IN THE MATTER OF **Ref: ARB/100842/SPLASHTAVERNS**

THE PUBS CODE ARBITRATION BETWEEN: -

Splash Taverns Ltd.

(Tied Pub Tenant)

Claimant

-and-

(1) Ei GROUP PLC
(Pub-owning Business)

First Respondent

-and-

(2) UNIQUE PUB PROPERTIES LIMITED
(Subsidiary of the First Respondent and landlord of the Claimant)

Second Respondent

Award

Summary of Award

The MRO full response was not compliant. It is appropriate that an order under Regulation 33(2) requires the Respondent to serve on the Claimant a revised response including a proposed MRO lease in the form of a deed of variation of the existing lease, on terms to be agreed or ordered. It may not be in the form of a deed of variation by reference, or as discussed in paragraph 27 of this award.

Introduction

1. The Claimant is the tied pub tenant of The Perseverance, 2 High Street, Wraysbury, TW19 5DB ("the Pub"), which it occupies by virtue of an assignment to it made on 17 October 2011 of a lease granted on 30 September 1998 by the Respondent Pub-Owning Business's predecessor in title for a term of 30 years from 1 August 1998. The Claimant is represented by its guarantor Mr Nick Higney and the Respondent is represented by Gosschalks Solicitors of Queens Gardens, Hull, HU1 3DZ. The applicable law and procedure is set out at Appendix 1 to this award.

2. The Claimant alleged in this referral[1] that the proposed MRO tenancy[2] was not compliant. The Claimant challenged the following on the basis that they were unreasonable (including not common) terms in free of tie agreements[3]:

    1. Inflationary annual rent increases
    2. Quarterly rent in advance
    3. 3 months' rent deposit
    4. New Business Plan / Credit Check
    5. Repair & Maintenance Fund
    6. Effect on Renewal Rights
    7. Dilapidations survey
    8. The POB has failed to identify uncommon terms in the existing lease which render it unlawful to convert to MRO via Deed of Variation.

Procedural History

3. These proceedings have been rather drawn out. After consultation with the parties, I issued Directions on 30 April 2018. On 21 May 2018 the Claimant served a Statement of Case and on 11 June 2018 the Respondent filed a Statement of Defence. The Respondent on 29 June 2018 sought directions for the production by each party of expert evidence as to whether the disputed terms are not common in free of tie tenancies.

4. A telephone case management conference took place on 1 August 2018. On that day a List of Issues in Dispute was agreed by the parties, on the basis of which the Respondent confirmed that it no longer sought directions for expert evidence. The List of Issues in Dispute included the following:

    "8.
    It is agreed that the Respondents concede the following disputed terms:-

    a) First Schedule, Clause 2(1) – insurance clause relating to Landlord not insuring and that the Head Landlord has insured.
    b) Fourth Schedule, Clause 12(6) – non assignment period.
    c) LR 9.2 and Fourth Schedule, Clause 12 (6)(D) – Pre-emption right.

[1] Made on 5 March 2018 pursuant to reg 32(2) of the Pubs Code etc. Regulations 2016 ("the Pubs Code").
[2] Issued as part of its full response on 26 February 2018 pursuant to reg 29(3) of the Pubs Code.
[3] In breach of section 43(4)(a)(iii) of the Small Business, Enterprise and Employment Act 2015 ("the 2015 Act") and regulation 31(2) of the Pubs Code.

d) Fourth Schedule, Clause 14 (2)(D) – alterations to be carried out at the satisfaction of the Landlord – the Landlord is prepared to insert the word reasonable into this clause.
e) Fourth Schedule, Clause 24– obligation to keep the property open for set open hours.
f) Fourth Schedule, Part II, Clause 6 – access to e-mail and internet.
g) Fourth Schedule, Part II, Clause 7 – pay as you go meters.
(i) Clause 1 (13) – Permitted user and, Clause 19 – Tenant to pay costs of insurance valuation.
(j) Clause 1(13) – permitted user.
(k) Fourth Schedule, Clause 19 – tenant to pay costs of insurance valuation.

It is agreed that the Respondents will not pursue the payment of £1,950.00 towards the legal costs of granting a new lease if a new lease is granted.

9. It is agreed that the Respondent will not insist on the Claimant carrying out the repairs under the Schedule of Dilapidations dated 5 April 2018 as a condition of granting the new lease. The Respondent does, however, require Statutory Compliance prior to the completion of the MRO Tenancy.

10. It is agreed that the Respondent is happy to provide a side letter to go with the MRO Tenancy in the following terms:-

> *'Without prejudice to their rights to object to renewal or to plead reasons for the Court to grant a shorter renewal lease, Ei confirm that should the question of the length of term of a renewal lease under s.33 of the Landlord and Tenant Act 1954 come before the courts:*
>
> *a) The fact that the tenant has converted from a previous tied lease to the present Free of Tie lease under the Pubs Code 2016 shall not be taken into account, so that the term of the present lease is to be read as if commencing at the start of the previous lease.*
> *b) the tenant and any successor in title can rely on this letter in relation to the same.'*

LIST OF ISSUES IN DISPUTE

The following are issues in dispute by the parties:-

1. *Does a MRO compliant tenancy have to be offered by means of a new tenancy, or should a deed of variation be offered?*
2. *Do the terms of any FOT tenancy offered have to be the same as the terms of the existing lease, subject only to such variations as are necessary to render the tenancy MRO compliant, so that the proposed tenancy is not a proposed tenancy for the purposes of Regulation 29(3)(b) of the Code, or the terms offered which unnecessarily differ from the terms of the existing lease are unreasonable or is it permissible (or required) to offer wholly new terms, subject only to the requirements of Section 43 of the Act?*
3. *If the FOT tenancy should differ from the existing terms only to the extent necessary to render it MRO compliant, what terms would be required to be varied in the subject lease, and which would not be required to be varied, so that, in so far as the proposed tenancies purport to vary them, they are not MRO compliant or are unreasonable?*

4. *Whether the Fourth Schedule, Part I, Clause 9(6) – Jervis v Harris Clause relating to the testing of gas and electrical safety is deemed to be unreasonable under Regulation 31(2)(c) of the Code because it is not common in agreements between landlords and pub tenants who are not subject to products or service codes.*
5. *Whether a term can be unreasonable for the purposes of Section 43(4)(a)(iii) of the Act if it is not deemed unreasonable by Regulation 31 of the Code?*
6. *If 5 applies, the following terms are unreasonable:-*
   (a) *Fourth Schedule, Clause 1(2) – quarterly rent in advance.*
   (b) *Fourth Schedule, Clause 9(5) – requirements in relation to gas and electrical equipment and installations.*
   (c) *Fourth Schedule, Part I, Clause 9(6) – Jervis v Harris Clause relating to testing of gas and electrical safety.*
   (d) *Fourth Schedule, Clause 12(6)(B)(II) - Assignment condition - undertaking to pay costs incurred.*
   (e) *Fourth Schedule, Clause 19 – tenant to pay costs of any breach or suspected breach or covenant.*
   (f) *Fourth Schedule, Clause 19 – tenant to give prior security for the costs."*

5. The parties have conducted negotiations, and the Respondent has made certain sequential offers openly to the arbitrator and not in without prejudice communications.

6. On 24 September 2018 the Respondent offered to the Claimant what it referred to both as an "amended full response" and a "Revised Full Response". This comprised a Deed of Variation which deleted all of the terms of the existing lease, apart from parties, demise and term, and inserted the terms of its proposed MRO lease (a "DOV by reference"), subject to the Respondent's concessions.

7. Subsequent case management steps have been overtaken by events, in light of the Respondent's concession which I shall turn to below. However, for completeness I summarise here what took place.

   a. A further telephone Case Management Conference that had been listed for 27 September 2018 was postponed at the Claimant's request and held on 17 October 2018, after which further directions were issued in relation to a concession by the Respondent regarding the schedule of dilapidations and the Claimant's application that he be permitted to broaden the issues in dispute in the agreed list (in relation to which the parties were invited to, and did, make representations). The Respondent renewed its request for expert evidence and a Direction was also issued for the parties to agree to the identity of and instructions to an expert to advise on the commonality of the proposed *Jervis v Harris* clause in free of tie leases.

   b. On 24 October 2018 an amended DOV by reference was served by the Respondent on the Claimant to reflect the concession made in this case that only statutory compliance is required prior to completion.

   c. On 14 November 2018 I wrote to the parties indicating that I would issue an award dealing with generic issues set out at issues 1,2,3 and 5 above in the List of Issues in Dispute agreed on 1 August 2018. I also indicated that I would deal with the Claimant's request to broaden the issues in

dispute, but before doing so and having had the opportunity to reflect on the parties' evidence and submissions, I considered it necessary to clarify the Respondent's position in light of service of the DOV by reference, and that clarification has taken some time.

Jurisdictional Issues

8. The arbitrator's jurisdiction arises in respect of a referral of the POB's full response under regulation 32(2)(b). Where a full response is not compliant (or is conceded as non-compliant), I have the power to make an order under regulation 32(2)(b) ordering the POB to serve a revised response.

9. In a letter from my office to the parties on 7 February 2019 the Respondent was requested to confirm within 7 days that it consented to an order that my powers under regulation 33(2) are engaged. The Respondent did not reply to that letter. The Claimant in its reply implied that it may want no award to be made until certain issues relating to works and local authority steps had been concluded. It was therefore unclear to me whether the Claimant wanted the proceedings to be stayed. The parties were advised on 1 March 2019 that they could agree to postpone any final determination on the dispute by the arbitrator, but the Claimant clarified on 5 March 2019 that it did not seek a stay in the proceedings.

10. On 1 March 2019 I also wrote to the parties in the following terms:

> *"On 27 September 2018 the Respondent sent to the Claimant a Revised Full Response. The Respondent has failed to respond to the DPCA's request made on 7 February 2019 that it confirm whether it consents to an order that her powers under regulation 33(2) are engaged. The DCPA now orders:*
>
> > *Unless the Respondent by 5pm on Wednesday 6 March 2019 files grounds upon which it considers in the circumstances that the DPCA's jurisdiction under regulation 33(2) is not engaged, the DPCA will proceed to issue an order pursuant to that regulation that the Respondent is ordered to provide a revised response to the Claimant within 28 days of the arbitrator's determination of its terms."*

11. The Respondent replied on 4 March 2019, refusing to concede the non-compliance of the MRO full response in the following terms:

> *"Although the Respondent has made concessions in this matter with a view to negotiating a settlement this does not mean that the Respondent accepts that the MRO tenancy sent to the Claimant is not compliant. There must be space to make offers without immediately triggering an Award for non-compliance.*
>
> *The Respondent does not consent to an Order that the arbitrator's powers under Regulation 33(2) are engaged."*

12. On 7 May 2019 the Respondent served a further DOV by reference making further concessions as follows:

Fourth Schedule, Part 1, Clause 9 (6) has been removed - the Jervis v Harris Clause in respect of Statutory Compliance;
Fourth Schedule, Clause 12 (6)(v)(i) has been removed – the undertaking to pay the costs incurred;
Fourth Schedule, Clause 19 has been amended – the tenant is to pay the cost of any breach of covenant and not any suspected breach of covenant;
Fourth Schedule, Clause 19 has been amended to remove the requirement for prior security for costs.

13. A letter from my office then sent to the parties dated 20 May 2019 set out the terms of the Respondent's reply to me of 4 March 2019 and included the following:

> *"Having reviewed the papers and considered the directions issued, the arbitrator finds that she is unclear on the Respondent's position as to her jurisdiction in this case and on the issues on which it considers she must reach a determination.*
>
> *…*
>
> *The arbitrator must avoid any procedural irregularity or legal error, and wishes to offer a further opportunity for the parties to clarify relevant matters without delay. If either party does not agree with the arbitrator's summary as set out below of the matters she must determine, then they must respond and clarify as soon as possible and in any event by 5pm Tuesday 28 May 2019.*
>
> *1. The Respondent contends that its full response was MRO compliant. The Claimant disputes this.*
> *2. The arbitrator should make a determination as to the compliance of the full response.*
> *3. In the event that she finds the full response was not compliant, the arbitrator would have jurisdiction under regulation 33(2) to determine the terms of a compliant full response.*
> *4. The DOV by reference, though offered as a "Revised Full Response" is in fact merely an offer in negotiation, and has no statutory significance.*
> *5. In the event that the arbitrator finds that the full response was not compliant, the Respondent seeks an order that a revised response be served in the terms of the latest version of its DOV by reference, but the Claimant will seek a line-by-line variation of his existing lease.*
> *…"*

The Respondent's Concession as to Non-Compliance

14. The letter also raised matters concerning the issues in dispute, which it is not necessary to set out in light of the Respondent's reply of 24 May 2019 in the following terms:

> *"In light of your letter, the Respondent confirms that the initial full response sent to the Claimant was non-compliant. It is believed that the DoV by Reference sent to the Claimant on 7 May 2019 is compliant and it should be the terms of this proposed DoV by reference that are determined."*

15. The Claimant responded acknowledging the concession, seeking its costs, and expressed its understanding that in the circumstances it was not for the Respondent to determine the terms of the revised response.

16. On 13 June 2019 I responded to the parties:

> *"The arbitrator notes the contents of the correspondence from the Respondent dated 24 May 2019, in which it acknowledges that the MRO full response was not compliant. Though the Respondent states that: "[I]t is believed that the DoV by Reference sent to the Claimant on 7 May 2019 is compliant and it should be the terms of this proposed DoV by reference that are determined", it does not explain that statement in the context of the arbitrator's jurisdiction in these proceedings.*
>
> *The arbitrator repeats that she must avoid procedural irregularity. It is not understood whether or not the Respondent disagreed with the arbitrator's summation. In the absence of express disagreement from the parties received by Wednesday 19 June 2019 the arbitrator will be entitled to assume that the parties agree with the following summation of their positions revised in light of the Respondent's concession:*
>
> *1. The arbitrator has jurisdiction under regulation 33(2) to make an order for the service of a compliant revised response, and has the power to determine the terms of the proposed MRO lease.*
>
> *2. The Respondent seeks an order to under regulation 33(2) that the terms of the proposed MRO tenancy forming part of that revised response should be those of the latest DoV by reference served as an offer in negotiation on the Claimant. The Claimant resists this. The parties are content for the arbitrator to determine that matter on the evidence and argument currently before her."*

17. The Respondent has not replied, though the Claimant wrote on 27 June 2019 seeking progress. The parties were advised in correspondence from my office dated 28 June 2019 that the case management proceedings were closed and that I would issue my award as soon as reasonably practicable.

Compliance of the MRO Proposal

18. In relation to the generic issues in the List of Issues in Dispute, these have been raised in a numerous other arbitrations before me under regulation 32(2) of the Pubs Code, and I have issued awards in respect of those issues[4].

19. In summary, I am satisfied that it is permissible in law for a compliant MRO proposal to be offered either in the form of a new lease or a DOV. The primary consideration which applies to the choice of the MRO vehicle and terms by the POB is that it must be demonstrably reasonable. I do not find that the terms of any MRO tenancy offered necessarily have to be the same or substantially the same as the terms of the existing lease, subject only to such variations as are

[4]Including awards published with party consent, In particular (in a case involving this Respondent) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766648/Quarter_3_2__MRO_award_.pdf, but also https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766633/Quarter_4_1__MRO_award_.pdf

necessary to render the tenancy MRO compliant. It could have been prescribed in the statutory scheme that the necessary starting position for determining compliant terms of the MRO lease is the existing lease, but it was not. It is permissible to offer new terms for an MRO tenancy, subject only to the requirements of section 43 of the 2015 Act, but only if it is reasonable to do so, and such an offering is not a requirement in every case; each case must be looked at and considered on its own facts.

20. In light of the Respondent's concession made on 24 May 2019 in this case, however, it has not been necessary for me to reach a determination as to the compliance of the MRO full response. Nevertheless, I have reproduced here in full certain Appendices setting out reasoning I have elsewhere applied in considering these questions. This serves to explain my approach to compliance, including reasonableness, which I apply in now considering the making of an order under regulation 33(2) in this case, as discussed below.

Determination

21. In the absence of objection from the Respondent, I have proceeded on the basis that my summation of its position is accepted. The MRO proposal was not compliant, and accordingly my powers under regulation 33(2) are engaged, pursuant to which I have the power to determine the terms of the proposed MRO lease.

22. The Respondent in conceding the non-compliance of the full response did not identify in respect of what disputed terms and conditions that non-compliance was acknowledged. It is important that there is no room for debate that my discretion to make an order under regulation 33(2) is somehow limited to those terms and conditions which were non-compliant, and thus that some procedure is required in order to revisit which of them were, and thus extend the proceedings further while determinations are reached, or concessions made, in respect of the compliance or otherwise of the individual terms and conditions of the full response.

23. The duty imposed on the POB by the legislation includes a requirement that the proposed MRO tenancy must be on terms that are not unreasonable. Any lawyer will understand that there will in each situation be a range of reasonable responses in complying with that duty. Parliament has decided that in serving the MRO full response the POB may choose any option within this reasonable range, even one that may not be the preferred choice of the tenant, and even if other choices would demonstrably be better for the tenant, as long as that choice is not unreasonable taking into account all of the circumstances.

24. The statutory duty on a POB is to serve a proposed MRO tenancy which is compliant, and the jurisdiction of the arbitrator on a referral under regulation 32(2) is to determine whether that proposal was compliant. Where it was not, the jurisdiction under regulation 33(2) is different, in that the terms of the revised response are not the choice of the POB. They are at the discretion of the

arbitrator. It is for the arbitrator to exercise the discretion to order compliant terms.

25. The arbitrator's discretion must be exercised reasonably, taking into account the relevant issues, circumstances and evidence in the case. Thus, the POB which serves a non-compliant full response loses the statutory right to advance the terms entirely of its choice to form part of the revised response.

26. The Claimant has been successful in these proceedings. He seeks an order for a DOV of his existing lease and I consider it appropriate to approach and address the associated options for a DOV which present themselves on consideration of the particular evidence in this case. I appreciate that the Respondent would prefer a new lease based on its template (though up to date proposed compliant terms are not put before me), and even if that was a reasonable approach (subject to its terms), where there are a range of reasonable options it is for me now in the exercise of my discretion to choose one. I have considered the reasons why the Respondent seeks new and homogenised lease terms, e.g. (at E12) so that it can have policies consistent across its estate, ensure greater comparability of rents, make training of its staff easier and reduce costs, and these are relevant considerations. There are likely impacts for the tenant (principally SDLT as well as some other smaller costs addressed by the parties) which are relevant considerations also. The Respondent has been content to make a small number of exceptions in respect of pre 2003 leases, and I see nothing unreasonable about it doing so in this case and consider this to be the appropriate course of action in this case.

Line-by-line DOV amending the existing lease to the POB's proposed terms.

27. At H54-60 the Respondent has set out argument why it would be unreasonable to amend the existing lease on a line-by-line basis into the standard form of its MRO lease – because it would be extremely difficult for a conveyancing solicitor, increase fees and be time consuming. It also says it might reduce the value of the leasehold interest. I accept the Respondent's case that this approach would be unreasonable.

The DOV by Reference

28. I decline to make an order under regulation 33(2) for the service of a revised response including a proposed MRO lease in the terms of the Respondent's latest version of the DOV by reference. In dealing with the interpretation of the legislation if the proposed MRO lease could be offered by way of DOV, owing to the complications considered in paragraph 23 above, at H62 of its Statement of Case dated 11 June 2018 the Respondent said:

> *"Ultimately, there is a real prospect that to ensure the MRO-compliant lease complied with the Code, the DOV would have to delete all of the terms of the existing tenancy (and all other agreements set out above) and replace them with the standard form in a schedule. Such a DOV would be very uncommon and artificial. The Respondent is not sure how it would be viewed by HMLR, HMRC and others. If the sole purpose of using a DOV was to avoid SDLT,*

that would seem improper and the Respondent would not wish to be seen as a promoter of such a scheme."

29. In spite of having proposed the DOV by reference in the first instance some nine months ago (24 September 2018), the Respondent has at no stage asked to produce evidence to demonstrate its assertion that it could be a compliant MRO lease. It has not sought to improve on its pleaded position since then (including in relation to the revised DOV served on 7 May 2019), and to support its case for the compliance of the DOV by reference, which is precisely the type of document that is described in paragraph H62 as uncommon, artificial and (possibly) improper. The Respondent has not sought permission to produce further evidence and submission in relation to this point and, given the evident contradiction in its case, and the Claimant's reluctance to accept this option for essentially the reasons the Respondent put forward in its Statement of Defence, I find, bearing in mind the particular submissions made in the pleadings and the evidence before me in this case, that it would be unreasonable for me to adopt this approach in making my order.

Other Deed of Variation

30. The Claimant seeks a more modest variation of the existing terms, but he has not set out the terms of any such DOV. The Claimant has produced a DOV for the Star and Garter, which the Respondent says is not typical as it sets the rent for 15 years. However, I consider better evidence comes from the Respondent's treatment of its own estate, as set out in its evidence. I have considered the Respondent's Statement of Case to identify submissions relevant to its position.

31. The Respondent in its Statement of Case at I4 denied that the conversion of tied tenancies to FOT terms is commonly delivered by DOV. Its case is that it granted 112 FOT tenancies to existing tenants between July 2014 and January 2018, and that therefore the switch to FOT terms is commonly delivered by new lease. The Respondent's statement, at E6-7 of its Statement of Defence, that during the same period none of its 13 renewals and 112 new FOT lettings to existing tenants was by DOV appears tautological. The Respondent's case is that during that period it granted only five DOVs to existing tenants fully releasing the tie, and thus that they are not common.

32. It states (at E8) that in each of those five cases of FOT lettings created by DOV, the original lease pre-dated 2003 and the leases were varied to make them similar to the terms of the Ei standard FOT tenancy. The significance of that year is that SDLT was introduced on 1 December 2003, and in relation to leases that commenced prior to that date there is no entitlement to SDLT overlap relief where there is a surrender and regrant, and thus there may be double taxation.

33. As for what is "not common", the Respondent says (at G8 of its Statement of Defence) that the interpretation of this word is a matter for the arbitrator or the courts to determine, but it should be given its ordinary English meaning of unusual or rare. This is not disputed by the Claimant and I therefore accept it. That does not exclude the need to consider what are appropriate comparators in the market in deciding what is common however (rather than looking at the whole

of the FOT market), and this is not a matter which the Respondent addresses in detail.

34. The Respondent does argue that the individual bargaining position of the tenant is not relevant to decide if something is not common. However, I have set out in the Appendices how I consider that the core Pubs Code principles apply to the consideration of whether a term is unreasonable. The test of whether a term is "not common" is a sub-set of the unreasonableness test. It does not appear to me, on the argument before me, that the negotiating strength of the parties must be disregarded in deciding what are appropriate comparators for the purpose of determining whether terms are common, and reasonable, in the FOT market.

35. In the present case the lease also pre-dates 2003. The Respondent has not produced sufficient evidence to satisfy me that the grant of a DOV to an existing tied tenant with a lease granted before 2003 is not common. The number of cases in which the Respondent did this (five) is not compared with the number of pre-2003 leases which were converted to FOT (either by DOV or new lease), and I am not persuaded on the present evidence that this is rare or unusual for this Respondent.

36. No evidence is produced as to any particular market factors at play – for example, whether there was different treatment of pre-2003 leases depending on the length of their remaining term (and this affected the amount of any SDLT that they might be liable to pay), or whether there were other factors (such as investment) that formed part of any commercial consideration for the 112 leases on which the Respondent's data is based.

37. I must confine myself to the particular evidence in this individual case. There is no evidence before me about what occurs in the rest of the industry. The Respondent has not sought expert evidence as to what takes place in the market in general, and has not done enough in this case to show that the use of a DOV is not an appropriate commercial approach, and one which it uses, when agreeing FOT terms with an existing tenant with negotiating strength who has a pre-2003 lease and significant SDLT to pay. In this case the Respondent calculated the SDLT to be about £5,000 in August 2018, and it has produced no evidence to suggest that this puts this case outside the class of those in which its use of a DOV is common. I know this is an issue which is of general interest in the industry and it must be understood that my findings in this arbitration are not, and cannot be, of general application, since they must be based on consideration of the cases put forward by the parties and evidence produced by them in this statutory arbitration procedure alone.

38. As I have set out above and in the Appendices, I have found that the existing lease is not the necessary starting point for the POB in offering FOT terms in the full response, but that does not mean that the variation of some terms of the existing, such as to ensure it contains terms which are reasonable and understood to be common in the FOT market, could not be compliant. Indeed, in relation to pre 1 December 2003 leases, and on the evidence presented to me in this case, using the existing lease as a starting point for variation to FOT terms

does not appear to be an uncommon approach for this Respondent. In identifying compliant terms for the purpose of an order under regulation 33(2), this is the approach which I require the parties to adopt in the present case, subject to my findings at paragraph 27 above. The parties may wish to focus their minds on the particular hallmark terms of a FOT lease in seeking to agree appropriate variations to the existing lease to produce compliant terms in this case. I expect the parties to endeavour now to agree the terms of that DOV.

Costs

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

Operative Provisions

40. In the circumstances of this case, and on consideration of the evidence produced by the parties, it is appropriate that I exercise my power under regulation 33(2) to order the Respondent to serve on the Claimant a revised response in the form of a DOV of the existing lease in terms to be agreed or determined. It may not be in the form of a DOV by reference or as discussed in paragraph 27. The parties should advise me within 14 days if settlement terms have been agreed, or as to what further order or directions they consider I should make in respect of this matter.

41. In the light of the above:

a) The MRO full response was not compliant.
b) The First Respondent is ordered to provide a revised response to the Claimant within 28 days of the arbitrator's determination of its terms.
c) The arbitrator to issue further directions if settlement is not reached within 14 days.
d) Costs are reserved.

Arbitrator's Signature

Date Award made 01 July 2019.

Claimant's Ref: ARB/100842/SPLASHTAVERNS

Respondent's Ref: ARB/100842/SPLASHTAVERNS

Appendix A – Applicable Procedure and Law

Procedure

1. The seat of this arbitration is Birmingham, England. The applicable law is that of England and Wales. I, Ms Fiona Dickie, Deputy 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**").

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. Where a conflict arises between the Pubs Code statutory framework and these rules or the 1996 Act, the Pubs Code statutory framework (being the 2015 Act, the Pubs Code or the Fees Regulations) prevails.

Law

3. 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:

> *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-owing 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.*

4. Section 43 of the 2015 Act provides that the Pubs Code must require POBs to offer TPTs (defined as a tenant or licensee of a tied pub) a market rent only option ("an MRO option") in specified circumstances.

5. Subsections (2) to (5) of section 43, being those relevant to the matters at issue, provide:

> *(2) A "market rent only option" means the option for the tied pub tenant –*
>
> *(a) to occupy the tied pub under a tenancy or licence which is MRO-compliant, and*
>
> *(b) to pay in respect of that occupation –*
>
> *(i) such rent as may be agreed between the pub-owing business and the tied pub tenant in accordance with the MRO procedure (see section 44), or*
>
> *(ii) failing such agreement, the market rent.*
>
> *(3) The Pubs Code may specify –*
>
> *(a) circumstances in which a market rent only option must or may be an option to occupy under a tenancy;*

(b) circumstances in which a market rent only option must or may be an option to occupy under a licence.

(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.

(5) 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).

6. 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.

7. So far as is relevant, regulations 30 and 31 of the Code provide:

Terms and conditions required in proposed MRO tenancy

30 - (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 tenancy 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) ….

(2) Where the MRO notice states that the event specified in regulation 24, 25 or 27 has occurred, the proposed MRO tenancy is MRO-compliant only if it contains provisions the effect of which is that its term is for a period that is at least as long as the remaining term of the existing tenancy.

Terms and conditions regarded as unreasonable in relation to proposed MRO tenancy etc.

31 – (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 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-owing 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 draftsman 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" appearing 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. Indeed, where a head landlord’s consent to the grant of a new lease is required but cannot be obtained, the practical necessity of this construction becomes clear.

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 here 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 that 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, even in 9.6 and 9.8 where a tenancy has already been referred to in the sentence, and 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 the 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 on a 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 unreasonableness.

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 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 the 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-owing 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-owing 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-owing businesses with their tied pub tenants" and the Code regulations, pursuant to section 42, are "about practices and procedures to be followed by pub-owing 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. So, for example, it may be necessary for the POB to consider what a well-advised tenant with negotiating strength would do where their existing lease was granted prior to the introduction of Stamp Duty Land Tax, and Stamp Duty having been paid there would be no overlap relief available upon the completion of a new MRO lease.

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.

Terminal Dilapidations on surrender of the existing tenancy

25. As a consequence of the choice of a new lease as the MRO vehicle the dilapidations covenant in the existing lease will be triggered as a matter of law on its termination. Dilapidations represent the cost of complying with the existing lease covenants to repair (subject to any applicable limit on them). Dilapidations claims are limited by law so that the landlord cannot claim terminal dilapidations for amounts that exceed the extent to which the value of the landlord's interest in the property is diminished by the repair.

26. There can be no real doubt that, when the cost of dilapidations is high, the requirement for their immediate payment may represent a real disincentive to a TPT to take the MRO option. A reasonable landlord should manage its estate responsibly throughout the term. The landlord should not be using surprises on the request for an MRO option as an adversarial weapon. The need for fair dealing arises, and what is appropriate will depend on the facts of the individual case.

27. Where the POB chooses a new lease over a DOV, the landlord may have to take steps to mitigate the impact of the tenant's liability for dilapidations if it is to show it is acting reasonably. If it is a logical assumption that a tenant with more bargaining power than a TPT in the MRO process would negotiate with the landlord to carry out any repairs over a reasonable period, then a POB which refuses to do that now may be acting in a manner that is inconsistent with the principle of fair dealing and giving rise to unreasonable terms and conditions.

Appendix 4 – Severing the Tie and Existing Lease Terms

In law, the existing lease terms are not the necessary starting point, but they are not irrelevant in considering what is reasonable.

1. There will be more than one way to achieve a compliant lease in each case, and the legislation gives to the POB the choice of proposed MRO lease to form part of the full response. To show that a POB's proposal of a new lease is unreasonable, it is not enough for a tenant to assert that the existing lease (with or without minor amendments). The fact that tied lease terms commonly permit the landlord by notice or deed to effect a tie release is not the point. However, it is possible to consider whether the terms of the existing lease, including any as to the release of the tie, are relevant to the question of unreasonableness more generally. Doing so, it does not seem that the fact that many tied tenancies may contain an option for the landlord to release the tie is a helpful comparison. The option here is that of the tenant, who exercises a right conferred by statute. Many leases confer a unilateral right on the landlord, and it has an absolute choice in respect of that. There are not sufficient parallels between that and the landlord's position in the statutory scheme to make it unreasonable in all cases not to exercise that right, or to make more than the minimum changes necessary to the lease, during the MRO process. The principle of fair dealing cannot be stretched to provide the tenant with a right which was not in the contemplation of the parties when they signed the original lease. There is nothing in the legislation which requires only minimum changes to the existing tied tenancy to release the tenant from the tied trading provisions.

2. It is also relevant to recognise that a POB in severing a tie by notice under the lease, or by DOV, was exercising a right in an individual case, and not in light of a statutory scheme which could make substantial changes to its business. The considerations for the POB in deciding on the means of tie release are not now the same.

3. There is no support in the legislation for an assertion that the necessary starting point for an MRO tenancy is the existing lease. A tenancy which contains product or service ties and an MRO tenancy are treated as different creatures by the Act and the Code. The definition of an MRO-compliant tenancy (in section 43(4) and (5)) makes no reference to the terms of the existing tied tenancy.

4. By comparison, when renewing a tenancy under section 32 to 35 of the 1954 Act (arguably the closest example on the statute books of a statutory jurisdiction to determine the terms of a commercial tenancy) terms are to be determined by the court by reference to the existing lease as a starting point. It is for the party seeking a departure from those terms to justify why it is fair and reasonable, having regard to the purpose of the Act. The legislature would have been aware of the criteria used in the 1954 Act when enacting Part 4 of the 2015 Act and it is significant that it in doing so it did not choose to take the same path.

5. Moreover, there are instances in the Code where reference is made back to the tied tenancy, e.g. in relation to provisions for security of tenure (regulation 31(3)(b)) and the duration of the new term (regulation 30(2)). The absence of any reference to the terms of the tied tenancy in both section 43(4) and (5) is significant.

6. The existing lease is not the necessary starting point in this statutory procedure. A DOV is not the default option. The tie and tie free lease are fundamentally different relationships. That does not mean however that it will always be reasonable to change terms in the existing lease which are also common in FOT lease.

7. Furthermore, that does not mean that the existing lease terms and conditions cannot be relevant to the question of whether the new terms and conditions are MRO-compliant. In order not to be unreasonable, the landlord in offering terms of the MRO option may need

to have regard to the existing contractual relationship between the parties. The existing lease terms will be in the mind of the TPT who is entering into negotiations for a new lease. The landlord will have their own commercial considerations in mind. From their respective positions, parties motivated to reach an agreement rather than a stalemate will negotiate from these starting positions to one that is acceptable for both. Therefore, both will have to take into account the position of the other if they intend to reach a deal. This is what a landlord would do if it wanted to tempt a preferred tenant into a new contractual relationship. That is the position in which the TPT tenant should be in the MRO procedure.

8. There may be other reasons why the existing terms are relevant, but it would not be appropriate to set out an exhaustive list. For example, where a landlord offered (perhaps fairly recently) a particularly favourable term on the tied lease which suggests the tenant was viewed as a preferred operator, and without good reason will not offer a comparably favourable term now, that may be an indicator that the POB is not acting fairly, and that the terms are not therefore reasonable. The particular terms (e.g. a keep open clause) may have had an effect on trade and goodwill to date, such that it would be unreasonable to change them. There may be an occupation clause pursuant to which wider family members reside in the pub, and it may be unreasonable to restrict that. Each case must be looked at on its merits, but to suggest the existing lease terms are always irrelevant is untenable.

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