IN THE MATTER OF **Ref: ARB/105072/ROWEN**

THE PUBS CODE ARBITRATION BETWEEN: -

MS DEBORAH ROWEN

Claimant

-and-

PUNCH TAVERNS ~~PLC~~ LIMITED

Respondent

Preliminary Award

Summary of Award

The answers to the questions posed are set out here in summary in order to assist the parties. These short answers should not be relied upon as forming part of the award or its reasoning, which is set out in full below.

a) Does a compliant MRO proposal have to be offered in the form of a new lease, a deed of variation ("DOV"), or is either vehicle permissible in law?

Either is permissible

b) If either form is acceptable, in law what considerations apply to the choice of vehicle?

It must be reasonable

c) Do the terms of any FOT tenancy offered have to be the same or substantially the same as the terms of the existing lease, subject only to such variations as are necessary to render the tenancy MRO compliant?

No

d) Is it permissible (or required) to offer wholly new terms, subject only to the requirements of section 43 of the Act?

It may be permissible but only if reasonable. It is not required.

e) Can a term be unreasonable for the purpose of Section 43(4)(a)(iii) of the 2015 Act if it is not deemed unreasonable by virtue of regulation 31 of the Code?

Yes

f) How is the test of reasonableness in section 43(4)(a)(iii) of the 2015 Act to be interpreted?

In accordance with the core Code principles and as set out below

The remaining issues will be the subject of a further award if the referral is not settled by agreement between the parties.

Introduction

1) The applicable procedure is set out in Appendix A to this award. The Claimant is Ms Deborah Rowen, tied-pub tenant ("TPT") of The Queens Ground Hotel, 401 Langsett Road, Sheffield, S6 2LJ ("the Pub"). The Respondent is Punch Taverns ~~Plc~~ Limited of Jubilee House, Second Avenue, Burton upon Trent, Staffordshire, DE14 2WF. The Claimant is represented by Lupton Fawcett LLP and the Respondent is represented by Weightmans LLP. The Claimant presently occupies the Pub under the terms of a lease dated 10 November 1997 for a term of six years automatically renewed unless determined as set out in the lease, originally granted by Vaux Breweries Limited to whom the Respondent is successor in title ("the Lease").

Background

2) On 9 May 2018 the Claimant gave the Respondent a notice (an "MRO notice") in relation to the Pub in accordance with regulation 23 of the Pubs Code Etc. Regulations 2016 ("the Pubs Code"). On 31 May 2018 the Respondent purported to send to the Claimant a "full response" for the purposes of regulation 29(3) of the Pubs Code, including a proposed tenancy ("the proposed MRO tenancy") which is the subject of this dispute.

3) On 12 June 2018 the Claimant made a referral to the Office of the Pubs Code Adjudicator under regulation 32(2)(a) of the Pubs Code. The duty on the POB under that regulation which the TPT disputes has been complied with is that in sub-paragraph (b): to send to the tenant a proposed tenancy which is MRO-compliant.

4) The parties have filed pleadings pursuant to case management directions. Among the issues for determination between the parties is a dispute as to the vehicle by which an MRO-compliant lease can and should be achieved. The Respondent has purported to offer an MRO option, compliant for the purposes of s.43(4) of the Small Business, Enterprise and Employment Act 2015 ("the 2015 Act"), by way of an offer of a new lease. The Respondent's position is that as a matter of law a new lease is required, and an MRO option cannot be offered by way of a deed of variation ("DOV") of the existing lease. This is a matter of statutory interpretation, and one in relation to which there has been much debate in the industry since the introduction of the Pubs Code.

The Issues

5) Having considered the issues in dispute, and after various written exchanges from the parties, they were directed to file legal submissions on 16 November 2018 on the following preliminary issues:

    a) Does a compliant MRO proposal have to be offered in the form of a new lease, a deed of variation ("DOV"), or is either vehicle permissible in law?

b) If either form is acceptable, in law what considerations apply to the choice of vehicle?

c) Do the terms of any free of tie ("FOT") tenancy offered have to be the same or substantially the same as the terms of the existing lease, subject only to such variations as are necessary to render the tenancy MRO compliant?

d) Is it permissible (or required) to offer wholly new terms, subject only to the requirements of section 43 of the 2015 Act.

e) Can a term be unreasonable for the purpose of Section 43(4)(a)(iii) of the 2015 Act if it is not deemed unreasonable by virtue of regulation 31 of the Code?

f) How is the test of reasonableness in section 43(4)(a)(iii) of the 2015 Act to be interpreted?

6) The deadline for filing was subsequently varied on request, and the submissions were received from the parties on 14 January 2019.

7) This arbitration is not the first in which it has been necessary for me to determine these issues[1]. I have however given the submissions of the parties full consideration with an open mind. Nevertheless, I have found nothing in the Respondent's submissions to persuade me to its position that the MRO may only be delivered by way of a new lease.

8) To date there has been no fully argued appeal to the High Court on any Pubs Code matters. The parties are aware that on an application for permission to appeal an arbitration award of the PCA, in proceedings[2] in the High Court, Business and Property Court, Mr Justice Zacaroli by order sealed on 19 January 2018 granted permission to appeal on certain grounds but refused permission to appeal the finding that the MRO could lawfully be offered by new lease or DOV.

9) In March 2018, the PCA published an Advice Note on MRO Compliant Proposals[3] which addressed the vehicle issue (advising that the PCA considered it could lawfully be a new lease or DOV) and other matters. The issue of that Advice Note was the subject of two claims for judicial review by regulated POBs in June 2018, but permission to bring those claims for judicial review was refused in July and September respectively. In the first case an application was made to renew at an oral hearing but was subsequently withdrawn in October 2018. No application to renew was made in the second

[1] some previous arbitration awards have been published with party consent https://www.gov.uk/government/collections/pubs-code-adjudicator-published-mro-awards

[2] case reference BL-2018-000019

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685133/2018_03_02_PCA_Advice_Note_MRO_Compliant_Proposals_11.05.pdf

case and that claim was dismissed in October 2018. The Respondent to these proceedings was not a party to those claims. It remains of the view however that the Advice Note is wrong in law, and the MRO can only be achieved by way of a new lease.

10) For the sake of clarity and readability I have included full analysis of these issues of law in the appendices to this decision. Their use and their form should not be used to infer that I have not considered the issues in the present case afresh.

11) In summary, the Respondent's position on the preliminary issues is as follows:

a) An MRO-compliant tenancy must be executed by way of a new lease, this being required by the correct interpretation of the statutory language, which, "*plainly indicates that the MRO option given to a tied pub tenant to take a MRO compliant tenancy is an option to take a new tenancy, not to require a variation of the existing tenancy"*. The relationship between landlord and tenant contemplated following the exercise of an MRO option is a new one, and under the Pubs Code the starting point when considering the terms that will govern that relationship should be a standard free-of-tie lease, and not the terms in the existing tied agreement.

b) As there is no choice in law between a new tenancy or a DOV, the Respondent declines to provide any further submissions as to what considerations apply to the choice of an MRO vehicle, stating plainly that, "*The vehicle must be by way of new tenancy*".

c) The starting point when considering the terms that will govern that relationship should be a standard FOT lease, and not the terms of the existing tied agreement, which is, "*diametrically* [opposite] *to using the current tied tenancy as a starting point, or for the terms of the MRO proposal to have to be the same or substantially the same as the terms of the existing tied lease*".

d) It is possible to offer wholly new lease terms, subject to the requirements of section 43 of the 2015 Act. The legislation, *"contemplates a new free of tie tenancy to represent a new and entirely different relationship"* being put in place.

e) In certain circumstances a term can be unreasonable under section 43(4)(a)(iii) of the 2015 Act even though it is not unreasonable under regulation 31 of the Pubs Code, but in such circumstances, "*it would have to be replaced by another term which is common in free of tie leases*".

f) The test for reasonableness under section 43(4)(a)(iii) of the 2015 Act is to be interpreted on the basis, firstly, that if a term is not common in an FOT lease then it is automatically unreasonable, and; secondly, that if a term *is* common but also found to be unreasonable in the circumstances of a particular case, then it, "*must be replaced by another common term in free of tie leases*".

12) The Claimant's submissions on the above issues are summarised as follows:

a) An MRO proposal may take the form of either a DOV or a new lease, and both the Pubs Code and the 2015 Act contemplate the possibility of a DOV to the existing lease being used to provide a TPT with an MRO tenancy, there being no express provision in either requiring the creation of a new lease, but that, "*The Adjudicator should endeavour to give effect to the MRO lease by way of a deed of variation, where possible, so as to avoid a surrender and regrant of the existing tenancy and the additional liabilities that would follow*".

b) The choice must be, "*reasonable and fair in all of the circumstances and in accordance with the 2015 Act and the Code"*. Further, demanding a wholly new lease instead of a DOV puts in a condition precedent to obtaining an MRO lease which may trigger liabilities in terms of SDLT and dilapidations etc. which may put off a TPT from pursuing MRO.

c) The starting point for the terms of an MRO tenancy should be, "*the same or substantially the same as the terms of the existing lease, subject to variations to render it compliant with the 2015 Act and the Code*". The Claimant argues that to do otherwise would *contradict the core principles of the Code, make the MRO less attractive and require TPTs to oppose the demands of POBs who may wish to change each and every term of the existing tenancy.*

d) *"It is unacceptable and inconsistent with the 2015 Act and the Pubs Code for a POB to wholly depart from the terms of the existing lease",* when offering MRO terms.

e) A term in an MRO proposal can be unreasonable for the purpose of section 43(4)(a)(iii) of the 2015 Act whether or not it is not deemed unreasonable by virtue of regulation 31 of the Pubs Code. Section 43(5) of the 2015 Act provides that whilst the Pubs Code, "*may give specific examples of terms that will be regarded as unreasonable … by doing so it does not abrogate the general test of reasonableness if regulation 31 of the Code does not specifically mention a particular term*".

f) The test of reasonableness under section 43(4)(a)(iii) of the 2015 Act is to be considered in the context of a, "*negotiation between a landlord and tenant for a lease of a free of tie pub*", and interpreted with reference to the facts of any given case, but with consideration also given to both redressing the balance of power between POBs and TPTs and enabling a TPT to go FOT (which the Claimant asserts is the underlying purpose of all of the Pubs Code legislation), as well as to the terms of the existing lease between the parties, and whether any terms are common in agreements between landlord and pub tenants who are not subject to a product or service tie, as per regulation 31(2)(c) of the Pubs Code.

Decision

13) I make only a few general comments here, referring the parties to my full analysis of the issues of law raised in this preliminary issue set out in the appendices to this award, wherein my full conclusions can be found. I determine in summary 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. Whilst the Claimant's argument that the starting point for determining compliant terms should be the terms of the existing lease due to the potential impacts on a TPT from departing from these terms is well rehearsed, it falls down on the basis that Parliament could easily have prescribed such a starting position but did not do so.

14) 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 necessary to render the tenancy MRO compliant. 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.

15) 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 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. The Claimant's reliance on assessment of the impacts on the tenant of the choice of a new lease over a DOV serves in fact to demonstrate that such assessment needs to be made on a case by case basis, and that it cannot as a matter of

statutory interpretation inform a general rule as to the necessary starting point in every case.

16) I have given particular consideration to the Claimant's reliance on legal authorities to illustrate that there is no settled definition of reasonableness in a landlord and tenant context, and by analogy to the cases of *Landlord Protect Ltd. v St Anselm Development Ltd* [2009] EWCA Civ 99 and *Mount Eden Land Ltd. v Straudley Investments Ltd* (1996) 74 P. & C.R. 306. These authorities establish that it is unreasonable for a landlord to seek to enhance its contractual position as pre-condition to exercising its contractual power under a lease. Thus, the Claimant says that the Respondent's perceived collateral attempts to alter the terms between the parties in their favour in this case similarly cannot be reasonable.

17) There are three reasons why it appears to me that these authorities, and this common law principle, are not applicable to the MRO procedure. Firstly, the parties are not seeking to agree the exercise of a contractual power, but instead are pursuing a statutory procedure which prescribes the characteristics of a compliant MRO proposal. If Parliament had intended that the default position would be for a TPT to retain all of the rights and protections of their existing lease in addition to gaining the right to go FOT, then the legislation would have made this clear.

18) Secondly, the commercial position of both parties changes under a FOT agreement, and different considerations may apply in determining what terms would be reasonable for the landlord as well as for the tenant under the new trading model.

19) Thirdly, the terms and conditions of the compliant MRO agreement are only one part of the statutory MRO process, and only one part of the bargain between landlord and tenant that is changed. Once these terms and conditions have been agreed (or otherwise imposed) the MRO rent will then be identified. Whilst these processes are separate, it is important to be mindful of the fact that the terms of the MRO agreement should be reflected in the level of rent set in accordance with the legislation. It is a resetting therefore not just of the contractual terms, but also of the market rent payable in light of those terms.

20) The fact that the procedure creates the potential for disputes does not mean that as arbitrator I should impose a strained interpretation on the legislation to find words and meaning within it which are not present. Parliament made provision for a means of dispute resolution with the arbitrator's costs normally being the responsibility of the POB, and also for the statutory powers of the PCA as regulator. As the PCA arbitrates less in individual disputes and is involved in progressively more regulatory activity, it expects to influence MRO compliance to a greater extent.

21) Thus, I do not accept the Claimant's approach to the test of reasonableness, though I am clear that a POB must have fair reasons for its choice of terms in each case. The lens through which reasonableness in section 43(4)(a)(iii) of the 2015 Act should be understood is discussed in my full reasons and is consistent with the Pubs Code core principles. It is not disputed by these parties that a term may be unreasonable for the purpose of Section 43(4)(a)(iii) of the 2015 Act even if it is not deemed unreasonable by virtue of regulation 31 of the Pubs Code.

Costs

22) Issues as to costs of the arbitration are reserved.

Operative provisions

23) The remaining issues will be the subject of a further award if this referral is not settled by agreement between the parties.

Arbitrator's Signature: 

Corrected to substitute Punch Taverns Limited as Respondent in place of Punch Taverns PLC

Date Award made: 10 April 2019

Award Corrected on: 24 June 2019

Award corrected pursuant to Article 38 of the CIArb Rules 2015.

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.

- end -