**IN THE MATTER OF Ref:**

**THE PUBS CODE ARBITRATION BETWEEN: -**

**MR JOHN CLARKE and MS LESLEY MINETT**

**Claimants**

**(Tied Pub Tenant)**

**-and-**

**EI GROUP PLC**

**Respondent**

**(Pub-owning Business)**

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**Preliminary Award**

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## 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 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) 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 seat of this arbitration is Birmingham, England. The applicable law is that of England and Wales.

2. I, Ms Fiona Dickie, Deputy Pubs Code Adjudicator, am the arbitrator. I replaced Mr Paul Newby, Pubs Code Adjudicator, as arbitrator of this dispute on 20 November 2017. 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 Act").

3. The Claimants are Mr John Clarke and Ms Lesley Minett, the tied pub tenants (TPT) of the Pottery Hotel, Upper Parkstone, Bournemouth, Dorset BH14 0RS ("the Pub"). The Respondent is Ei Group Plc of 3 Monkspath Hall Road, Solihull, West Midlands, B90 4SJ. Pursuant to a licence to assign dated 2 December 2013 the Claimants took an assignment of the leasehold interest in the Pub, which is let under a 20-year tied lease granted to their predecessor in title dated [redacted] and commencing on [redacted].

4. On 1 November 2016 the Claimants gave the Respondent a notice (an "MRO notice") in relation to the Pub in accordance with regulation 23 of the Pubs Code.

5. On 22 November 2016 the Respondent purported to send to the Claimants a "full response" for the purposes of regulation 29(3), including a proposed tenancy ("the proposed MRO tenancy") which is the subject of this dispute.

6. On 8 December 2016 the Claimants made a referral to the Office of the Pubs Code Adjudicator under regulation 32(2)(a), which provides for the TPT or the POB to refer the matter to the Adjudicator where the POB does not send a full response (in this case) under regulation 29(3). 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.

7. The Claimants are represented by [redacted]. The Respondent is represented by Gosschalks Solicitors.

## Procedure

8. 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 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 Act, the Pubs Code or the Fees Regulations) prevails.

9. The following is a brief chronology of the case management:

a. A Statement of Claim was filed on 19 May 2017 on behalf of the Claimants.

b. A Statement of Defence was filed on 12 June 2017 on behalf of the Respondent.

c. The Claimants' Response to the Respondent's Statement of Defence was filed on 23 June 2017.

d. The Respondent's Reply to the Claimants' Response was filed on 10 July 2017.

e. Pursuant to permission granted, the parties were have each filed an expert witness report on whether disputed terms of the proposed lease were common terms.

10. There was a subsequent disagreement between the parties with regard to the content of a joint list of issues in dispute. A telephone case management conference took place on 6 June 2018. Further to the agreement of the parties, it was agreed and decided that I would proceed to determine certain preliminary issues of law on the papers, and it is a determination on those issues which is contained in this award. Neither party sought to make further submissions in addition to the above Statements of Case ahead of the issue of this preliminary award.

**Issues**

11. The Respondent POB has purported to offer an MRO option, compliant for the purposes of s.43(4) of the Act, by way of an offer of a new lease. In this preliminary award, I shall determine the following issues of law which are currently in dispute between the parties.

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 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 Act.

e. Can a term be unreasonable for the purpose of Section 43(4)(a)(iii) of the 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) to be interpreted?

I hope that this award clarifying these issues will assist the parties in effective negotiations to settle the dispute.

**Applicable Law**

12. Section 42 of the 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.*

13. Section 43 of the 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.

14. 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).*

15. 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.

16. 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.*

**Vehicle for the MRO Option**

17. The Claimants argue that the vehicle by which an MRO tenancy is achieved should be a DOV to the existing lease and not a new lease. They contend that the use of a new lease is unreasonable or unfair. In response, the Respondent's position is that it is restricted by the statutory language from using a DOV as the legislation requires that an MRO option must be offered only by way of a new lease. In the alternative the Respondent argues that, if it is wrong on its primary position and it is permitted to offer MRO by way of a DOV, that it is not required to do so, and a valid MRO-compliant tenancy can be by way of new lease.

18. The Claimant relies on the statement of claim prepared by [redacted] considers that a DOV results in higher legal costs, Stamp Duty Land Tax (SDLT), higher rental deposit, terminal schedule of dilapidations, potential re-

mortgage issues and the imposition of new lease terms by the POB on the TPT that have not been negotiated between the parties.

19. The Respondent's position is that the legal costs are likely to be higher in relation to a DOV, the rental deposit would be no different in any DOV compared to a new lease, the Claimants are liable for dilapidations in either case and the reference to potential re-mortgaging costs is not understood.

20. [redacted] produces two sample DOVs from 2010 and 2014 between other landlords and tenants releasing the beer tie in exchange for a new rent. One of them, unusually, sets out the rent to be payable for the next 15 years, and in relation to the other the Respondent reports on enquiries that the landlord in that case wanted to limit their interaction with the tenant owing to a breakdown in the relationship, and that shortly after the DOV was executed it told its freehold reversion. [redacted] asserts that DOVs are common when releasing a TPT from a tie but new leases are not.

**Statutory Interpretation – the MRO Vehicle**

21. A matter of statutory construction arises as to the form of the vehicle by which an MRO option may be given. It is necessary objectively to ascertain, by the language of the relevant statute / statutory instrument, what Parliament intended. The language of the statute or regulation should be given its natural meaning rather than a strained one. Importantly, background material must not be allowed to take precedence over the clear meaning of the words used. The cardinal rule is that legislation should be construed according to the intention expressed in the language, and sight of this must not be lost. Regard should therefore first be had to the words themselves.

22. When interpreting the Code, it is proper to have regard to the extent of the rule-making power conferred by the primary legislation. The Act requires the Code to confer on the TPT a "market rent only option" - Section 43(1) of the 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 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).*

23. 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 content of the MRO-compliant tenancy. Neither of these provisions 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.

24. It is immediately clear on reviewing the relevant legislation that there is no express provision in either the 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.

25. That the legislation does not by implication require an MRO-compliant option to be given only by way of a DOV seems to me 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[1]. 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 Act) because pursuant to section 43(4)(b) an MRO tenancy cannot be a tenancy at will, the MRO must therefore must be a new tenancy.

26. I am not persuaded that the word “tenancy” (in and of itself) gives any further guidance; a DOV, when incorporated into the existing lease, will comprise a tenancy just as effectively as a new lease. It is the position of the Respondent that the statutory language is more aptly suited to that of a separate agreement being entered into. However, I note that absent are clear words on the matter - 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 to my mind consistent with a new tenancy or a varied one.

27. The Respondent relies on a number of provisions in the Pubs Code and Act as indications that Parliament intended that the MRO-option was to be implemented by the grant of a new tenancy rather than by varying the existing tied tenancy. I have considered these, and whether it is possible to construe the legislation in the way the Respondent suggests it must be, looking at the way in which the term “tenancy” is used in context within the legislation:
    a. Regulation 29(3) requires the POB to send to the TPT “a proposed tenancy which is MRO-compliant”.

[1] Friends Provident Life Office v British Railways Board [1996] 1 All ER 336.

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

c. 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". This language, says the Respondent, pre-supposes the grant of a new term of years, not the continuation of an existing one (noting that if an existing term is extended by DOV, in law a new tenancy is created) as the distinction between the term of that tenancy and the term of the existing tenancy would be otiose if the MRO option may be exercised only by varying the existing tenancy.

d. Regulations 34(2) and 37(1) refer to the "proposed tenancy or licence".

e. 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. The Respondent argues that this language is not appropriate for the execution of a DOV.

f. The definition of "market rent" in section 43(10) of the 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.

g. Section 43(4)(a) sets out the circumstances in which a tenancy or licence is "MRO-complaint" and provides that a tenancy at will cannot be an MRO-compliant tenancy. The Respondent argues that since a tied lease will not be a tenancy at will, the legislators must have envisaged a new tenancy being granted rather than a variation of the existing one.

h. Section 44(2)(b) of the Act refers to 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."

28. Having considered all of these provisions, I am not persuaded that there is anything in the way that the term tenancy is used in context that indicates whether MRO should be offered by way of a new lease. I have particularly considered regulations 30 and 31 which refer on the one hand to an “existing tenancy” and a “proposed tenancy”; however, there is nothing within the use of these two phrases 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. The provisions relating to the market rent (in section 43(10) of the Act) relate to the rent under the MRO-compliant lease, but do not inform what those lease terms and conditions are.

29. Furthermore, I am satisfied that the draftsman was alive to the need to specify a “new” MRO tenancy, to distinguish it from the existing tenancy, if such a need existed. The expression "new tenancy" appears in the Code no less than 19 times. It appears within the definition of "new agreement" (and it refers only to a new tied tenancy). It would have been simple for the draftsperson to have made similarly

clear the restriction which the Claimants argue exists, and the complete and consistent failure to do so in the language of the Code demonstrates clearly that no such restriction was intended.

30. The Respondent relies on correspondence to the then Secretary of State Vince Cable MP dated 25 October 2013 from CAMRA and others advocating the MRO option, which referred expressly the expectation that the POB would issue a DOV, to show that how the MRO-compliant lease was to be delivered was in the Government's contemplation. However, this only serves to demonstrate that, having been asked to contemplate a DOV, the Secretary of State did not make regulations which expressly prohibited it. If it was intended to prohibit the use of a DOV the regulations would not have used such permissive language.

31. Several extracts from the Government Consultation on the new Pubs Code (October 2015) are relied upon by the Respondent. However, the fact that open language has been used in the legislation does not mean that its meaning is unclear. I do not consider that it is. 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.

32. I am mindful that 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*) 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."*

33. Furthermore, the Respondent directed me to no consultations prior to the passing of the Act, where the definition of an MRO-compliant tenancy is found (this is not surprising given that the MRO option was the result of an amendment passed unexpectedly), and Parliament cannot retrospectively express intention.

34. Nevertheless, if regard is to be had to the consultation documents, I do not find support in them for the Respondent's position. A number of references are extracted from Section 9 of this Consultation, which 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.*

35. It is clear that there was no intention to prescribe a form. An expectation as to the form is referenced, and this 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 this statement, it would be hard to rely on others in 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.

36. The Respondent also relies on a few other extracts which refer to a new (MRO) agreement. The expression "new tenancy" is not found, however, 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 the unequivocal marker of intention the Respondent seeks. 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. The Respondent is to my view reading too much into the selected words of the consultation (and 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).

37. Powers to make provision in relation to the MRO procedure, delegated under section 44(1), are considered in section 10 of the same Consultation, from which the only reference relied upon by the Respondent is:

> *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.*

38. 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 wholly new. 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, and therefore does not assist the Respondent.

39. Looking at these passages, they are far from conclusive. The Respondent looks for the silver bullet within them but, in my opinion, it is not there. These extracts cannot be viewed too selectively, nor 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.

40. I am satisfied therefore that there is nothing in the legislation which precludes or requires the grant of a new tenancy, and I am sure that, 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, I conclude that either a DOV or a new lease (subject to its terms and conditions) is capable of bringing about an MRO-compliant tenancy.

41. 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. The Claimants directed me to no substantive argument on matters of statutory interpretation which could lead me to another conclusion.

**Statutory Interpretation – s.43(4) and regulation 31**

42. 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.

43. 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 to me 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.

44. The referral under regulation 32(2)(a) can be made where the POB does not send a full response under regulation 29(3), and that regulation requires the POB to send an MRO-compliant proposed tenancy. The definition of such a tenancy is in s.43(4) of the Act so it is clear to me that the Pubs Code Adjudicator has jurisdiction under the regulations to determine whether the tenancy complies with the requirements of that section.

45. 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 terms of a lease may be unreasonable by virtue of words which are not included, and not just those that are.

46. Furthermore, I do not consider that the language of the Act and Pubs Code requires consideration of each 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 whether 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.

47. Thus, for example, were I to look individually at the payment of an increased deposit, rent in advance and payment of insurance annually in advance, I am looking at 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 and decide if that cost is or is not reasonable – it will depend on the context.

48. 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 me to consider whether the agreement as a whole is one which is not common in tie free agreements.

**Is the MRO Vehicle subject to the test of unreasonableness?**

49. The Claimants argue that the MRO-compliant tenancy should comprise the tied tenancy, minus the tied trading provisions, and with a revised rent. A DOV which merely excises the tied trading provisions (which will usually be contained in a schedule to the Lease) and substitutes a new rent for the existing rent, would be straightforward, it is said. However, this may well not amount to an "MRO-compliant tenancy" as provided for in the Code, as it may contain uncommon or otherwise unreasonable terms in a FOT lease, individually or collectively.

50. 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. I am satisfied that this is broad enough to encompass the requirement to enter into a new tenancy (in this case set out in the covering letter and implicit in the proposed tenancy being a new one). Therefore, the choice of vehicle is subject to a test of unreasonableness.

51. I consider that 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 agreed 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 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 regulation 31(2)).

**Unreasonableness**

52. 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.

53. 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 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 Act) is that she/he must seek to ensure that it is consistent with those principles.

54. It is clear that 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 Act (in this case, as to reasonableness in section 43(4)(a)(iii)) are not, there would be a fundamental incompatibility between these instruments. I am furthermore satisfied that, were the language in the Act and Pubs Code not consistent with these principles, the Secretary of State would not have enacted the Pubs Code in its current form.

55. I therefore consider it is proper to conclude that the Code and s.43(4)(a)(iii) of the 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*

56. Its long title states that the 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 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).

57. Overall, I can see nothing in the statutory language which excludes the POB's conduct in the MRO procedure from being "dealings" with the TPT. I consider that the meaning of the term is broad, and I understand from its context that 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*

58. 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. I am aware that this has been a principle in tied pub rent valuation since at least 2009, when it was referenced in RICS guidance. It is not for me in this decision to consider an exhaustive definition of this principle, but provisionally 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 of 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*

59. 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 conditions than that which would be made available to a 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, 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, it seems to me that these principles follow from the general concept of reasonableness, taking into account the relative negotiating positions of the parties within this statutory scheme.

60. 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. Accepting for present purposes that the POB, in a new letting on the open market, would make an offer of a lease in identical terms to the proposed MRO tenancy before me, 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.

61. 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.

62. 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.

63. It must be emphasised that the existing tied deal is one to which the TPT contractually agreed. However, the occurrence of a specified event 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.

64. Take, for example, a significant increase in price (an event which pursuant to regulation 24 gives the TPT the right to serve an MRO notice). This significant price increase would be a unilateral decision of the POB which may materially affect the commercial attractiveness of the tied deal. The TPT is not in the position of a tenant of a FOT lease, who may decide to accept or reject a supplier's prices. If the MRO option is financially prohibitive, it may not be a realistic option for the TPT to accept it. The only option would be to remain with the tied deal (which may now be a poor one) or accept an offer that a prospective new tenant of a tie free lease might not without negotiation, and in such negotiation that prospective tenant would be in a very different bargaining position to the TPT. 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.

65. 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. Thus, for example, of the choice of a new lease over a DOV leads to a liability on the part of the tenant to terminal dilapidations, the landlord may have to take steps to mitigate the impact of that liability if it is to show it is acting reasonably in its choice of vehicle.

66. 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.

67. 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.

68. 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.

*Severing the Tie*

69. The Claimant appeals to the market as to the mechanism it says is usually adopted to change from a tied tenancy to a FOT tenancy. To the extent that this argument places reliance on a term of the existing lease as being common does not invoke regulation 31(2)(c), as it is the uncommonness of such lease terms in tie free leases which is at issue. The fact that the common terms in a tied lease or by notice between a landlord and tied tenant to effect tie release would be by DOV is not the point.

70. It is not enough for the Claimant to assert that the existing lease (with or without minor amendments) would be sufficient. 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 to me 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, which it would presumably only exercise when satisfied it was in its interest to do so, and it has an absolute choice in respect of that. I do not see 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 the "minimum changes" sought by the Claimants to the existing tied tenancy to release the tenant from the tied trading provisions.

71. Even if this were the yardstick by which the Respondent's decision to send a new tenancy rather than a DOV falls to be judged, the Claimants produce insufficient evidence to prove that that the grant of a new lease to a tied tenant is an "uncommon" means for a landlord to agree a new FOT tenancy with a tied tenant. In considering whether the choice of vehicle is reasonable I was not impressed with [redacted] supporting evidence. Whilst a DOV is used in the market, it is not shown it is the most common method of tie release, (to any extent that that is relevant to whether the use of a new lease was unreasonable).

72. 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 the context 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 simply not the same.

**Are the existing lease terms relevant?**

73. The Claimants' position is that the starting point for the MRO lease is the existing lease terms. However, there is no support in the legislation for this assertion. 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.

74. 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) "reasonable" terms 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 Act and the Code and I consider it is significant that it in doing so it did not choose to take the same path.

75. 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.

76. I therefore make it clear to the Claimants: 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 leases.

77. Furthermore, in my view 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.

78. There may be other reasons why the existing terms are relevant, but I cannot set out an exhaustive list. For example, where a landlord offered (perhaps fairly recently) very favourable deposit terms on the tied lease which suggests the tenant was viewed as a preferred operator, and there has been no relevant change of circumstance, if the POB will not offer favourable deposit terms now that may be an indicator that the POB is seeking to raise unmanageable entry costs and 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 in my view.

## Costs

79. Issues as to costs of the arbitration are reserved.

## Next Steps

80. Unless this case is settled, a case management conference will be listed in 3 weeks' time in order to issue further directions for the determination of this referral.

**Arbitrator's Signature**

**Date Award made** 02 August 2018

**Claimants Ref:**

**Respondent's Ref:**