Pubs Code Adjudicator

Pubs Code and Pubs Code Adjudicator: Statutory Review

Submission by the Office of the Pubs Code Adjudicator

July 2019

Market Rent Only

The MRO Offer and MRO Negotiation Period

1. The legislation gives the initiative in the MRO process to the POB from the outset, in that it must choose the lease terms to offer in the MRO proposal[1]. The burden is therefore on the individual TPT to assess whether the offer is MRO-compliant and to challenge it. These essential characteristics of the MRO process are reflected in the primary as well as the secondary legislation[2].

2. Time-limited phases to the MRO procedure were aimed at incentivising the parties to move through the process efficiently – through notification, negotiation of terms, assessment of MRO rent, acceptance and completion, with the opportunity to arbitrate disputes at each stage. However, the strict sequencing of the various phases of the MRO procedure provided for in the Code does not, in the experience of the D/PCA, reflect the reality of how parties negotiate and reach agreement either when a new tenant is considering free of tie terms in the market or when a tied tenant and landlord are agreeing a change of lease terms for commercial reasons.

3. Furthermore, in at least some other statutory interventions in contractual arrangements, negotiation is not commenced by requiring an offer from one party. For example, in statutory renewal under the LTA the parties negotiate and agree new terms, or they are ordered by the court, which must take into account the existing arrangements[3].

4. In general, the lack of negotiating strength on the part of the TPT in the MRO process and the fact that dispute resolution is only through statutory arbitration are disincentives on the POB to negotiate as they would in the free market and a major cause of the high level of disputes[4].

[1] Under regulation 29(3) of the Code.

[2] See s.43 of the 2015 Act.

[3] See s.35(1) LTA - the court shall have regard to the terms of the current tenancy and to all relevant circumstances.

[4] With 312 referrals for arbitration which involved issues related to MRO received during the statutory review period. This is 84% of total referrals received during that period.

5. In particular, the requirement first to settle the MRO terms and then assess the MRO rent tends to misunderstand their complex interaction. Often terms may become acceptable to a TPT if the rent is adjusted to take account of them, and vice versa.

6. The legislation does not provide a mechanism for compelling POBs to revisit the terms of their MRO offers other than formal arbitration[5]. In fact, a lack of understanding of what may constitute a 'subsequent proposed tenancy'[6] during the negotiation period (which triggers a fresh right to challenge in arbitration) may actually be having a chilling effect on negotiation.

7. Other than the operation of regulation 28[7], there are no incentives against delay in the MRO process. There are no provisions in the 2015 Act or the Code for the backdating of the MRO rent and terms to the date of requesting the option (and in any event tied and free of tie rents are valued on a different basis). The Secretary of State may wish to consider whether there are other incentives that can be considered to ensure that the parties do not delay the resolution of the MRO process.

8. A more holistic negotiation of the whole MRO agreement might be achieved by greater integration of the MRO rent assessment process within the period for the negotiation of the MRO terms, where the parties want it. For example, the Secretary of State might wish to consider allowing the parties flexibility to agree terms and rent before the formal offer by the POB is required later in the negotiation period, and then to refer either or both for dispute resolution.

<u>MRO Compliance</u>

Reasonableness

9. Aside from meeting other specific descriptions of non-compliant terms, the terms of the proposed MRO tenancy must not be unreasonable. In any given commercial situation, and depending on the facts, there may be a wide range of reasonable approaches, and there will be no single reasonable free of tie offer that is compliant. This is consistent with Parliament's decision not to prescribe the terms of a compliant MRO proposal.

10. The POB has the choice of what MRO terms to offer and will be motivated to offer free of tie terms which advance its commercial objectives. The bar is set very high for a TPT who objects to the terms on offer. They must show in formal

[5] Under regulation 32 of the Code.
[6] See regulation 35(1) of the Code.
[7] Where no increase in the tied rent is recoverable during the MRO procedure – nor is it ever recoverable if the MRO option is accepted by the TPT.

arbitration proceedings that the MRO proposal is outside of the range of reasonable approaches.

11. The office of the PCA has sought to provide POBs in particular, and the industry in general, with clarity over how to approach reasonableness in the MRO procedure – including by publishing arbitration awards and by issuing statutory advice[8]. The D/PCA has stressed that there is no 'one size fits all' approach to MRO compliance, and that this will be a question to be decided on the facts of each individual case.

12. Disputes about the reasonableness of the MRO terms offered by POBs have dominated the D/PCA's arbitration caseload throughout the review period. Parties have had very different expectations. POBs have largely claimed that their standard terms are common in free of tie agreements and reasonable in the context of MRO leading to the complexity outlined below. Many TPTs have argued that the starting point should be the terms of the existing lease.

Commonality

13. The proposed MRO tenancy terms will be unreasonable if they are not common in the free of tie market[9]. The apparent simplicity of this test belies substantial complexity in its application. It is not clear that there is a single understanding of what terms are common in the free of tie market. POBs have not universally risen to the challenge of demonstrating their understanding. TPTs in particular are ill-equipped to understand this without professional advice, and consequently to challenge the proposed terms in arbitrations. Expectations that the regulator can identify and accredit common standard compliant terms in a dynamic market are unrealistic. Even experts call into question the value of needing to identify commonality in the market, and indeed if it ever truly achievable.

14. What the experience of arbitration has demonstrated is that the assumption in the legislation that MRO and free of tie agreements are one and the same thing is mistaken. In reality, MRO and free of tie agreements operate under distinct commercial circumstances. MRO is something completely new in the market – a statutory procedure for a TPT to move from a tied to a free of tie agreement without the landlord's consent, often mid-tenancy, but which is not achieved by simply removing the tie.

15. The test of commonality as an absolute barrier to compliance has directly increased the number, scope and complexity of MRO disputes and prolonged and increased the costs of arbitration proceedings. It has consequently acted

[8] Under section 60 of the 2015 Act.

[9] The PCA has made it clear in its Advice Note that the list of unreasonable terms in regulation 31(2) is not exhaustive. Terms must therefore be common and not be unreasonable.

as an unavoidable and significant technical obstacle to a TPT's ability to access MRO terms that are best suited to their circumstances in a reasonable timeframe. In some cases, POBs have used the requirement of commonality to refuse to offer a TPT a term that they seek (that in all the circumstances may well be otherwise viewed as reasonable).

MRO Vehicle

16. The Pubs Code legislation is silent on whether a compliant MRO agreement should be concluded by way of either a deed of variation (DoV) to the existing tied tenancy or a wholly new agreement. The choice of MRO vehicle rests in the first instance with the POB. The office of the PCA has reminded POBs that they must exercise this choice in line with the core Code principles and in a way that ensures that each TPT has the choice of an accessible MRO option.

17. In reality, however, it will most often be the MRO terms and not the MRO vehicle that will be more important. The D/PCA has taken steps to make MRO more accessible to TPTs, for example in arbitrations by recognising that standard commercial rent deposit and rent in advance terms may not compensate for the TPT's lack of negotiating strength in the MRO procedure, or reflect what existing contracting parties would do in a renegotiation in transitioning to a new arrangement.

18. Questions of accessibility arise where, for example, the choice of a new agreement would make the TPT liable to pay Stamp Duty Land Tax that would not apply were MRO to be effected by way of a DoV[10]. On the other hand, a new agreement might be a better MRO option for a TPT who would value the granting of a term longer than the unexpired term of the existing lease, and it can offer clearer drafting with reduced risk of errors at lower costs for use of standard terms.

19. The D/PCA's arbitration caseload demonstrates a very high level of disputes concerning the MRO vehicle where MRO has been requested at rent review or in respect of another mid-agreement event. Where the gateway to the MRO is renewal of the tenancy, and therefore new lease terms must be agreed in any event whether the TPT is staying tied or going free of tie, the level of MRO disputes referred to arbitration has been minimal.

20. These MRO vehicle disputes characterise the difficulties in overlaying a statutory framework on an existing contract. A large proportion of the TPTs with the most protracted arbitrations have relied on support from campaigning groups now also acting as tenant advisers. TPT arguments in these cases have

[10] Significantly, because the lease was granted prior to the introduction of SDLT on 1 December 2003, and no overlap relief is therefore available

consistently been supported by positions that reflect what those advisers believe the law should be rather than what it actually is.

21. The Secretary of State might consider whether giving POBs freedom to make the choice on MRO vehicle in all cases is consistent with the core Code principles and permits TPTs to exercise a genuine choice to take up an accessible MRO option. There might for example be a case for different provisions in respect of MRO at different points in the tenancy, or for an element of tenant choice.

22. The Secretary of State may in summary wish to consider whether the Code should provide further prescription or presumptions on the vehicle by which POBs must offer MRO agreements, and the nature of compliant terms, to reduce the risk of protracted challenge either in arbitration or to the exercise of the regulator's powers in this area[11].

MRO Referral Window

23. There is a strict 14-day window, following the end of the period the POB has in which to give its full response, for a TPT to refer their MRO offer for arbitration. The calculation of this period and/or its brevity has caused TPTs to miss out on their right to refer.

24. TPTs who receive a MRO offer which they believe is non-compliant have little or no time to engage with their POB on the terms. Their only practical option to preserve their position is to make a referral for arbitration to the PCA, regardless of whether the matter can in fact be settled by negotiation. This goes some way to explaining the high number of arbitrations which ultimately settle by negotiation[12].

25. There is, however, little evidence that simply extending the window for referral for arbitration would produce better results for tenants and significantly reduce litigation if it is not accompanied by other measures to improve the MRO process and address the imbalance in the parties' negotiating power within it. The voluntary option of an 'initial stay' (typically for 3 months) introduced by the D/PCA in November 2018 into MRO arbitration proceedings has been designed to incentivise negotiation and present POBs with a significant financial incentive to settle[13]. It is not yet clear, however, that this incentive is sufficient – only 4 settlements (out of 20 initial stays which have now come to an end) have been achieved during the stay, and none of these before the end of the review period.

[11] See for example judicial review challenges latterly dropped in connection with the PCA's MRO Advice Note

[12] In the statutory review period 169 arbitration referrals were settled by negotiation or withdrawn.

[13] Where matters are settled within the stay period, the case will not be counted towards the POB's share of the annual PCA levy where that levy is calculated in part by reference to arbitration cases.

MRO Revised Response

26. There is a right to refer for arbitration the full response and any subsequent response, but the Code is not explicit as to whether there is subsequently such a right in respect of a revised response ordered by the arbitrator[14]. For example, in that event there is no MRO Notice from which to calculate any window for referral. If it is established that there is no such right, the arbitrator would have to reserve such jurisdiction in the first arbitration until satisfied a compliant MRO proposal has been offered, which can lead to further complexity. Some clarity over any right to arbitration of a revised response would remove dispute.

Stocking

27. The 2015 Act introduced the concept of a stocking requirement, which is a term obliging a tenant to stock beers or ciders produced by a brewer POB (or one of its group undertakings) so long as these may be purchased on the open market and there is no prohibition on stocking competitor brands. For the purpose of identifying a tied pub, a stocking requirement is excluded from the definition of a tie. The application of these provisions relating to stocking requirements in MRO proposals is a further area for dispute.

28. The D/PCA announced on 10th July 2019 an investigation under section 53 of the 2015 Act into the use of stocking requirements by a POB. The report on the outcome of the investigation may provide further evidence on the application and impact of the stocking requirement provisions in the 2015 Act.

29. At this stage it is appropriate to note that the Pubs Code legislation stocking requirement was a novel concept that had not previously been developed in the market. It is an unknown quantity, but will certainly change the market, and these consequences will need to be carefully considered. The close business relationship under the tie can facilitate appropriate adjustments of the product range available to the tenant in light of market changes. By contrast, there is no such close relationship when free of tie, yet it is necessary for a stocking requirement to remain sufficiently relevant, flexible and fair over the life of a potentially long lease to avoid an unknown commercial risk to the tenant. This has given rise to dispute.

30. The Secretary of State may wish to consider if there are adverse market factors associated with a stocking requirement, which protects a route to market for brewer POBs in this way – whether it may remove the imperative to be competitive on price and/or quality, and/or may stifle innovation and choice. While it is not for the D/PCA to consider if this is positive for competition in the industry as a whole, we have the impression that the actual and anticipated

[14] Pursuant to regulation 33(2) of the Code.

burdens of a stocking requirement may be putting some TPTs off pursuing their MRO option, depending on their particular circumstances, trade and free of tie business planning.

31. The Secretary of State may therefore wish to consider whether the relationship between the stocking requirement and the reasonableness of MRO terms could potentially be addressed by making specific reference to stocking within any revised provisions on the reasonableness of MRO terms in the Pubs Code Regulations.

Landlord and Tenant Act 1954 (LTA)

32. Renewal of the tied tenancy is one of the gateways to the MRO option. The right of the POB to seek to oppose renewal of a tenancy protected by the LTA on specified grounds, including that it intends to take the pub back into its own management, is unaffected. Ultimately applications to take the pub back into landlord possession will be a matter for the courts. Changes were made to the CPR to allow decisions about objections to renewal to be made before those on renewal terms, to allow the latter to take account of the outcome of the MRO process. There remains the scope for tension between the potential for Code avoidance and changes in the free market.

33. As Code protections do not extend to the tenant who has entered a free of tie agreement through the MRO process, there is nothing to prevent a POB at the end of the term of the MRO lease from opposing renewal on the grounds that it seeks to take it back into management. Given that the minimum MRO lease term is the remaining term of the tied lease, tenants may fear the consequences at renewal of running a successful free of tie pub and decide not to pursue the MRO as a result.

34. There is a difference in approach between the LTA and the MRO procedure at renewal, as to the timetable and the means by which lease terms are agreed or imposed. For example, the lease term in the former will be determined with regard to the term of the existing lease subject to a maximum of 15 years[15]. The Secretary of State may wish to consider whether there is reason for there to be greater alignment.

Interaction of tied rent review and MRO process

35. The Pubs Code is prescriptive as to how POBs must present their tied rent proposals[16] but leaves it to the existing tenancy agreement to determine how that rent should be negotiated, and how any disputes are resolved and agreed. Conversely, the Code sets out in detail the process by which a POB must make

[15] See s.33 of the LTA.

[16] In Schedule 2 of the Code.

the offer of a MRO rent and provides a specific mechanism of independent assessment for resolving disputes.

36. In neither case does the Code make specific provision for how the tied and MRO rent processes are to be run in parallel to ensure that the TPT has the opportunity to make a genuine choice and satisfy themselves that they will be no worse off – aside from providing that the right to accept the MRO offer does not lapse until the end of the tied rent review.

37. The Code requires rent (assessment) proposals to be prepared in accordance with RICS guidance and signed off by a RICS member. The Code also requires a member or fellow of RICS to confirm that the rent assessment has been conducted in accordance with RICS guidance. It is not clear that this second requirement adds any assurance for the TPT given that there is no prescribed RICS procedure for negotiation of rent and the sign-off comes after the event.

MRO Rent

38. There is no statutory duty on the POB to provide justification for the MRO rent it is proposing. The definition of market rent[17] does not expressly enable the effect of a capital investment in the pub made by the TPT under the tied tenancy to be disregarded when assessing the MRO rent.

39. Independent Assessors are required under the Pubs Code to provide a rent assessment within a statutory time period. There is currently no statutory mechanism by which an Independent Assessor may recover their fees from the parties.

Dispute Resolution Mechanism

Arbitration – process and procedure

40. The dispute resolution mechanism for all Pubs Code disputes (whether MRO or non-MRO) is statutory arbitration. The nature of disputes that may arise under the Code is very broad – and arbitrations this office has received range from challenges to the actions of the Business Development Manager to the right to request a MRO offer, the terms of the MRO offer itself, the MRO rent, information to be provided in a rent assessment proposal and whether the tenant has suffered detriment.

41. Referrals for Pubs Code arbitration have greatly exceeded expectations, with 360 received during the statutory review period. This reflects the pent-up demand for change within the industry that the Code was enacted to address together with the absence of detailed definitions in the legislation of some of the

[17] In s 43(10) of the 2015 Act.

most contentious aspects of the regime, and of the MRO provisions in particular.

42. Formal arbitration proceedings have in many instances been a cumbersome, costly and inefficient mechanism – regardless of the nature of the dispute. The layered statutory framework, institutional rules and the 1996 Act has made for a process that is rather confusing, litigious, and (for unrepresented tenants) sometimes overwhelming. The deterrent effect of litigation costs, unsurprisingly, has acted disproportionately on TPTs rather than POBs. Indeed, delay may prejudice the commercial interests of the TPT more than those of the POB.

43. Arbitration is also an unnecessarily adversarial mechanism for addressing complaints (typically about the behaviour of the POB or its employees) as opposed to more formal disputes relating to commercial considerations, and has been shown to be a blunt tool for the resolution of disputes as to the entire terms of a lease.

44. There are several areas which this office has seen lead to confusion, dispute, costs, challenges and/or delay all of which have had an impact on swifter resolution of cases and would warrant consideration to bring about clarity and remove ambiguity which leads to challenge and delay.

Confidentiality

45. Arbitration proceedings are confidential between the parties at common law and by virtue of provisions of the CIArb rules. Outside of the Pubs Code lease terms are not confidential matters and are challengeable in open court.

46. Confidentiality has had a negative impact on the resolution of Pubs Code disputes. A POB who has been involved in multiple cases on the same or similar issues has an advantage over a TPT who has not, and who will be seeking for the first time to understand the process and legal tests, and to respond to evidence on very technical considerations.

47. The D/PCA's aim to ensure they act in the public interest has led to them seeking the agreement of the POBs to the publication of awards. This has been given in principle, but in practice still requires the consent of the parties in each case, including that of the TPT, and the removal of personal data before publication. Overall this has proved resource intensive, slow, and unsatisfactory. Where a tenant does not agree to publication, there is an effect on transparency. The D/PCA must consider the balance of data protection principles and the public interest in deciding whether an anonymised version of the award is for the benefit of the industry and should be published.

Institutional Arbitration Rules

48. The CIArb rules are the default procedural rules applied by the statutory framework, but the latest version of them was published after Royal Assent to the 2015 Act and contained significant changes. There are areas where their interaction with the Pubs Code legal framework has caused tension and dispute, including the power of the D/PCA to appoint the arbitrator and the rules on challenging the appointment of an arbitrator; the rules on agreement to removal of appeals; the provisions relating to costs; and the provision of awards.

49. Where, unlike in commercial arbitration, there has been no consent between the parties as to the application of the rules, differences of views on their application continue to arise. A bespoke set of rules may remove that uncertainty.

Appeals

50. As there is no specific provision for appeals from arbitration decisions any appeal is made to the High Court. The appeal right is limited by the provisions of the 1996 Act. This adds costs for the parties and exposes the TPT to costs outside the Fee Regulations.

51. The court's permission is required to appeal an arbitration award and the grounds on which permission may be granted are limited. Pursuant to the CPR, applications for permission to appeal arbitration awards are private and a decision to refuse permission cannot be made public without party consent or order of the court. The wider regulated sector (including TPTs) may therefore never know if a POB has unsuccessfully sought to appeal a decision. The PCA is not automatically a party in such appeals and has experienced POB objection to intervening as the regulator, having to make applications to the High Court and Court of Appeal before securing the consent of the parties to the disclosure of the content of an order on an application for permission to appeal. This is not supportive of the D/PCA's transparency agenda, and absorbs the regulator's time, cost and resource.

52. The Secretary of State may therefore wish to reconsider the approach to dispute resolution under the Code, especially in relation to MRO disputes. Particularly helpful would be a swifter approach to determining MRO terms, with an appeal mechanism that does not expose TPTs to the costs of a High Court appeal. One option would be an expert Chamber which can give quick decisions. There may also be scope for different approaches for MRO (which are focused firstly on property rights) and non-MRO disputes (that typically arise from behavioural disputes or rent assessment). The Secretary of State may wish to consider the application of the CPR in statutory arbitrations such as Code disputes.

PCA as Regulator and Arbitrator

53. The Pubs Code legislation gives the D/PCA the responsibility to act as regulator, as well as arbitrator in individual disputes. Over the last three years, these dual statutory functions have frequently exerted pressures on each other.

54. A consequence of the consistently heavy arbitration caseload throughout the review period has been the impact on the ability of the D/PCA to take regulatory steps to enforce the Code whilst simultaneously seeking to reach impartial decisions in arbitration cases, based on the evidence in that particular case. Now that some fundamental decisions have been made on key elements of the Code, the office of the PCA is seeking to make much greater use of alternative arbitrators to create the space and resource to take action in the regulatory arena.

55. Pubs Code arbitration disputes have rarely simply been about POB behaviour and have turned very heavily on what the complex statutory provisions mean, increasing the level of technicality required in (and time to produce) arbitration awards. In many cases there has been poor, or no, submissions made on the law, leading to increased burden on the arbitrators to analyse the legal issues themselves. The D/PCA are often being asked in arbitrations to make determinations on the law. It is highly unusual for the regulator to have to make decisions on what the law means ahead of taking regulatory action on that law. It is ultimately for the courts to interpret the law, but as yet there have been no court judgments resulting from legal challenges to provide legal certainty.

Information gathering powers

56. Parliament afforded the D/PCA the power to request information from parties to an arbitration and any alternative arbitrator. The scope of the information gathering power contained the 2015 Act for non-MRO disputes[18] is not replicated in the Code for MRO purposes[19]. The D/PCA considers this anomaly should be amended so the powers are consistent in scope.

Other issues

Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016

57. The D/PCA has the power to appoint an alternative arbitrator to arbitrate disputes. The usual practice in private arbitration is that the parties pay the arbitrator's costs in advance of receipt of the award – the default position under the 1996 Act being that both parties are jointly and severally liable for those

[18] At section 52 of the 2015 Act.

[19] Regulation 61 of the Code.

costs. The POB in a Code statutory arbitration is required to pay the arbitrator's reasonable fees and expenses, except in the situation where the referral was made by a TPT and the arbitrator determines that the referral was vexatious. However, there is no express power in the Code for an arbitrator to take enforcement action and recover those costs if a party fails to pay them.

The Regulated Market

58. Overall the tied pub market has seen some significant changes over the review period, with other events on the horizon, potentially changing the number and type of regulated POBs. The Secretary of State will wish to bear in mind the movements in the market in reviewing the nature of regulated POBs under the Code.

Pubs Code Adjudicator

ANNEX

Glossary of terms

The 2015 Act	The Small Business, Enterprise and Employment Act 2015
The Code	The Pubs Code Etc. Regulations 2016
The Fees Regulations	The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016
PCA	Pubs Code Adjudicator
DPCA	Deputy Pubs Code Adjudicator
D/PCA	Pubs Code Adjudicator and Deputy Pubs Code Adjudicator
The 1996 Act	The Arbitration Act 1996
POB	Pub-owning business
TPT	Tied pub tenant
MRO	Market rent only
LTA	Landlord and Tenant Act 1954
CIArb	The Chartered Institute of Arbitrators
CPR	Civil Procedure Rules