IN THE MATTER OF **ARB/000281/AGT INNS**
THE PUBS CODE ARBITRATION BETWEEN:

AGT INNS LIMITED
(Tied-Pub Tenant) Claimant

-and-

EI GROUP PLC
(Pub-owning Business) Respondent

FINAL AWARD
EXCEPT IN RELATION TO COSTS

Summary of Award

The Respondent's MRO Proposal of 23 May 2017 is non-compliant with regulation 29(3) of the Pubs Code, both by virtue of the form of the proposed MRO tenancy, and the Respondent's requirement for the inclusion of terms providing for quarterly rental payments and a rent deposit. The Respondent is therefore to provide a revised response to the Claimant within 21 days (with a copy to the Arbitrator) in the form of a DOV, without providing for quarterly rental payments or a rent deposit. The Arbitrator retains jurisdiction to consider the compliance of that revised response if called upon to do so within 21 days from the date of that revised response.

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Introduction

1. The seat of this arbitration is Birmingham, England. The applicable law is that of England and Wales. I, Mr Paul Newby, Pubs Code Adjudicator, am the arbitrator. I act pursuant to my powers under regulation 58(2) of the Pubs Code etc. Regulations 2016 ("**the Pubs Code**") and paragraph 5 of Schedule 1, Part 1 of the Small Business, Enterprise and Employment Act 2015 ("**the 2015 Act**").

Procedure

2. This is a statutory arbitration within the meaning of section 94 of the Arbitration Act 1996 ("**the 1996 Act**"). The statutory framework governing this arbitration, other than the 1996 Act, is contained in Part 4 of the 2015 Act; the Pubs Code; and, The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016 ("**the Fees Regulations**"). The applicable rules for the conduct of this arbitration are the Chartered Institute of Arbitrators Rules ("**the CIArb Rules**"). Where a conflict arises between the Pubs Code statutory framework (being the 2015 Act, the Pubs Code and/or the Fees Regulations) and either the CIArb Rules or the 1996 Act, the Pubs Code statutory framework shall prevail.

3. This referral was made on 13 June 2017, and in relation to a purported full response under regulation 29(3) of the Pubs Code provided by the Respondent to the Claimant on 23 May 2017 with a proposed MRO tenancy ("the MRO Proposal"). The Claimant asserts in its referral that the MRO Proposal is not MRO-compliant within the meaning of section 43(4) of the 2015 Act, as required by regulation 29(3)(b). Following receipt of the referral, directions were issued for the management of the proceedings and each party has had the opportunity to put forward its statement of case and documentary evidence. In addition, an oral hearing took place before me on 20 June 2018 in advance of which both parties helpfully provided skeleton arguments.

The Parties

4. The Claimant is AGT Inns Limited of the Shipwrights Arms, 88 Tooley Street, Bermondsey, London SE1 2TF ("the Pub") and is the tied pub tenant ("TPT") of the Pub within the meaning of section 70(1)(a) of the 2015 Act. The Respondent is Ei Group Plc of 3 Monkspath Hall Road, Solihull B90 4SJ and is a pub-owning business ("POB") within the meaning of section 69(1) of the 2015 Act. The Claimant occupies the Pub under the terms of a lease dated 16 January 2003 granted by Unique Pub Properties ("the Lease"), a group company of the Respondent.

5. The Claimant is represented by Freeths LLP of Routeco Office Park, Davy Avenue, Knowlhill, Milton Keynes MK5 8HJ, and [redacted] of counsel. The Respondent is represented by Gosschalks Solicitors of Queens Gardens, Kingston upon Hull HU1 3DZ, and [redacted] of counsel.

Applicable Law and Legal Reasoning

6. For clarity and ease of reference, consideration of the legal issues is set out in the Appendices to this award. Applicable Law is set out at Appendix 1 and legal reasoning in relation to the vehicle for the MRO option and unreasonableness at Appendices 2 and 3 respectively. This legal reasoning represents my own independent view on the PCA's and DPCA's shared understanding of the legislative framework. It is these reasons on which my decision is based.

7. Both parties made reference to the PCA's Advice Note on MRO-compliant proposals of March 2018 ("the Advice Note"). At the hearing, [redacted] for the Respondent made reference to a separate claim for judicial review in relation to the PCA's decision to the publish the Advice Note, and aspects of its content, which had been brought by the Respondent and which was, at that time, awaiting a decision on permission. [redacted] argued that as the judicial review was on-going, that my decision in this case should be reached without reference to the Advice Note. Permission to bring the judicial review was refused and the claim subsequently discontinued by the Respondent. The Advice Note remains the position of the PCA as regulator, setting out the position on reasonableness and what motivated parties would expect to agree in an open market negotiation including where appropriate mitigation of adverse terms to a tenant. However, I retain an open mind and consider why that Advice Note ought not to apply in any given case. This I have done in this case. However, nothing that has been argued before me leads me to consider the content of that Advice Note is wrong or should be disapplied in this case and I consider it to be relevant to deciding the issues in this case.

The Issues

8. At the commencement of this referral there were several issues in dispute between the parties, but I have been assisted by the parties' efforts in narrowing the issues in dispute both in advance of and subsequent to the hearing.

9. At the time of the hearing there were three issues in dispute between the parties:

    9.1 Whether MRO should be achieved by way of a new lease or via a deed of variation ("DOV");

    9.2 Whether the MRO tenancy (in whatever form) should provide for rent to be paid quarterly or monthly in advance; and,

    9.3 Whether the MRO tenancy (in whatever form) should provide for the Claimant to provide a rent deposit equivalent to a quarter's rent.

10. Immediately in advance of the hearing, the Respondent made an open offer to the Claimant that it would allow six months to build up the quarter's rent deposit, and twelve months to prepare for the switch from paying rent monthly

in advance (as is done presently under the terms of the Lease) to quarterly in advance. However, this offer was made conditional upon the Claimant agreeing in return to enter into a new lease rather than insisting on a DOV. No application was made to amend the pleadings as a result of the offer.

11. Since the hearing, the Respondent has confirmed in open correspondence from its solicitors dated 30 October 2018 that it will enter into an agreement in the form of a DOV, and therefore has, as a result of this, demonstrated that MRO terms can in fact be achieved via a DOV rather than exclusively by way of a new lease in this case. In this correspondence, the Respondent has provided the Claimant with a draft form of DOV that it would be prepared to enter into, and agreed to honour the concessions referred to at paragraph 10 above, by providing a side letter confirming that the Claimant can build up the security deposit by six monthly instalments and pay rent monthly for twelve months before then switching to quarterly rent.

12. With these subsequent events in mind, as a point of law and for the reasons fully set out in Appendix 2 to this Award, I am satisfied that MRO can be achieved by way of either a DOV or the grant of a new lease, and that it is (generally speaking) a question of reasonableness as to which vehicle can be pursued in any given case.

13. However, whilst the Respondent has now confirmed that a DOV can be MRO-compliant, it does not appear that the Respondent has expressly conceded that a new lease could not also be MRO-compliant in this case. I therefore consider that I should determine this issue.

14. One of the Claimant's main arguments was that the MRO proposal was drafted in such a way as to make the MRO option appear as unattractive as possible and to persuade the Claimant to remain tied, and that this included its decision to offer the MRO option by way of a new lease rather than a DOV. Further, the Claimant also argued that the Respondent failed to put forward a good reason for its choice of new lease in this case given the impact that such a proposal would have on the Claimant. The Claimant rejected the assertion by the Respondent that an MRO-compliant tenancy can only take the form of a new lease and that the mode of delivery of MRO is not subject to a test of reasonableness. Besides the disputed issues of quarterly rent and rent deposit, the Claimant cited the disadvantages of a new lease including liability for Stamp Duty Land Tax upon the grant of the new lease and liability for dilapidations/repairs upon the determination of the existing lease.

15. The Respondent considered that there were three questions to answer: does the statutory position permit MRO to be delivered by DOV; if so, is the Respondent's choice of vehicle capable of challenge; if so, should a DOV have been provided in this case? The Respondent argued that Parliament's clear intention was that MRO should be achieved by the grant of a new lease, and further that if a DOV was permitted that the law does not provide a TPT with a right to challenge a POB's choice of vehicle. The Respondent sought to argue that it had been conceded by the Claimant that such a choice was not subject to a test of reasonableness, but it seems plain to me that this was not

the Claimant's position. In relation to whether a DOV was a reasonable means of achieving MRO in this case, the Respondent argued that it was generally desirable to have uniformity, and that a standard form of new lease is preferable ("the estate management argument") and that there would be considerable difficulties in varying the existing tied tenancy terms, with the grant of a new lease being more straightforward ("the drafting argument"). The Respondent rejected the Claimant's arguments about the disadvantages of a new lease.

16. The Claimant argued that the Respondent had failed to show good reason for proposing a new lease in this case. The Claimant rejected the estate management argument stating that uniformity should not be applied indiscriminately without regard to existing terms, and that whether or not this might be justifiable in other cases, there was no such justification in this instance given the relatively modern form of the Lease and its similarities to the proposed MRO agreement. In relation to the drafting argument the Claimant asserted that the alleged difficulties were exaggerated and would be capable of resolution by negotiation in the same way as the terms of a new lease.

17. Whilst the choice of MRO vehicle in a particular case is that of the POB, there must be fair reasons for that choice, and fair reasons for any new terms and conditions that form part of the offer. Having regard to the circumstances of this case I find I agree with the Claimant that the Respondent has failed to demonstrate that there is a requirement for a new lease and has failed to show sufficient reasons for this choice in this particular case, bearing in mind the impact of those choices on the Claimant, and that therefore the MRO offer is non-compliant. The offer made by the Respondent at a relatively late stage as to quarterly rent and rent deposit (and, initially at least, only if a new lease was taken rather than a DOV), did not adequately mitigate these disadvantages to the Claimant, and therefore does not render the MRO offer compliant. I consider on the balance of probabilities that these concessions did not adequately reflect the likely outcome of negotiations between motivated parties in the market, and I find that the Respondent's subsequent offer of a DOV is a strong indication that further mitigation of the adverse effects of the MRO proposal in this case would have resulted from genuine open market negotiations. The circumstances arising here, again on the balance of probabilities, strongly suggest that the parties to such negotiations in this case would agree a DOV rather than a new lease, and I find as such.

18. In relation to the DOV offer made by the Respondent after the hearing, it is not clear to me whether this was merely a settlement offer or an acceptance by the Respondent that the original MRO offer was non-compliant. In any event this second offer is not the statutory proposal that has been referred for arbitration, and is not a matter in dispute in relation to which I have jurisdiction or that has been tested in evidence before me. I therefore make no findings as to whether the terms of the proposed DOV are MRO-compliant.

19. Having set out my findings in relation to the vehicle issue in this case, I now proceed to determine the remaining matters in dispute set out at paragraphs 9.2 and 9.3 above.

Should the terms of the MRO tenancy provide for rent be paid quarterly in advance and for the Claimant to provide a quarterly rent deposit?

20. The Claimant's case on these issues was put forward in its pleadings, as well as in the skeleton argument prepared by in advance of the hearing and was further advanced by at the hearing itself. of the Claimant company, gave evidence at the hearing and also provided witness statements in advance.

21. The Respondent's case on these issues was put forward in its pleadings, as well as in the skeleton argument prepared by in advance of the hearing and was further advanced by at the hearing itself. gave evidence for the Respondent at the hearing on the issue of commonality of terms and provided witness statements in advance.

22. referred to the Advice Note and asserted that the Respondent's requirements for the Claimant to move from monthly to quarterly rent and provide a 3-month rent deposit (amongst other things) were intended to make the MRO option as unattractive as possible, and that the Respondent failed to show good reason for these requirements or (at least prior to offering the concessions referred to at paragraph 10 above which the Claimant, whilst admitting that these would lessen the impact of the MRO proposal, maintained were unreasonable and therefore non-compliant) to mitigate their effect. asserts that the Respondent's intention was to effectively persuade the Claimant to stay tied.

23. As part of its justification for these (and other) proposed terms, the Respondent relied upon the estate management and drafting arguments, as referred to above. As previously stated, I am not persuaded in this case that either of these arguments are good reasons, either generally or specifically in relation to these two terms, to outweigh the disadvantages to the Claimant, and to reflect what motivated parties would agree in a market negotiation in this case.

24. Referring to the Advice Note, the Claimant adopts the following position with regard to the reasonableness of these terms:

    24.1 That the terms of an MRO-compliant tenancy do not have to remain the same as in the existing tied tenancy.

    24.2 That the terms, individually and taken together, have to be reasonable.

    24.3 That whether a term is unreasonable (otherwise than being uncommon) will depend on the circumstances, but that the Respondent's MRO Proposal should be consistent with the Pubs Code

core principles, and that in determining reasonableness it is relevant to consider whether there are any fair reasons for proposing any new terms and conditions, the terms of relevant existing tenancies and the existing contractual relationship between the parties.

25. As to the commonality of the two terms, the Claimant suggests that the Respondent's approach is not universal, and that for instance it does have a number of free of tie leases where rent is payable monthly. However, the Claimant also argues that commonality in itself does not provide fair reason in circumstances where a term has an adverse effect that is unreasonable to a TPT. The Claimant's argument is essentially not about commonality but about the reasonableness of the Respondent's approach in this case.

26. As to the Respondent's arguments that it is reasonable for them to seek the administrative benefits that accrue from proposing standard terms, the Claimant argues that this approach is flawed because the Respondent already administers FOT leases with different terms, and that there would be no great material benefit to the Respondent in insisting upon the incorporation of these terms in an MRO tenancy.

27. On the basis that the two proposed terms will cause the Claimant disadvantage, the Claimant submits that they are therefore unreasonable and so not MRO-compliant. Essentially, the disadvantage arising is to the Claimant's cash position/cash flow in being required to pay rent quarterly in advance, and by placing three months' rent into a deposit.

28. In the evidence of [redacted] for the Claimant, it was confirmed that the rent was paid up-to-date and that there had not been a missed rental payment during the term of the Lease. The Claimant recognised the subsequent offer made by the Respondent, and as stated above it was conceded that these would make the proposed terms more affordable. However, specifically with regard to the rent deposit, [redacted] for the Claimant stated that a requirement to pay £73,750 (as per the figures provided with the MRO Proposal) based solely on commonality grounds was still unreasonable, on the basis that the Claimant being a substantial company, with an unblemished payment record and providing personal guarantees provided adequate protection against risk for the Respondent. In addition, the proposed alienation provisions (which were not in dispute) would provide the Respondent with adequate protections in relation to any incoming assignee as well, if any assignment was ever proposed.

29. In order to determine whether these terms render the MRO Proposal non-compliant, [redacted] for the Respondent considered it necessary to address whether MRO terms should be on the same basis as the existing tenancy, subject only to changes necessary to make it compliant, and if not whether the terms are common and if they are common whether they are otherwise reasonable. [redacted] argued that the Respondent's evidence demonstrated that both such terms are common, and that this is itself strong evidence that such terms are reasonable. He argued that the evidence shows that quarterly payments are common and that monthly rent payments are not

common and are therefore unreasonable. Further he similarly argued that the Respondent's evidence shows that a three-month rent deposit is common and therefore reasonable, and that with the higher rent liability and the changing nature of the relationship between the parties, it is reasonable for the Respondent to have this additional security.

30. In [redacted] evidence for the Respondent, he stated that these terms were shown to be common by the documentary evidence provided by the Respondent but did concede under cross-examination that there were some such leases with monthly rent payment terms, particularly in relation to tied DOVs. He also admitted that monthly rents were not more difficult to administer than quarterly rents. [redacted] stated however that there was a property value issue in relation to the requirement for quarterly rents, as the market preferred these to monthly rents. [redacted] admitted that the Respondent had not made any specific assessment of the risk to the Claimant in this case by insisting on quarterly rents but stated that the Claimant's business was doing well. In relation to the Respondent's evidence of 18 tie release transactions, [redacted] accepted that there was no evidence of a rent deposit being required in 13 of these.

Decision

31. I consider that the Claimant's arguments are based more upon the general unreasonableness of the proposed terms (as per section 43(4) of the 2015 Act) rather than on the uncommonness of the terms (under regulation 31(2)(c) of the Pubs Code).

32. As the Claimant has not put its case on the grounds of commonality, I make no particular findings on this except to acknowledge that on the Claimant's case the two terms in dispute have not been shown to be unreasonable by virtue of being uncommon. Nevertheless, and although the Claimant's case is brought primarily on the grounds of reasonableness, the parties were not agreed on the principles of commonness. In particular, the Respondent asserted that monthly rent payment is uncommon and therefore unreasonable, a point disputed by the Claimant. Notwithstanding my findings above on commonality in relation to rent payment frequency, on the basis of the evidence in this case I find that I am not persuaded on the balance of probabilities that monthly rent payments are uncommon and therefore unreasonable in this respect.

33. The issue that remains for me to decide therefore is whether or not the two terms are otherwise unreasonable in these particular circumstances, in relation to which I have had regard to the Pubs Code core principles and all other relevant factors.

34. In this case I find that a proper challenge has been made by the Claimant to these two terms, and further the Respondent has not persuaded me on the balance of probabilities that there are fair reasons for their insistence upon these terms in this case.

35. I find that movement to a quarterly rent in advance and the provision of a three-month rent deposit will have a sufficiently significant negative impact on the Claimant's cash position in the business to be unreasonable. In arriving at my decision, I recognise that it is relevant to consider that alternative variations incorporating monthly rent payment and no rent deposit relate to an earlier time, mainly prior to the Pubs Code, and that the Respondent is now granting a larger number of tie free tenancies to existing TPTs due to the statutory scheme, which is changing the nature of its estate. Nevertheless, in this case I find that the Respondent has not shown that it has applied its mind to the particular circumstances of the Claimant, having adopted standard terms which it seeks to apply as a matter of policy. Further the Respondent has not shown that it has considered the strong financial record and covenant strength of the Claimant, and what it would do in these circumstances if it was negotiating willingly in the open market with a tenant coming to the negotiating table with such a good track record. On this basis, I consider that the Respondent has not demonstrated that it has approached the matter with regard to the specific circumstances of the Claimant and in doing so has imposed unreasonable terms. On the balance of the evidence before me, I find that the existing business/lease relationship between the parties, the Claimant's good track record, and the evidence that the Respondent has adopted a variable/flexible approach towards rent payment frequency in other cases all provide strong evidence that the Respondent's insistence upon these two terms is unreasonable in the circumstances of this case. Furthermore, the fact that the Respondent made subsequent offers to the Claimant allowing time to build up to adopting quarterly rent, and to build up the rent deposit, show that there was further room for change on these terms, and show that the Respondent had not previously fully considered whether the terms of its full response were reasonable for this tenant.

36. Whilst it is necessary for me to consider reasonableness from the position of both parties, I am not persuaded by the Respondent's arguments that commonality proves reasonableness to the exclusion of other considerations. The points made in evidence about the administrative benefits of quarterly rent now seem weak, as also do submissions about the financial standing of the Claimant and his ability to meet these costs, particularly as the Respondent has other substantial protections and reassurances, given the Claimant's unblemished rent payment record which is not in dispute. Whilst I understand the point made about the value of the Respondent's reversionary interest (which was not accepted by the Claimant) I am not persuaded that this is a factor that should outweigh other considerations in this particular case.

37. With regard to the concessions offered by the Respondent these were not part of the original proposal and made at a relatively late stage in the proceedings, and then only linked explicitly to the taking of a new lease, which I have found to be a non-compliant approach. The offer of the same concessions after the hearing in relation to the proposed DOV is not a matter that has been tested in evidence before me, and I make no finding in this respect.

38. On this basis, I find that the Respondent's requirements that the proposed MRO tenancy should include terms for quarterly rental payments and a three-month rent deposit (or any deposit on the evidence in this case) are unreasonable, and that therefore the MRO Proposal is non-compliant.

39. In the last 12 months, a number of Pubs Code arbitration awards have been issued in respect of referrals to the PCA under regulation 32(2)(a) of the Pubs Code. Regulation 33(2) empowers an Arbitrator to rule on such a referral that the POB must provide a revised response to the tied tenant. A "revised response" is defined in regulation 33(3) as a response which includes the information mentioned in regulation 29(3)(a) to (c) (which includes a proposed tenancy which is MRO-compliant).

40. The power in regulation 33(2) is not prescriptive. It does not restrict the nature of the ruling which I may make as Arbitrator in this case.

41. I am of the view that following this Award the revised response should be such that further disputes as to the compliance of that revised proposal do not arise. There remains, as ever, a hope and expectation that parties will seek to negotiate mutually acceptable MRO terms in this case. However based upon my experience where an MRO proposal is found to be non-compliant and a direction is made to provide a revised response without specifying its precise form, there is a significant risk of continuing disagreement between the parties about the interpretation of an award, therefore risking further delay to the MRO process. As such, failing such agreement in this case, I consider that the appropriate course of action is for me to make a ruling under regulation 33(2) of the Pubs Code for the Respondent to provide a revised MRO proposal to the Claimant within 21 days, which is to be copied to me as Arbitrator. That revised response should be in the form of a DOV and should not contain terms for quarterly rent or a rent deposit, which I have found to be non-compliant. I will retain jurisdiction to consider the compliance of that revised response if called upon to do so by the Claimant within 21 days from the date of that revised response. This will include, if necessary and appropriate, determination of a compliant MRO proposal such that my ruling under regulation 33(2) could (at that stage) be for the Respondent to provide a revised response in precise terms to be ordered, and for which I may require both expert advice as to what those terms should be, and legal assistance in the drafting of the appropriate form of agreement to achieve MRO compliant terms.

Costs

42. Issues as to costs of the arbitration are reserved pending the parties' opportunity to make submissions as to costs.

Operative Provisions (Order)

43. In light of the above findings:

43.1 The Respondent's MRO offer in the form of a new lease is unreasonable and therefore non-compliant and contains terms in relation to quarterly rent payment and one quarter's rent deposit that are unreasonable and therefore non-compliant;

43.2 The Respondent is to provide a revised response (within the meaning of regulation 33(2) of the Pubs Code) to the Claimant which is to be in the form of a DOV and which is not to contain terms for quarterly rent or a rent deposit;

43.3 The revised response must be provided to the Claimant, with a copy to the Arbitrator, within 21 days of the date of this Award;

43.4 If the Claimant is not satisfied with the terms of the revised response, the Arbitrator reserves jurisdiction upon the Claimant's request received by him within 21 days from the date of the revised response to issue further directions for the determination of the reasonableness of the terms of the revised response, or (at his own discretion) to appoint an alternative arbitrator to do so;

43.5 Costs are reserved.

Arbitrator's Signature ……..

Date Award made ……25/01/2019..……

AMENDED PURSUANT TO ARTICLE 38(1) & (2) OF THE ClArb ARBIRATION RULES ON 29TH April 2019.

Appendix 1 – Applicable Law

1. Section 42 of the 2015 Act makes provision for the Secretary of State to make regulations about practice and procedures to be followed by POBs in their dealings with TPTs, to be referred to as "the Pubs Code", and subsection (3) provides:

> *(3) The Secretary of State must seek to ensure that the Pubs Code is consistent with –*
>
> > *(a) the principle of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants;*
> >
> > *(b) 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.*

2. Section 43 of the 2015 Act outlines the specified circumstances when a pub-owning business must offer a market rent only option to a tied pub tenant, and what is required in a compliant market rent only tenancy/licence, and sub-sections (4) and (5) provide that:

> *(4) A tenancy or licence is MRO-compliant if—*
>
> > *(a) taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy or licence it—*
> >
> > > *(i) contains such terms and conditions as may be required by virtue of subsection (5)(a),*
> > >
> > > *(ii) does not contain any product or service tie other than one in respect of insurance in connection with the tied pub, and*
> > >
> > > *(iii) does not contain any unreasonable terms or conditions, and*
> >
> > *(b) it is not a tenancy at will.*

3. Regulation 23 of the Code provides for the TPT to give the POB an MRO notice where a specified event occurs. Where the POB agrees that the TPT's description in the notice demonstrates that a relevant event has taken place, pursuant to regulation 29(3) the POB must send the TPT a statement confirming its agreement and, where the MRO notice relates to a tenancy or licence, a proposed tenancy or licence respectively which is MRO-compliant.

4. Regulation 31 of the Pubs Code then outlines some terms which are to be regarded as unreasonable in relation to proposed MRO tenancies, and paragraphs (1) and (2) provide:

> *(1) Paragraph (2) applies where—*
>
> > *(a) a tied pub tenant is subject to a tenancy ("the existing tenancy") granted by the pub-owning business;*
> >
> > *(b) the tied pub tenant gives an MRO notice to the pub-owning business; and*
> >
> > *(c) the pub-owning business sends a proposed tenancy ("the proposed MRO tenancy") to the tied pub tenant as part of a full response under regulation 29(3) or a revised response under regulation 33(2) or otherwise during the negotiation period.*
>
> *(2) The terms and conditions of the proposed MRO tenancy, taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy, are to be regarded as unreasonable for the purposes of section 43(4) of SBEEA 2015 if they—*
>
> *…*
>
> > *(c) are terms which are not common terms in agreements between landlords and pub tenants who are not subject to product or service ties.*
>
> *(3) Paragraph (4) applies where—*
>
> > *(a) the conditions in paragraph (1)(a) to (c) are met, and*
> >
> > *(b) the existing tenancy is a protected 1954 Act tenancy.*
>
> *(4) The terms and conditions of the proposed MRO tenancy, taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy, are to be regarded as unreasonable for the purposes of section 43(4) of SBEEA 2015 if they exclude the provisions of sections 24 to 28 of the Landlord and Tenant Act 1954 in relation to the proposed MRO tenancy.*

Appendix 2 – Vehicle for the MRO Option

1. There has been much debate as to whether the MRO should be delivered by way of a new lease, or by way of a variation by deed of the terms of the existing lease. There is no express provision in either the 2015 Act or the Pubs Code which states that an MRO-compliant tenancy must be provided either by way of a new lease or by way of a DOV. Indeed, there is no express provision as to its form at all, only as to its terms.

Interpreting the Legislation

2. In interpreting legislation, it is necessary to ascertain objectively, by reference to the language used in it, what Parliament intended. That language should be given its natural meaning rather than a strained one, and background material must not take precedence over the clear meaning of the words used. Legislation should be construed according to the intention expressed in the language.

3. The word “tenancy” (in and of itself) does not gives any particular guidance; a DOV, when incorporated into the existing lease, will comprise a tenancy just as effectively as a new lease. The statutory language does not suggest that a new and separate agreement must be entered into. There are no clear words which would indicate this - such as the “grant” of a tenancy or its "commencement", or the “termination”, “surrender” or “end” of the existing tenancy. The language used, for example “accept” and “enter into” in regulation 39, is consistent with a new tenancy or a varied one.

4. When interpreting the Code, it is proper to have regard to the extent of the rule-making power conferred by the primary legislation. The 2015 Act requires the Code to confer on the TPT a "*market rent only option*" - Section 43(1) of the 2015 Act provides that the Pubs Code must "*require the pub-owning business to offer their tied pub tenants falling within s.70(1)(a) a market rent only option in specified circumstances*". Section 43(2)(a) provides that the "*market rent only option*" means the option for the TPT to occupy the tied pub under a tenancy or licence which is MRO-compliant. Subsection (4) specifies the circumstances in which a tenancy or licence is "*MRO-compliant*". Therefore, the definition of an MRO-compliant tenancy is set out within the 2015 Act, not the Code, other than as delegated under section 43(5), which provides for the matters in respect of the content of proposed tenancy which are delegated by the Act to the Code as follows:

> *The Pubs Code may specify descriptions of terms and conditions—*
>
> *(a)which are required to be contained in a tenancy or licence for it to be MRO-compliant;*
>
> *(b)which are to be regarded as reasonable or unreasonable for the purposes of subsection (4).*

5. It is under this section 43(5) power that regulations 30 (regarding lease terms) and 31 (as to terms and conditions regarded as unreasonable) are made, and these are the only regulations in the Code that provide for the form and content of the MRO-compliant tenancy. Neither provision relates to the form or content of the proposed MRO tenancy as being the terms of a new lease or the terms of the

existing tied lease varied by deed. It was open to Parliament to make further provision as empowered by section 43(5), but it conspicuously did not.

6. Section 44(1)(a) of the 2015 Act provides that the Pubs Code may "*make provision about the procedure to be followed in connection with an offer of a market rent only option (referred to in this Part as "the MRO procedure") …*". This delegates to the Code the procedure in connection with an offer of an MRO option, and not the form or content of the proposal, which is the subject of the separate delegation in section 43(5).

7. Considering the language of the Pubs Code and looking at the way in which the term "tenancy" is used in context within the legislation does not indicate that Parliament intended the MRO option was to be implemented by the grant of a new tenancy only and not a DOV. The provisions referring to a "tenancy" include:

    1. Regulation 29(3) requires the POB to send to the TPT "*a proposed tenancy which is MRO-compliant*"

    2. Regulation 30(1)(a) and (c) refer to the "*existing tenancy*" and a "*proposed MRO tenancy*"

    3. Regulation 30(2) refers to the term of the existing tenancy and the term of the proposed MRO tenancy, which must be "*at least as long as the remaining term of the existing tenancy*". Regulations 34(2) and 37(1) refer to the *"proposed tenancy or licence".*

    4. Regulation 39(2) and (4) (dealing with the end of the MRO procedure) refer to the POB and TPT *"entering into"* the tenancy or licence.

    There is nothing in the language of these provisions that is not appropriate for the execution of a DOV.

8. Considering the following language also provides no grounds to undermine the proposition that the MRO can be the existing tenancy amended by deed:

    1. The definition of "market rent" in section 43(10) of the 2015 Act, which provides for an estimated rent based on certain assumptions, including that the lease is entered into on the date the determination of the estimated rent is made, in an arm's length transaction.

    2. Section 43(4)(a) sets out the circumstances in which a tenancy or licence is "MRO-compliant" and in doing so refers to the "t*enancy or licence" "taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy or licence*".

    3. Section 44(2)(b) of the 2015 Act sets out provision for a negotiation period for parties to agree rent *"in respect of the tied pub tenant's occupation of the premises concerned under the proposed MRO-compliant tenancy or licence."*

9. There is nothing in the way that the term tenancy is used in context that indicates that the MRO could only be offered by way of a new lease. There is nothing in the use of the phrases "existing tenancy" and "proposed tenancy" in regulations 30 and 31 to suggest that the existing and proposed tenancy must be different tenancies – i.e. that the latter must bring an end to the former, or that the proposed tenancy must be completely contained within a new document from that of the existing

tenancy. Parliament chose not to make provision that a compliant MRO proposal must contain a new tenancy to be granted upon the surrender of the existing one, though it might easily have done so. The provisions relating to the market rent (in section 43(10) of the 2015 Act) relate to the rent under the MRO-compliant lease, but do not inform what those lease terms and conditions are.

10. Furthermore, the draftsperson was alive to the need to specify a “new” MRO tenancy to distinguish it from an existing tenancy, if such need existed. This is clear from the expression "new tenancy" appeared in the Code no less than 19 times (within the definition of "new agreement", which refers only to a new tied tenancy). It would have been simple for the draftsperson to have made clear any restriction against the use of a DOV, and the complete and consistent failure to do so in the language of the Code demonstrates plainly that no such restriction was intended.

11. That the legislation does not by implication require an MRO-compliant option to be given only by way of a DOV seems to be clear however. Regulation 30(2) provides that an MRO tenancy will only be MRO-compliant if its term is at least as long as the remaining term of the existing tenancy, and its term can therefore expire after the date of expiry of the original lease. As a matter of law, where the term of a lease is extended by way of a DOV, it operates as a surrender of the existing lease and a grant of a new lease. Furthermore, if the proposed tenancy was intended to be achieved by variation of the existing tenancy only, there would be no need for the provisions in regulation 31(3) and (4) preserving rights under the Landlord and Tenant Act 1954 where they apply to existing leases, as such protection would be unaffected. Lastly, where the existing TPT is a tenant at will (as per section 70(2) of the 2015 Act) because pursuant to section 43(4)(b) an MRO tenancy cannot be a tenancy at will, the MRO must therefore be a new tenancy.

Background Material

12. Correspondence to the then Secretary of State Vince Cable MP dated 25 October 2013, from CAMRA and others advocating the MRO option, referred expressly to the expectation that the POB would issue a DOV. This serves to illustrate that, having been specifically asked to contemplate a DOV, the Secretary of State did not make regulations which expressly prohibited it.

13. The fact that open language has been used in the Government Consultation on the new Pubs Code (October 2015) does not mean that its meaning is unclear. In fact, it is not. On the contrary, the ordinary meaning of the language is permissive of either a new lease or a lease varied by deed, and this is not a reason to look at other material to seek to interpret the ordinary meaning in a more restrictive way.

14. Such background material must not be allowed to take precedence over the clear meaning of the words used. In *Milton v DPP* [2007] EWHC 532 (Admin), Smith LJ stated at [24] (as cited with approval in *Christian UYI Limited v HMRC* [2018] UKUT 0010) that:

> *"If the meaning is clear, there is no need to delve into the policy background. If the court is uncertain as to the meaning, it may well be helpful to consider background material in order to discover the "mischief" at which the change in the new law was aimed."*

15. Section 9 of this consultation considers the powers to be delegated under section 43(5) in respect of the compliant MRO tenancies, including:

> *9.4 The Government does not propose to prescribe a model form of MRO-compliant agreement in the Code. Rather we expect MRO agreements to be modelled on the standard types of commercial agreements that are already common for free-of-tie tenants.*

16. It is clear that there was no intention to prescribe a form. An expectation as to the form is referenced which is a precursor to the commonness test in regulation 31(2)(c), the meaning of which does not require clarification by reference to this paragraph of the consultation. Notwithstanding the inclusion of the word "commercial" (which does not appear in the legislation) it is not clear that Parliament is intending to exclude a lease varied by DOV, rather than leaving the matter to the market. Given paragraph 9.4, it would be hard to rely on other parts of the consultation to show that the Government did indeed intend to prescribe that the MRO-compliant agreement could not be in the form of a tied lease with a tie release by DOV, rather than to leave it to the market to decide.

17. The expression "new tenancy" is not found in other paragraphs of the consultation which refer to a new (MRO) agreement, not even in paragraphs 9.6 and 9.8 where a tenancy has already been referred to earlier in the sentences. Furthermore, the expression "new agreement", which is not consistently used in the consultation, is not an unequivocal marker of intention. In 6.13 a "new agreement" which will end a rent assessment does not need to be a new tied tenancy after surrender of the old. There should not be too much read into selected words of the consultation or into the Government's response to the consultation dated April 2016, where the expression "new agreement" does not occur in the context of MRO at all.

18. Powers to make provision in relation to the MRO procedure, delegated under section 44(1), are considered in section 10 of the same Consultation:

> *10.11 However, where the tenant requests an MRO agreement, their intention is to move to a completely new form of contractual relationship with the pub-owning business. Changes to the old tied terms that occur during the MRO procedure will have no equivalent terms in the MRO agreement. It is therefore neither appropriate nor practical to alter the MRO offer to take account of the increased prices paid by the tenant during the MRO procedure.*

19. All that this means is that the "form of contractual relationship" (i.e. tie free) is new, not necessarily that the contractual documentation itself is a wholly new entity. The remainder of this paragraph deals with changes in tied terms during the MRO procedure (and not as a result of it), and the rent.

20. Looking at these passages, they are far from conclusive that only a new lease can be compliant. There is no silver bullet within them. These extracts cannot be viewed too selectively to be understood to point towards a prohibition of DOV. These are a few of many references in the consultation documents to the MRO agreement. Read as a whole what is obviously lacking is any direct and decisive comment on the permissible vehicle for the MRO, which is consistent with an intention not to make unjustified intervention in commercial dealings between the parties.

21. There is nothing in the legislation which precludes or requires the grant of a new tenancy, and if this had been the intention of Parliament or the Secretary of State, there would be express provision to one effect or the other. Accordingly, either a DOV or a new lease (subject to its terms and conditions) is capable of bringing about an MRO-compliant tenancy.

22. It should also be observed that the legislation, however, in not prescribing the contents of the MRO-compliant tenancy except as set out in section 43(4) and regulation 31, has not expressly required that the terms of the MRO-compliant tenancy remain the same as the terms of the original tenancy, with variation only of the rent and severance of the tie. This is consistent with the MRO vehicle not being restricted to a DOV and is another matter for which there could easily have been provision if that was the legislator's intention.

Appendix 3 – Unreasonableness

The terms and conditions must not be unreasonable overall. Uncommonness is merely one way in which terms can be unreasonable.

1. Pursuant to section 43(4) an MRO-compliant tenancy cannot contain any unreasonable terms or conditions. Regulation 31 of the Code makes provision for certain terms and conditions which will automatically be unreasonable, amongst them (under paragraphs (2)(c)) terms which are uncommon in tie free leases.

2. It is necessary first to consider whether the terms set out in that regulation are an exhaustive list of all unreasonable terms and conditions, but it is clear from a straightforward reading of the legislation that they are not and are merely particular examples of unreasonable terms. Section 43(5)(b) is a power not a duty, and section 43(4) renders a tenancy non-compliant for any unreasonable terms or conditions in any event, notwithstanding that the Secretary of State might not have chosen to exercise that power to specify descriptions of terms and conditions to be regarded as reasonable or unreasonable. It is still necessary for all terms and conditions in the proposed tenancy to be reasonable in a broader sense.

3. Therefore, determining MRO-compliance is not simply a question of looking at each individual term to decide whether it is uncommon for the purposes of regulation 31, but whether the proposed MRO tenancy contains terms or conditions which are unreasonable. The term or conditions of a lease may be unreasonable by virtue of words which are not included, and not just those that are.

The terms and conditions must not individually and collectively be unreasonable

4. Furthermore, it is not the case that the language of the 2015 Act and Pubs Code requires consideration of each proposed term or condition in isolation. A judgement as to whether an individual term or condition is unreasonable may be affected by the other terms and conditions of the proposed tenancy. Two or more terms and conditions together may render the proposed tenancy unreasonable, for example, where they are inconsistent with each other, or where their combined effect is too onerous for the tenant. Indeed, this is reflected in the normal course of negotiations between parties in the market, in which a tenant may not look at each term or condition in isolation to decide if it is reasonable. A tenant may consider that a number of terms together in a lease may make the proposed terms unreasonable. There may be some particular terms which are make or break, but often some terms objected to may be rendered acceptable by virtue of concessions elsewhere in the negotiation. It is necessary therefore to consider not just whether the individual terms are unreasonable, but also whether that test applies to the proposed lease as a whole.

5. Thus, for example, the payment of an increased deposit, rent in advance and payment of insurance annually in advance would constitute additional costs to the tenant. Other cost considerations at entry may be legal fees and the payment of dilapidations. Where costs, including entry costs, are excessive in total, but negotiated to a reasonable level overall, it may not be correct to focus on an individual term or condition in isolation to and decide if that cost is or is not reasonable – it may depend on the context.

6. A tenancy will not be compliant if its terms and conditions, individually or collectively, are unreasonable. That this is the correct approach to considering whether proposed lease terms are uncommon is furthermore clear from the wording of regulation 31(2), which refers to terms and conditions only in the plural. Therefore, this regulation requires

consideration of whether the agreement as a whole is one which is not common in tie free agreements.

The choice of vehicle for delivering MRO cannot be unreasonable

7. Section 43(4) refers to a tenancy being MRO-compliant if "taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy or licence" it does not contain any unreasonable terms and conditions pursuant to subsection (iii). There is no necessity to restrict the interpretation of "contained" to the express terms of the proposed tenancy document alone. This is broad enough to encompass the requirement to enter into a new tenancy. Therefore, the choice of vehicle is subject to a test of unreasonableness.

8. The question of whether the choice of MRO vehicle is unreasonable can correctly be analysed in both of the following two ways. Firstly, the lease terms individually and collectively cannot be unreasonable, and if they are in the form of a new lease which unreasonably imposes an excessive burden on the TPT, then those terms can be unreasonable and non-compliant. Secondly, the fact that the POB offers the proposed MRO tenancy only by way of new lease can amount to an implied condition (precedent) in the lease, in that the MRO option can only be exercised if the TPT agrees to a new lease. The method of delivery would on that analysis be a term or condition which, if challenged by the TPT, falls for consideration under section 43(4) of the 2015 Act and may be unreasonable if there is no good reason for any resulting disadvantage imposed on the TPT (while noting that it is only uncommon terms, not uncommon conditions that fall foul of the wording of regulation 31(2)).

Unreasonableness - meaning

9. The legislation imposes on the POB a statutory duty to serve on the TPT a proposed tenancy which is compliant. Accordingly, it is for the POB to make the choice of terms and vehicle, and that choice must not be unreasonable in the particular case. Communicating those reasons will help to avoid disputes and is consistent with the fair dealing principle.

10. In determining what is unreasonable, it is apparent that there is nothing in the statutory language which requires the meaning of that term to be determined only in light of open market considerations which would affect two unconnected parties entering into a new FOT lease. A term will be judged to be unreasonable or not based on all of the circumstances, as they are known (or ought to be known) to the parties, and each case will turn on its own facts. While a POB might achieve some certainty that particular lease terms are common in the tie free market, what is reasonable in one case for one particular pub may not be reasonable for another.

11. It is necessary to consider whether there is statutory guidance which assists in applying the test of unreasonableness. The starting point to understanding the Pubs Code and the statute which enabled it is the core principles, found in section 42 of the 2015 Act. Parliament's instruction to the Secretary of State in making the Pubs Code (which includes particular examples of unreasonable terms and conditions made pursuant to a power in the 2015 Act) is that she/he must seek to ensure that it is consistent with those principles.

12. The core Code principles are at the heart of the statutory purpose behind the establishment of the Pubs Code regime under the 2015 Act and relevant to the exercise of discretion or evaluative judgements pursuant to it. Furthermore, since provisions in the Pubs Code (including any regulations made under the power delegated in section 43(5))

are to be interpreted as consistent with the two core principles, if the provisions in the 2015 Act (in this case, as to reasonableness in section 43(4)(a)(iii)) are not, there would be a fundamental incompatibility between these instruments. Were the language in the 2015 Act and Pubs Code not consistent with these principles, the Secretary of State would not have enacted the Pubs Code in its current form.

13. It is proper to conclude therefore that the Pubs Code and s.43(4)(a)(iii) of the 2015 Act, read together, can be interpreted in a manner consistent with the principles of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants and that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie. If it is necessary to call statutory interpretation principles in aid, this is a purposive approach. Thus, these principles are relevant to my understanding of what terms and conditions may be "unreasonable", and some consideration is appropriate as to what they might mean in practice.

The Pubs Code Principles

Fair and lawful dealing

14. Its long title states that the 2015 Act is "to make provision for the creation of a Pubs Code and Adjudicator for the regulation of dealings by pub-owning businesses with their tied pub tenants" and the Code regulations, pursuant to section 42, are "about practices and procedures to be followed by pub-owning businesses in their dealings with their tied pub tenants." The term "dealings" is not defined in the 2015 Act. I note there is some inconsistency between the Pubs Code provisions at regulations 54 and 55 (which imply that "dealings" with a TPT may take place in relation to the MRO provisions by virtue of certain exclusions provided for) and the Explanatory Note (which does not form part of the regulations).

15. Overall, there is nothing in the statutory language which excludes the POB's conduct in the MRO procedure from being "dealings" with the TPT. The meaning of the term is broad, and it is fit to encompass any of the activities in the business relationship between the TPT and POB regulated by the Pubs Code. The term references the existing commercial relationship between them and includes interactions pursuant to the current lease as well as their business practices with each other in relation to a proposed lease and more generally. The requirement that such dealings are fair means that Parliament intended that, in addition to complying with legislation and private law principles, they should be in good faith, equitable and without unjust advantage.

No Worse Off

16. The second core Pubs Code principle requires a comparison of the position of TPTs with tenants who are tie free, and the former are intended to be no worse off than the latter. It would seem to me to be a judgement of fact and degree in each case whether a TPT is worse off. That judgement would include financial matters, particularly profit, but could it seems also include considerations not directly expressed in financial terms – for example a difference in bargaining power and the reduced risk in having a tied deal, or the business support available to a TPT from a POB may be something of value for the TPT. By pursuing the MRO option, the TPT should be in the position of being able to compare, and make an informed choice between, the two options.

The Application of Pubs Code Principles

17. It is consistent with the Pubs Code principles that the proposed tenancy which is made available to the TPT through the MRO procedure is not on worse terms and conditions

than that which would be made available to a free of tie ("FOT") tenant after negotiations on the open market. This is for two reasons. Firstly, if the POB was able to get more favourable terms from the TPT using the MRO procedure than it would on the open market, or than it would offer to a TPT it was motivated for business reasons, not required, to release from the tie, this would not be fair dealing. Secondly, the TPT would be worse off in having a choice to accept terms which were worse than would be available to a FOT tenant, including for example an existing FOT tenant renegotiating terms on lease renewal. In any event, these principles follow from the general concept of reasonableness, taking into account the relative negotiating positions of the parties within this statutory scheme.

18. Furthermore, the proposed new lease would be unreasonable and inconsistent with Pubs Code principles if it represented an unreasonable barrier to the TPT taking an MRO option, and thus frustrated Parliamentary intention. If the POB, in a new letting on the open market made a lease offer, the prospective new tenant would have various options available – including accepting the offer, negotiating different terms, negotiating better terms in respect of a different pub with one of the POB's competitors, or walking away.

19. The commercial relationship between the TPT and the POB on service of an MRO notice is different. The TPT (except at renewal) does not have the right to walk away or contract elsewhere. It only has the right to keep its current tied deal or to accept the offer. Even at renewal, any goodwill earned will be a relevant consideration for the tenant, as will the availability of the County Court's jurisdiction to determine reasonable terms of the new tenancy. The TPT in the MRO procedure is not in an open market position.

20. The test of unreasonableness is the counterbalance to the negotiating strength of the POB, with its inherent potential for unfair dealing towards a TPT in the MRO procedure (or any step to make the tenant worse off than if they were FOT). In addition, an attempt to thwart the MRO process by making the MRO proposed tenancy too unattractive would not be lawful dealing.

21. It must be emphasised that the existing tied deal is one to which the TPT contractually agreed. However, the occurrence of a specified event giving rise to the right to serve an MRO notice in each case is by its nature something which has affected the commercial balance of that deal as between the parties, and Parliament intended that this should give rise to a meaningful right to go tie free. The test of reasonableness requires that the POB, in offering the terms of the purported MRO tenancy, cannot take advantage of any absence of commercial bargaining power on the part of the existing TPT pursuing the MRO procedure.

22. It is in this particular context that a POB must be able to show that its choice of MRO vehicle is not unreasonable. This may be the case if there is a significant negative impact on the TPT arising from that choice, including one which operates as an unreasonable disincentive to taking the MRO option. Furthermore, the POB must be able to show that its choice of terms of the MRO tenancy are not unreasonable, and they may be if they have an impact of that nature. The choice of vehicle and proposed terms and conditions cannot be used to create an obstacle to the TPT exercising the right to an MRO option. There must be an effective choice available to the TPT.

23. Showing that the landlord's choices are not unreasonable naturally includes being able to articulate good reasons for them. This is necessary if the POB is to show it is not taking advantage of its negotiating strength. Communicating those reasons would reduce the chance of disputes (and it would support the fair dealing principle for the POB to provide those reasons alongside the MRO proposal, to aid negotiation). There must be

fair reasons for the POB's choice of MRO vehicle, and fair reasons for proposing the particular terms. Where fair reasons cannot be shown to exist, the terms and conditions of the MRO proposal may be considered unreasonable and not compliant.

24. Whether the terms of the MRO proposal are reasonable will depend on the impact they have on both parties. The interests of one party cannot be considered in isolation. The consideration must be balanced and the terms, and choice of vehicle, not unreasonable when viewed from either party's perspective.