then expects responses within an exceptionally short (and what we consider to be an unreasonable) timeline. On some cases and issues, we hear nothing from the PCA's office for prolonged periods (often months), before calls and meetings are arranged at minimal notice. We outline some examples:

- In one referral, we received directions on the afternoon of Thursday 27 December requesting we disclose *"all file notes and records, including but not limited to notes of conversations between the executor and BDM, estate manager or other employee or agent of the Respondent",* in addition to a case update by 3 January 2019. This allowed only 7 days, 4 of which were non-working days, to collate, review and consider what could be a significant volume of documents. This would be a challenging timescale in any event, however was exacerbated by staff holidays which could be reasonably anticipated, and public holidays (our business is also headquartered in Scotland where public holidays include both 1 and 2 January).
- In another referral, we were directed to come back to the PCA with further cost submissions within 7 days, which again included 4 non-working days (due to the weekend and public holidays).
- We are also regularly requested to submit our position as to the consent to publication, and redactions of arbitration awards within 7 days, irrespective of the complexity or nature of the award.

Similarly, we believe it would be helpful to have clearer timeframes on our annual Pubs Code compliance reporting requirements. As it currently stands, we are not given the report in its final format (i.e. the detail on what we are required to report on) until after the end of the reporting period. It would be helpful if we were told at the start of the reporting period what information we should be collecting. This would allow us to provide better information and data in our report.[21]

We want to work collaboratively with the PCA to resolve issues. We have been frustrated at times that the PCA has not given us clearer, more specific, detailed and practical guidance. We think there are opportunities for the PCA to give us better quality guidance - and to improve their engagement with us on the implementation of it, both formally and informally. The PCA could be much clearer in terms of what they require and want from us.

The PCA's lack of proactivity in terms of telling us whether an MRO agreement is compliant or not is causing unnecessary issues (which we outline in our responses to Questions 1 and 9). The PCA is taking a very subjective approach to decisions and this risks making the process overly lengthy and complex and is ultimately more costly for both pub companies and licensees.

In addition, please comment on:

a) Whether the PCA has sufficient and proper powers to enforce the Code effectively.

It is a matter for the Government to consider which powers should be at the PCA's disposal. The PCA's office should use those powers as they see fit (subject to the below). If the PCA has evidence that pub companies are not behaving with the spirit of the Code, and, despite his warnings, are continuing not to behave within the spirit of the Code, the PCA should take whatever action he believes necessary to call out or end these practices.

These powers should clearly be exercised fairly, impartially and in a balanced manner. The PCA engages with pub-owning businesses regularly in a regulatory capacity, and there is ample opportunity for issues or concerns to be addressed in advance as opposed to being first rehearsed through arbitral awards.

It is in the interest of licensees and pub-owning businesses that any potential compliance issues be discussed between parties and resolved in early course. We would welcome discussion with the PCA proactively on such matters, to avoid investigation where discussion at the time would have been capable of resolving such matters.

b) How effective the PCA has been in exercising his powers. What has been done well and what do you think could be done differently.

Please see our response to the question above.

c) How effective the PCA has been in enforcing the Code. In particular, how effective has the PCA been in undertaking the following? Giving advice and guidance; investigating non-compliance with the Code; where non-compliance is found, requiring publication of information, imposing financial penalties or making enforceable recommendations; and arbitrating disputes under the Code.

[21] As per the regulations, all compliance reports are available on our website (https://www.starpubs.co.uk/sites/default/files/misc_docs/PCAComplianceReportSPB.pdf)

Giving advice and guidance - in some instances, the PCA's guidance effectively creates a Code within a Code or more layers of compliance, when we consider that really it should be about improving culture and behaviours (e.g. Regulatory Compliance Handbook, December 2018).

It is also important the PCA does not react to anecdotal feedback and often unsubstantiated arguments – and there is a balance to be struck in terms of the cost and benefit in some instances. For example, providing greater clarity on sediment allowance and operational waste in rent assessment proposals to tenants will create more transparency, but the complexity of the final requirements arguably went beyond a reasonable and proportionate approach, and may create more confusion than it seeks to deliver.

We also believe the PCA's original proposed timescales for implementation of that guidance were entirely disproportionate – giving us less than four working days to implement fundamental and far reaching changes to our rent modelling processes and systems. Despite the PCA consulting on the guidance, they expected us to invest implementing significant business-wide changes by pre-judging the outcome of a consultation, one which we hoped (and expected) would be evidence based and fair. While we are pleased the PCA has now shown more pragmatism on timings, the PCA could be better at developing clearer guidance which better understands the commercial nature of pub-owning businesses.

Investigating non-compliance - if the PCA has evidence that pub companies are not behaving with the spirit of the Code, and, despite his warnings, are continuing not to behave within the spirit of the Code, the PCA should take whatever action he believes necessary to call out or end these practices. As outlined above, whether it is naming and shaming, investigating, producing clear guidance or ultimately issuing fines – the PCA should use his powers as they see fit, in a proportionate and reasonable manner.

Arbitrating disputes under the Code: increasing numbers of alternative arbitrators – the appointment of alternative arbitrators is provided for in the legislation, but it has been the PCA's practice to appoint alternative arbitrators in all new referrals since March 2019. This is a departure from the PCA's Factsheet 14[22] which indicates that there will be a presumption that the PCA will arbitrate the majority of referrals.

We are keen to ensure that any alternative arbitrator appointed will have an understanding of tied pubs, leases and tenancies. To date, the approach adopted by arbitrators has been mixed, with significant variations in familiarity with the Code and the granularity of the awards pronounced. This creates an uneven playing field for both licensees and pub-owning businesses.

We are unsure of the training that the PCA's proposed alternative arbitrators have been given or their knowledge of the industry, or whether any criteria exist to which the PCA has reference in proposing an appointment. We understand from the PCA that a familiarisation session has taken place for interested arbitrators, although this is not a mandatory session. We propose that this session be mandatory and expanded into formal training, supplemented by written guidance provided to all potential appointees.

[22] 'Fact Sheet 14', Pubs Code Adjudicator, 7 March 2017 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/607205/17_04_07Arbitration_-_Factsheet_14FINAL.pdf)

The PCA has indicated to us that "*Arbitrators are appointed by the PCA upon consideration of the recommendation of a relevant institution, who has identified an individual having considered the essential and desirable skills and experience requested. The PCA requests that arbitrators have knowledge of the negotiation of contract terms and it is desirable (but not essential) that this is in the hospitality industry, preferably the pubs industry*."[23]

Given the Code remains a relatively new and novel area of law it would be beneficial to both parties that any arbitrator be fully familiar with its provisions and operation - to ensure a consistency of approach, reduce the initial preparation required and facilitate better decision-making. One solution may be to establish a small panel of arbitrators in the same way as has been done with rent assessors, with appropriate training in relation to the Code provided. We could see a potential benefit of such arbitrators being appointed from a pool of those with existing experience of property disputes.

There is currently no mandatory or prerequisite Pubs Code knowledge or training required, so additional delay time and costs are being incurred by arbitrators who are new to this area "reading in". In some instances this has been exacerbated by cases being referred by the PCA to an alternative arbitrator at a very late stage of proceedings, often where only tangential or administrative work remains outstanding. In such instances it may have been preferable for all parties for the PCA to have retained control and to have brought the proceedings to a conclusion.

Arbitrating disputes under the Code: increased cost to business due to increased appointment of alternative arbitrators - prior to March 2019 the majority of arbitrators were determined by the PCA or DPCA, whose expenses were charged at £160 per hour. The PCA has confirmed to us that there is no statutory cap on the amount of the alternative arbitrator's costs or any associated hourly rate[24]. As the costs are not capped, pub-owning businesses now face a wide variety of costs potentially charged in each referral, and have lost the ability to accurately budget costs for referrals.

Given the rates presently charged by the arbitrators instructed on matters pertaining to Star Pubs & Bars, the cost to business has increased by a significant margin. The lowest hourly rate currently charged is £180, with the highest at £450. Across the 15 arbitrators appointed the average hourly rate is £317, notwithstanding there are other potential costs for hearings if set down (with a day hearing at a charge of up to £2,800). This represents an average hourly increase of £157, which is a substantial rise in the costs ultimately borne by pub-owning businesses. We have also experienced arbitrators requiring deposits to be paid of up to £10,000 in advance of the arbitration progressing.

In order to address the inconsistency of cost, and to allow us to effectively budget and evaluate the cost to business, we would suggest that the PCA impose a standardised hourly rate for any alternative arbitrators to reflect the rate currently payable to the PCA, who is presumed to be the expert in these cases.

Separately, before the formal arbitral process commences we consider there would be merit in introducing a mandatory requirement for mediation between the parties. This would allow parties to ensure that all opportunities at resolution prior to the time and cost of arbitration commencing are

[23] Letter from the PCA to Star Pubs & Bars, 11 March 2019.
[24] Letter from the PCA to Star Pubs & Bars, 11 March 2019.

exhausted. This would provide a framework for constructive, timely and cost-efficient negotiation as opposed to such negotiation being drawn out through the arbitral process.

In view of Factsheet 14 it had been presumed that the PCA would be arbitrating in the majority of referrals, and as a result of the fees the pub-owning business being levied by alternative arbitrators this is putting additional layer of unpredictable expense on top of an already costly regime. Failing which, we would recommend that the PCA consider the hourly rates proposed by arbitrators at the appointment stage, in order to avoid hourly rates which are nearly triple that of the PCA's.

Further, the PCA should advise arbitrators when appointed that as the pub-owning business bears the cost of the arbitration as a statutory obligation, other than in limited specific circumstances, interim billing may be more appropriate, as opposed to large deposits.

Arbitration determinations: concerns with way PCA is determining lease length - we have concerns with the way in which the PCA is determining the length of lease in the arbitration process, a subject on which we are currently appealing a decision. Our initial consideration is to offer a tied pub tenant an agreement which is as long as the remaining term of the existing tenancy (as stipulated within the Pubs Code), or a term of 10 years – whichever is longer, however the term offered is assessed as part of the wider Estate Management strategy and at all times we retain commercial discretion over this policy - a different term may be offered for reasons of good estate management, and this discretion is exercised in full compliance of the relevant legislation.

In two cases, the PCA has stipulated that we serve a proposed MRO lease length for a specific length of time (one of which we are appealing). Under the statutory regime, the PCA only has the power to order us to provide a revised or suggested response, but no power to specify the term of any such revised response. Parliament set out clear powers on what the PCA could determine. This included setting the level of rent but not the length of the lease. In fact, Parliament was specific that it would be reasonable and MRO compliant to offer at least the unexpired term of the lease – which is what we did on these occasions. We believe these awards interfere with our ability to freely conduct business and negotiate commercial contracts with licensees, and is contrary to the objectives of the original legislation, and this is why we are appealing one of them.

Arbitrating disputes while regulating - we are also concerned about the increasing blurring of the lines between the PCA's role as arbitrator versus regulator. The PCA makes very clear on their website of "the need to separate the roles of regulator and arbitrator" and that "parties to arbitrations are entitled to have full confidence that the arbitrator has no conflict of interest and conducts arbitrations fairly". This language clearly suggests the PCA will keep its dual functions separate and does not permit information obtained in its regulatory role to be used in its arbitral role.

We are concerned about the blurring of lines between these two areas of their responsibilities. We have recently appealed an arbitration decision where the PCA used information (which we consider to have been interpreted erroneously) which we had given in accordance with our regulatory obligations in reaching an arbitration decision. The PCA specifically said; "When acting as arbitrator and managing an arbitration, I cannot 'un-know' information that I have received as regulator."

This is a clear conflict. The original legislation did not envisage this kind of blurring of the lines between arbitrator and regulator. This case has put us in the difficult position of having to either comply with regulatory obligations to provide information requested by the PCA (which can then be used against

us in a private arbitration with a licensee), or refusing to comply with our regulatory obligations (which is a criminal offence under the 2015 Act).

Arbitration proceedings are based on very clear rules. Among these are that the Awards are decided based only on the information provided by the parties. This is a principle that until now the PCA has stuck to, but in this particular case quite clearly the DPCA used information provided in a regulatory capacity outside of arbitration without the consent of the parties to the arbitration. This raises three concerns; firstly that the DPCA has breached the PCA's own commitment to separate its powers as arbitrator and regulator. Secondly, that the information available to other Independent Arbitrators hearing cases on behalf of the PCA will not be privy to the same information. This means there will be different tiers of arbitration in the future. Thirdly, we believe pub-owning businesses such as ourselves should be able to have full and frank discussions with the PCA in a regulatory capacity without this information being used in arbitration without consent.

We would therefore welcome clarification from Government and the PCA on this matter – the original legislation did not foresee such blurring of the lines.

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

As matters stand, as in any litigation expenses follow success. As indicated above, in circumstances where a subjective approach to reasonableness means that any proposed MRO-compliant tenancy is unlikely to be compliant, this means that in effect the pub-owning business will always require to meet the tenant's costs, and those of the arbitrator.

A tenant can only be required to meet a pub-owning business's costs where a referral or the notice was vexatious; or where the tied pub tenant's conduct in connection with the arbitration has resulted in an unreasonable increase in the costs of the arbitration. These are high thresholds and do not act as a disincentive to speculative or spurious referrals made by a tenant as part of a commercial negotiation strategy. In such instances, the cost burden remains with the pub-owning business.

Separately, we refer to our comments in above as to the alternative arbitrator's costs.

PART C: PUBS CODE REGULATIONS

7) There are two sets of regulations that relate to the Pubs Code: The Pubs Code etc. Regulations 2016 and the Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016. You may have commented on some of these provisions in response to questions in parts A and B of this consultation, 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.

Please refer to our response in Part A; Question 4.

PART D: IMPACT ASSESSMENT AND OTHER INFORMATION

8) The review will consider the key assumptions made in the Impact Assessments 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.

Cost to business: There is no doubt that the Code has put significant additional cost on our business – through levy fees, legal costs, senior management time, training and Code compliance. For example, we now have three full time employees working exclusively on Code compliance – a Code compliance manager and two pub support executives. We have calculated the overall costs of the Code in terms of management time and direct costs on our business - we would be happy to submit this separately to BEIS on request and in confidence.

As the BBPA outline in their response to this consultation, the existing voluntary Code of Practice and dispute resolution systems currently costs £18 per pub to be administered via the Pub Governing Body (PGB) and is widely regarded as working well. Since the Statutory Code has come into force, annual costs of the levy paid to the PCA are already rising sharply. The levy alone from all six pub companies in 2016/17 was £1.5 million – well in excess of £100 per pub. That figure obviously does not include the company costs of compliance, legal fees or increasing fees from alternative arbitrators.

There will always be costs associated with a regulatory framework such as the Pubs Code but we firmly believe that some of this could be avoided by taking some complexity and ambiguity out of the Code as outlined above.

Pub closures: Firstly, data suggests the level of pub closures is slowing. CAMRA data[25] shows that pub closures have slowed significantly over the last year – from 18 a week, now down to 14. Evidence suggests this is set to continue. The MCA Pub Market Report[26] suggests the end is in sight for net pub closures. Decline in the total number of pubs at the Top 10 pub groups slowed to -2.2% in 2017 from -3% in 2017, driven by a drop in tenanted closures. Smaller emerging pub groups with 20-100 pubs are expanding rapidly. After years of annual decline, MCA expects pub outlet growth to stabilise from 2021, and rise from 2023. However, the market will remain intensely competitive, meaning publicans will need to offer the highest quality drinks and food, tailored to their specific customer base, to succeed. Indeed there is further evidence to support this argument from advisers Christie & Co[27], who

[25] 'How Many Pubs Closed in 2018', Campaign for Real Ale, Morning Advertiser, 18 February 2019 (https://www.morningadvertiser.co.uk/Article/2019/02/18/How-many-pubs-closed-in-2018)

[26] 'UK Pub Market Report 2018', MCA, published July 2018.

[27] 'Business Outlook 2019', Christie & Co, Morning Advertiser, 17 January 2019 (https://www.morningadvertiser.co.uk/Article/2019/01/17/1-000-pub-closures-in-the-next-two-years-would-create-sustainable-equilibrium-predicts-Christie-Co)

claim that the past 12 months could serve as a turning point for the sector. They estimate a further 1,000 pubs need to close within the next 2 years to reach a 'sustainable equilibrium' of 47,000 pubs nationwide.

It is also important to put pub closures into context. Closures have been driven by a range of factors – namely changing consumption, increased competition and cost of doing business:

1) *Changing consumption* – young people are drinking less and spending their leisure time in different ways, while people also expect 'premium' experiences and great food when they are in pubs. The latest Government data[28] shows that 16-24-year-olds who say they never drink alcohol rose from 18% in 2005 to 30% in 2015. Those aged 26-35 are also more likely to go to the gym on their own rather than go to the pub, fueled by a focus on health and wellbeing[29]. Food is now present at a third of all drinking occasions and this is growing, while 50% of people want to make healthier lifestyle choices – whether that be abstaining from alcohol or choosing sustainably sourced products[30].

2) *Increased competition* – there is increasing competition for the leisure pound such as an increased number of coffee shops and more people choosing to entertain at home. From 5,000 coffee shops in 1999, there are now over 26,000 in the UK and this trend is predicted to continue – with an estimated 32,000 by 2023[31]. There has also been a huge shift to eating at home and through online and food home delivery channels. The number of visits to the on-trade has fallen by 10% in the last few years, due to more competition for consumers' hard-earned cash[32].

3) Cost of doing business – increasing wages, beer duty and increasing business rates are enormous costs for pubs. In fact, £1 in every £3 spent in the pub goes to the Exchequer. Around 7 in 10 alcohol drinks served in pubs is beer, yet the UK pays some of the highest rates of duty in beer in Europe – second only to Finland. Pubs pay 2.8% of the total rates bill yet represent only 0.5% of rate-paying businesses turnover, an overpayment relative to turnover of £500 million. Per pound of turnover, pubs pay more in rates than any other business sector[33].

Pub closures are a result of these three macro trends. Times are changing and standards in the industry have never been higher, which makes running a pub more difficult than ever before. It is a demanding market and there is therefore an inevitability about a level of closures in the sector - not every pub is a community asset and it is important to be realistic about the market.

The latest MCA Pub Market Report[34] suggests there is much to be positive about in the pub sector and the market in better shape than last year. Pubs remain the most popular Eating Out channel despite

[28] 'Young people turning their backs on alcohol', NHS England, 10 October 2018 (https://www.nhs.uk/news/lifestyle-and-exercise/young-people-turning-their-backs-alcohol/)
[29] 'Gym a bigger draw than pubs for Millennials', Survey, December 2017 (https://www.just-drinks.com/news/gym-a-bigger-draw-than-pub-for-uk-millennials-carlsberg-study_id124744.aspx)
[30] Kantar Alcovision, December 2017
[31] 'Coffee Shop Numbers by Outlet Type, Statista, 1 March 2019 (https://www.statista.com/statistics/863362/coffee-shop-numbers-by-outlet-type-united-kingdom-uk/)
[32] Kantar Alcovision, December 2017
[33] British Beer and Pub Association Data, 2019
[34] MCA, UK Pub Market Report 2018, published July 2018.

falling dining frequencies. Consumers rate pubs highly for value for money and food quality is a popular reason for visiting. Pubs are also showing restraint in putting up prices - absorbing rising cost pressures in order to increase value for money to consumers.

Lots of pubs will survive and ultimately the success of a pub comes down to the teams running the pubs, the quality of the environment and the amenities they offer. This is often delivered through significant and costly investment in pubs. We believe that well invested pubs with the right operators will continue to prosper and that is why we are continuing to invest in the sector (see more in investment section below).

However, the cost of doing business in smaller community pubs is high and there are areas where the Government can help such as more sector support on business rates. We would like to see the Government commit to its manifesto promise of a wholesale review of business rates to address the rapidly evolving nature of business (and particularly the move to online goods and services reflecting the growth of on-line businesses and ensuring on-line businesses pay a fairer share of the business tax burden).

Redistribution of income: In their report, Europe Economics[35] explain how the two parties (licensees and pub companies) are likely to derive most benefit from the tied agreement at different stages of the agreement and/or economic cycle. This justifies the concept of such tenancies, which act as a safety net when pubs are doing less well by balancing the fixed and variable costs over time. The report notes that the tied model lowers barriers to entry for those who want to run a pub and helps ensure ongoing investment.

Changes to ownership structure: Accusations have been levelled at pub companies that we are moving our pubs to managed houses to avoid the legislation. At Star Pubs & Bars we have around 120 Just Add Talent (JAT) pubs which are our managed expert operator agreement (the majority of which are former 'Falcon' sites we inherited through our acquisition of the Punch A estate in August 2017). We have always said that we will grow the managed estate part of our business, and expect to have around 150 JAT pubs by the end of 2019. This is absolutely not about avoiding legislation. It is about having the right agreement for the right pub.

Our ambition is to remain firmly a leased & tenanted pub business. Importantly, having a managed estate also helps our leased & tenanted estate. Our JAT model helps us do this by trialling new initiatives, such as Heineken 0.0 on Blade (our innovative countertop dispense system), and improving deals with our suppliers (we negotiate discounts for leased & tenanted licensees based on the purchasing power we have in our JAT managed operator estate).

Our managed pubs also give our Business Development Managers more detailed insight into daily pub operations, which helps to improve the business building support they provide to our leased & tenanted operators. As an example, we recently made our JAT food menu available to our leased & tenanted licensees – enabling them to benefit from negotiated discounts and food insight support it provides to managed operators. The Wellington Arms, Southampton, the first leased pub to trial the JAT menus – saw food sales immediately double and have remained at the higher level for 11 months. That is why we want to grow and invest in our managed estate as well as our leased & tenanted estate.

[35] 'Impact Analysis of the Statutory Code of Practice', Europe Economics, March 2019

We are investing £14.2m in our JAT pubs in 2019. We have many examples of us taking community pubs back from the ashes and giving people the opportunity to run their own business through our managed operator agreement - the JAT model is a great stepping stone into the trade. It gives operators a foot in the door to potentially run a leased or tenanted pub in the future. For example, we invested £400,000 in [Redacted] which re-opened in December 2018. Our investment transformed the former rundown pub and gave it a total overhaul, introducing coffee and food. Since re-opening the pub has increased trade by 70% and a further 7 jobs have been added to the original 10 new jobs created on the back of the refurbishment.

We are a predominately leased & tenanted business, and it is our absolute intention to remain so. We have always said the introduction of the legislation could have unintended consequences on the make-up and structure of the UK market. To be clear – we are not growing the number of our managed operator agreements to avoid the legislation. Our ambition is to Build Britain's Best Pub Company and, within that, for JAT to be the preferred managed operator agreement.

Investment and employment: We want our pubs to be relevant, innovative, have multiple income streams and successfully play their part in the heart of communities. As outlined above, pubs face increased competition and changing consumer demands. We want our pubs to be sustainable in the long-term. Our job is to help our pubs to develop an offer that meets today's consumer expectations on quality service, facilities, range, food and more.

That is why we invest in our pubs. HEINEKEN is investing £50million in its Star Pubs & Bars estate in the UK in 2019 – taking our total investment to £190 million over the last six years (since 2013). Our investments help broaden the pubs usage and create multiple income streams. For example, we might invest in signage to give the pub 'kerb appeal', or we could invest in the kitchen and food offer so it has multiple income streams.

A number of our licensees have chosen to opt out of MRO for up to 7 years because we have invested in the pub. In our first reporting period, we reported we have made 88 qualifying investments which trigger the investment waiver under regulation 56[36]. This number will increase significantly over our next reporting figures as we have increased the level of investment in our pubs, thus giving rise to more qualifying investments. Importantly, they are not waiving their Code rights entirely, just their ability to exercise their rights to be granted an MRO where a trigger event occurs for a period of 7 years - every other aspect of the Pubs Code continues to apply to them. They have made a positive choice to invest with us.

As evidenced in the Europe Economics report submitted alongside the BBPA submission to this consultation, through the leased & tenanted model, pub companies invest significant amounts in their pub estate. There is therefore a danger that, with a decline in the number of tied pubs, investment in the pub estate will also decline.

PART E: OTHER COMMENTS

[36] 'Pubs Code Regulation 43 Compliance Report Framework for Pub Owning Businesses: Star Pubs & Bars', Star Pubs and Bars, July 2018 (https://www.starpubs.co.uk/sites/default/files/misc_docs/PCAComplianceReportSPB.pdf)

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

Star Pubs & Bars is owned by HEINEKEN UK - we are also the UK's leading beer and cider business. As such, we have concerns about the PCA's subjective approach to decisions around the stocking requirements of our beer and cider brands in MRO agreements. We will outline our views on this issue in response to this question (which is also currently subject to an investigation by the PCA).

At the outset, it is important to note that the Government (and Parliament) recognised that brewers who own pubs have the right to protect their route to market. In 2014, Greg Mulholland MP, who was responsible for drafting the MRO provisions of the Pubs Code stated: *"[I]t is crucial to note that the clause will ensure that the statutory code can be drafted to allow the large brewing pub companies to continue to insist on only selling their beer in their own leased pubs."*[37]

In the House of Commons, the Government Minister Jo Swinson confirmed support for the stocking requirement and described the policy intent as: *"The original market rent only clause allowed brewers that own tied pubs to require their MRO tenants to continue to sell the brewery's products, as long as the tenant may buy them from any source. Amendment 46 implements that intention by amending clause 65 so that such a stocking requirement in a tenancy agreement would not of itself make the pub a tied pub. In stakeholder discussions, brewers requested greater clarity on what they were permitted to do under a stocking requirement; others were concerned that the stocking requirement might lead to undue restrictions on tenants who have chosen MRO.*

Amendment 46 clarifies that brewers may also protect their route to market by allowing some restrictions on the sales of competitors' products in their MRO pubs. However they will not be able to require that these pubs sell only their products and they will need to satisfy themselves that the requirements they are imposing are compliant with competition law. The restrictions may be placed only on beer and cider products and, crucially, tenants must be able to buy the brewer's products from any source."[38]

Parliament therefore decided to enshrine the principle of a stocking requirement in the primary legislation in the Small Business Enterprise and Employment Act (SBEE Act) 2015. It was intentionally not included in the Pubs Code. The legislation recognised that brewers who own pubs (as HEINEKEN does) should have a right to ensure that their own products are stocked, and that direct competitor brands can be restricted but not prevented.

That decision recognised the huge investment we make in our pubs, breweries and supply chain across the UK. Across our business we employ 2,300 people in the UK and over 90% of what HEINEKEN sells in the UK we produce in the UK – from across our ciderie and breweries in Manchester, Herefordshire, Tadcaster and Edinburgh. We have invested £100 million upgrading our breweries in the last three years and have a further £50 million planned in 2019.

[37] (Underline Emphasis Added) - Letter from Greg Mulholland MP to Star Pubs & Bars, 26 November 2014

[38] House of Commons Debate, 24 March 2015, vol 594, cols 1343 (https://hansard.parliament.uk/Commons/2015-03-24/debates/15032473000004/SmallBusinessEnterpriseAndEmploymentBill?highlight=brewer#contribution-15032473000201)

We have an industry leading portfolio of brands that consumers love. Those brands are sold successfully across the on and off trade. Of course we want to see our pubs sell our beer and cider brands because we know they perform well in the market and have the evidence to back that up[39].

The SBEE Act was clear that when a pub goes MRO we have a right to restrict (rather than prevent) competitor products in our pubs. The Code itself then silent on the parameters within which any proposed stocking requirement will be considered reasonable - no detail is provided on what the legislation does or does not permit. So Government set out the policy at a high level, enshrining the principle in primary legislation to leave practical implementation to brewer pub companies in line with prevailing competition law.

As there was no written guidance, at the outset we sought guidance from the PCA on our approach. Initially we developed our own MRO lease brand stocking policy, considering at length how best to implement the stocking requirement in a fair and reasonable way for both us and to our licensees. We recognised that the stocking requirement was a new concept to both the PCA and industry and took clear legal advice in order to provide stocking requirements which fell within the scope of the primary legislation outlined above.

When we started making our first offers to pubs that requested MRO, we opted to use share of taps on the bar and named brands as the defining criteria for three reasons; (1) we felt it was in line with the Act (2) this method was simpler and operationally easier for licensees and Star Pubs & Bars to understand and implement; and (3) it was easier to monitor and enforce. We shared this approach with the PCA, including the legal guidance from our lawyers on which it is based.

We did not receive any formal or direct feedback from the PCA on our approach, but we proactively evolved and amended the stocking requirement in response to arbitration decisions the PCA made. For example, following insight gained from a number of arbitral decisions from the PCA over the early course of 2018, we made a number of amendments to the stocking requirement in our MRO lease. We made these changes and adapted our approach based on the PCA's subjective approach to reasonableness, which meant that the same provision may be reasonable to one pub, but not another.

We've always sought to be compliant – sharing our initial, revised and re-revised versions with the PCA. For many months we asked for accreditation or approval from the PCA but did not receive any feedback. In fact, we detailed our initial, revised and re-revised MRO stocking policies to the PCA in a letter dated 3 October 2018, but no formal feedback was received. Following further correspondence, and a number of concerns we had with the PCA's approach on an arbitral decision[40], we proactively requested a meeting with the PCA specifically on this issue which took place on 14 February 2019. We went to that meeting in good faith, yet received no support or advice from them and further correspondence from the PCA's office did not make it clear whether they approved of our amended policy or not.

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[39] '2018 Drinks List', Morning Advertiser, 2018 (Strongbow is the #1 best-selling cider; Strongbow Dark Fruit is the #2 best-selling cider; Strongbow Cloudy Apple is the #3 fastest growing cider; Old Mout Cider is the #4 fastest growing cider; Fosters is the #2 best-selling lager; Birra Moretti is the #1 fastest growing lager; Amstel is the #4 fastest growing lager; while Heineken 0.0 is the #1 fastest growing no alcohol beer)

[40] Pubs Code Arbitration Case: Garden Pub Limited (Claimant) and Red Star Pub Company (First Respondent) and Star Pubs & Bars Limited (Second Respondent), PCA, 3 December 2018 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/794426/Quarter_4_2018_4_MRO_award.pdf)

We acknowledge that the PCA is empowered to give effect to the primary legislation, but as noted above, the primary legislation is silent as to the specified stocking requirements. We are also aware of one referral where the alternative arbitrator has exceeded this power and actually specified the stocking requirement term which should be drafted into the revised response. In this instance, the arbitrator dictated that the revised response must contain a 20% keg stocking requirement and failed to give proper reasons despite our request to do so. Without proper reasons the PCA fails to provide us with proper justification for their decision or provide the opportunity for the business to learn lessons to implement full compliance with the Code. This therefore put us in the unfortunate position of having to appeal the award (which is still subject to appeal).

Despite being confident in the legality of our original stocking requirement, we have been flexible in our approach and adapted our commercial MRO policy according to latest thinking and decisions made. We will continue to take a pragmatic approach to this issue but have been disappointed by recent decisions - and that the PCA has launched an investigation into us on this issue. In our view, had there been more constructive dialogue and direct feedback from the PCA, all of this could have been avoided.

We will continue to call for clearer guidance and suggest the PCA engages in more meaningful discussions with pub-owning businesses to approve standard terms and provide clearer guidance on the determination of stocking requirement levels. The variety of our beer and cider portfolio available to licensees and the significant popularity of those brands is not reflected in the PCA's determinations issued to date.

The PCA should prepare clear guidance for those pub-owning businesses who also own breweries to reflect brand strength and variety of portfolio. More equal weight needs to be given to brewer's right to market versus reasonableness. If the PCA's future decisions continue to follow this pattern, it will put future investment in both our breweries and our pubs at risk, as the route to market is compromised which impacts on our ability to continue investing in our brewed products.

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

The topic of the leased & tenanted pub sector is in many ways an emotive one, with debates often filled with anecdotes and unsubstantiated stories, rather than facts, evidence and robust figures. The consultation process must adequately weight responses and be based on robust data, evidence and independent surveys where possible.

Finally, it is important the Government considers the 'silent majority' in this consultation process - the majority of leased & tenanted licensees who understand the model, are comfortable with it, and are in genuine partnership with their pub company. Licensee Index data clearly finds that on a scale of 1-10 (where 0 is not at all likely and 10 is very likely), 6.4 licensees would recommend Star Pubs & Bars as a pub company to another publican – the 2nd highest out of the big six pub companies covered by the Code[41].

[41] 'The Licensee Index 2018/19 Wave 2', KAM Media, May 2019