Pubs Code Adjudicator

Consultation on proposals to issue statutory guidance on matters relating to the operation of the Pubs Code

Closing date: 10 December 2021

October 2021

Pubs Code Adjudicator's Foreword

I consider that the time is right to consult on the exercise of my powers to issue statutory guidance about the application of the Market Rent Only (MRO) provisions of the Pubs Code, and the steps that pub owning businesses need to take in order to comply with them. The aim of issuing such guidance would be to ensure that pub owning businesses take a consistent and fair approach to the application of the Pubs Code and to give tied tenants greater clarity and consistency about what they can expect to happen in the MRO process, to reduce apparent disincentives and barriers to them using the process, and to limit the scope for disputes which need to be resolved through arbitration.

When I took up office as Pubs Code Adjudicator on 3 May 2020 all pubs in England and Wales were closed as a result of the Covid 19 pandemic. So, on stepping into the role many of my plans – like those of everyone in the trade – had to take a different course.

The pub trade fought to meet an existential challenge and tied tenants were focussed on the survival of their pubs. The regulated pub companies' attention was on responding to these unprecedented circumstances and providing support to their tied tenants. The energies of my team had to be fully focussed on ensuring that support was provided in a fair manner, on the protection of tied tenant's Code rights and the promotion of their interests during the pandemic. It was not the right time to distract the industry with a statutory consultation exercise, and that continued to be the case until the industry could begin its recovery and return to trade once restrictions were removed. Though of course trading uncertainty still remains, I consider now is an appropriate time to engage the industry in a statutory consultation about matters which can impact on tied tenants' ability and willingness to use the MRO process as part of their business planning moving forward.

My resolve to ensure that the MRO process is accessible and fair for tied tenants, and delivers on Parliament's core Code principles, remains firm, and I have taken advantage of the intervening period to inform myself as to the recent experiences of tenants by commissioning independent research. This research explored the motivations of tied tenants who requested the MRO option, how they used the process and their overall experience, including potential barriers to tenants in seeking and progressing the MRO option. The results of this small-scale study were consistent with information that has come to my attention via arbitrations and in my capacity as regulator. Key barriers to tenant access to MRO appear to include uncertainty as to the process and complexity, rent offers, front loaded entry costs and concerns about a negative impact on the business relationship between the tenant and pub owning business if the tenant pursues the MRO option.

Delivering the Core Code principles through the MRO option

Parliament intended that the Pubs Code should deliver on two core principles:

- Fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants;
- That tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie.

These principles underpin the whole of the Pubs Code, including the MRO process, and are intended to address the issues that led to the introduction of the Code. The MRO process is, in particular, the critical route by which the second of these, the "no worse" off principle, can be delivered.

The regulated tenant can serve a MRO notice each time they have the right to renegotiate their tied rent[1]. Parliament's intention is to provide the tenant with the opportunity for effective negotiations in respect of their tied deal, with the right to choose to go free of tie if they feel that is the better option for their business. An effect of the availability of a free of tie offer is the exertion of commercial pressure on the pub company to offer a competitive tied offer against which it can be compared. The tied tenant who can judge if they would be worse off than if they were free of tie, and choose between the two options, has a stronger hand in negotiations. It is important to remember that tenants can use the MRO process whether or not they have any wish or intention to take on a free of tie tenancy and can, if they choose, use it purely as a negotiating tool at their tied rent review.

Given this fact, it can be seen that take up of the valuable commercial opportunity presented by the MRO process has however been relatively low. There were a total of approximately 11,700 tied pubs as at the start of the Code and approximately 8,619 tied pubs as at June 2021 whose tenants benefit from Code rights. However, between July 2016 and August 2021, after over 5 years since the commencement of the Pubs Code, I understand that there have been only around 1,200 MRO notices accepted by the POBs. Since the Code gives the tied tenant the right to request a rent review after 5 years if one has not taken place in that time, tied tenants of regulated pub owning businesses who have been trading since the commencement of the Code should by now have been through a 5 year rent review cycle and had the opportunity to serve a MRO notice. The service of a MRO notice could be a routine part of the renegotiation of rent by any Pubs Code tenant, and its increased use would mean that more such tenants are accessing their rights to ensure they are no worse off than if they were free of tie.

The fact that the tied tenant has the legal right, at certain gateways, to walk away from the tied arrangement provides an important incentive to the pub owning business to deliver on its duty to treat them in a fair and lawful manner throughout the tied tenancy. In my view it is important that obstacles to serving a MRO notice which may be suppressing tenant appetite to use it are removed.

[1] There are four circumstances under the Pubs Code where a tenant can ask for the MRO option. The Code calls these MRO events (also known as MRO gateways).

For the tenant to be fully empowered by the MRO process as Parliament intended, that process has to work smoothly, and not involve barriers or unnecessary disincentives which can put off the tied tenant from using it. If the tenant is frustrated in accessing their statutory right to MRO, or there are obstacles which make it an unrealistic option, the commercial pressure exerted on the pub owning business, including in the negotiations over the tied deal, is reduced. The ability of the tied tenant effectively to access a compliant MRO offer is therefore central to the success of the Code in fulfilling the core principles.

Fiona Dickie
Pubs Code Adjudicator

Contents

Introduction - why the Pubs Code Adjudicator is consulting

Statutory Review of the Pubs Code and the Pubs Code Adjudicator: 2016-2019

1. The Small Business, Enterprise and Employment Act 2015 and its Regulations require the Secretary of State regularly to review the Pubs Code and the performance of the Pubs Code Adjudicator (PCA). The first review covered the period from the appointment of the first PCA (2 May 2016) and the Code coming into force (July 2016) to 31 March 2019.

2. The Secretary of State in the statutory review received expressions of concerns from some respondents who said:

   "they had not achieved their preferred outcome and felt the MRO process was weighted against them, with issues not being resolved quickly enough by arbitration. The strict timing of MRO-related processes combined with the slow pace of the arbitration process was also found not to be working as well as intended."

3. The statutory review summarised the concerns of some stakeholders in relation to the MRO process:

   "While it was recognised that the MRO provisions had led to more choice between tied and free-of-tie agreements, most respondents agreed that the legal complexity of the MRO process had proved more challenging than any other aspect of the Code, in particular its interaction with the Landlord and Tenant Act 1954. Some respondents said that tied tenants using their right to request an MRO proposal had experienced obstacles by their pub-owning businesses which they felt had subverted the MRO process. Cited examples included: the reported pre-emptive use of notices under section 25 of the Landlord and Tenant Act, resulting in the threat of eviction; offers with onerous lease conditions; high terminal dilapidation costs; and rents which had failed to disregard pub improvements paid for by the tied tenant. It was noted that most MRO agreements were delivered by new agreement, even where the tied lease contained a clause enabling it to be altered by deed of variation."

4. The Secretary of State has recently consulted on options to amend the Pubs Code, including amendments to the Market Rent Only process. Amongst those options being explored are changes to the MRO process timetable, imposing an express requirement on the pub company to propose the MRO rent with the MRO proposal, providing an alternative appeal route in arbitration and removing the requirement that the MRO terms should not be "uncommon". What is proposed in this consultation is consistent with the themes of these options, whether or not the Secretary of State makes any such changes.

Regulatory Steps to Date

5. The PCA has to date taken a number of important steps to make the MRO process more accessible to tied pub tenants (TPTs) but considers more regulatory steps may be necessary to improve that access. The PCA seeks to reduce the potential areas for disputes over the compliance of a MRO option, and thus the need for arbitration referrals.

6. It is helpful in considering any need for statutory guidance at this stage to consider the ways in which the PCA has to date sought to support a fair MRO process for tied tenants, and to assess the success of those measures.

Arbitration of MRO Compliance Disputes

7. Dispute resolution in respect of the compliance of the MRO proposal is by way of statutory arbitration. The early life of the Pubs Code was characterised by a large backlog of such arbitration disputes and associated delays. The PCA has taken many important steps since then to improve the arbitration process, including:

    7.1 the publication of arbitration awards and summaries to improve transparency in relation to Pubs Code arbitration processes and the determinations being made;
    7.2 the development of arrangements to enable the efficient appointment of arbitrators other than the PCA in person;
    7.3 between November 2018 and September 2021, the offer of an initial stay on special terms to incentivise early settlement of arbitrations;
    7.4 the introduction from April 2021 of arbitration service standards;
    7.5 working to appoint a contractor to administer the arbitration scheme on behalf of the PCA.

8. Nevertheless, the requirement for a TPT to pursue formal litigation in order to test the compliance of their MRO proposal is widely understood to act as a significant disincentive to TPT's pursuing the MRO option. This is despite the statutory costs protections that they enjoy[2]. The TPT in litigation proceedings will invariably be facing a respondent pub owning business (POB) which is well-resourced and professionally represented by solicitors. Where there is a financial benefit to the POB in the tenant remaining tied, this can disincentivise the POB from seeking a swift resolution to the proceedings. Although the offer of an initial stay to proceedings of 3 months on special terms was taken up by the parties in over 80% of cases, settlement within that 3-month period was achieved in around 25% of those cases. In the PCA's submission to the statutory review it was commented that:

    "Formal arbitration proceedings have in many instances been a cumbersome, costly and inefficient mechanism – regardless of the nature of the dispute. The

[2] In most cases the arbitrator cannot order a tied pub tenant to pay more than £2,000 towards a POB's costs.

layered statutory framework, institutional rules and the 1996 Act has made for a process that is rather confusing, litigious, and (for unrepresented tenants) sometimes overwhelming. The deterrent effect of litigation costs, unsurprisingly, has acted disproportionately on TPTs rather than POBs. Indeed, delay may prejudice the commercial interests of the TPT more than those of the POB."

9. TPTs may face financial difficulty in paying for representation of their own, and there may be no equality of arms. Some TPTs may resort to reliance on unqualified or uninsured advisers, putting the interests of their businesses at risk. The burden of proving that a MRO proposal is non-compliant could fall on the TPT, where required in line within the rules as to burden of proof[3], in spite of the statutory duty to propose a reasonable MRO proposal being placed by Parliament onto the POB.

10. The appeal route in respect of a Pubs Code arbitration award is to the High Court. The cost and formality of High Court proceedings is a greater deterrent to many TPTs than to their POBs, and indeed to date, only pub companies are understood to have brought such appeals. This could have an impact on access to justice and the interpretation of the Pubs Code. The Secretary of State has consulted about whether it would be appropriate to change the appeal route.

11. Taking into account all of these factors, reliance on arbitration as the norm within the MRO process has the potential to place at its heart the sort of imbalance of power and resources which the Code was in fact designed to address. Whilst such reliance on arbitration has reduced, and the majority of arbitrations settle at some point without the arbitrator needing to make a decision on any issues in dispute, the negotiation of MRO outcomes under the cloud of the cost, time and risk associated with litigation, does not in the view of the PCA represent a level playing field in MRO negotiations for tied tenants.

The Compliant MRO Proposal

12. The PCA has taken a number of regulatory steps to provide clarity to the industry as to what is expected from a compliant MRO proposal, and to understand where any systemic compliance issues might lie. These include:

    12.1 The publication of factsheets informing tenants of their rights;
    12.2 A 2017 Verification Exercise conducted to examine whether policies/behaviours exist which may inhibit tied tenants from accessing the MRO option;
    12.3 The introduction in 2018 of a questionnaire to all tenants completing the MRO process;
    12.4 The publication of statutory advice, including notes on MRO Compliant Proposals (issued 2 March 2018) and Taking the MRO option – Tied rent considerations (issued on 7 June 2019);

[3] See (1) Punch Partnerships (PTL) Limited (2) Star Pubs & Bars Limited v Jonalt Limited [2020] EWHC 1376 (Ch)

12.5 A Regulatory Compliance Handbook, published in December 2017, substantially expanded to include a chapter on MRO proposals in November 2019 (and updated on 11 September 2020), and a Compliance Checklist and Declaration whereby the POB Code Compliance Officer must certify its compliance with the process;

12.6 A small-scale independent MRO research project looking at tenants' recent MRO experiences.

13. The PCA has also conducted a statutory investigation into the use by Star Pubs and Bars of unreasonable stocking terms in its MRO proposed tenancies. The PCA's report includes observations as to the part that cost, delay and unreasonable terms can play in disincentivising the tenant from pursuing the MRO process.

Effectiveness of Regulatory Steps

14. There is evidence that these steps, together with the PCA's ongoing interaction with the POBs, including their Code Compliance Officers, has had a positive impact on the effectiveness of the MRO process. Comparing 2018 with 2020, disputes by TPTs over the MRO tenancy terms offered have reduced by 65% from 101 arbitrations to 25. This reduction cannot merely be explained by the reduction in MRO notices served, which are 12% lower comparing the 12 months ending November 2018 to that ending 2020. In 2017 only 8% of tenants ending the MRO process went free of tie. In 2018 that figure was 20% and by 2019 it was 31%. The percentage of tenants ending the MRO process by going free of tie in 2020 had reduced to 23%, although closures in the sector due to the COVID-19 emergency and financial support for tied tenants may be relevant factors. These figures could suggest that the MRO process had got better at offering tenants who use it a real choice, and a real choice means that tenants' negotiating position in respect of their tied and free of tie options is likely to be strengthened.

15. However, there remain concerns that the MRO process may not yet be sufficiently accessible to tenants in spite of all of these improvements. While the number of arbitration disputes about the MRO tenancy has reduced, the PCA is still seeing a significant number of disputes requiring arbitral determination. In addition, there is some evidence of the same issues being challenged by different tenants within successive arbitrations.

16. There is evidence to show that the number of TPTs serving notices to seek access to the MRO option has decreased slightly year on year since 2016 (though there have been changes to the number of regulated tied pubs over that period). TPTs need to be confident in using the MRO process, including in what they can expect from the POB, to ensure that they are able to access the potential benefits. The PCA considers that transparency in the dealings of POBs with their TPTs, and consistency of approach across the tied pub industry, should assist TPTs in being clear and confident about the use of the MRO process.

17. The issues addressed in this consultation document as the potential subjects of statutory guidance have come to the PCA's attention as areas which represent possible barriers to TPTs exercising their rights. The PCA considers it will be to the advantage of all – both tied tenants and pub owning businesses, to have greater clarity on the parameters of what can be expected from the MRO process and consistency of approach from all POBs. The PCA seeks to promote this greater transparency and consistency via proposed statutory guidance.

18. The PCA will consider the outcome of the Secretary of State's consultation on Code changes and keep under review the need for guidance related to the terms of a MRO compliant proposal.

19. The PCA is also not at this stage consulting on issues around the management of debts relating to COVID and the repayment of any such sums. The PCA is monitoring the conduct of the POBs in respect of how this is managed as part of the MRO process.

Information about the Pubs Code Adjudicator

1. The Pubs Code Adjudicator (PCA) was created by Part 4 of the Small Business, Enterprise and Employment Act 2015 (the 2015 Act). The PCA is a corporation sole and an independent office-holder carrying out functions on behalf of the Crown. Fiona Dickie was appointed as PCA on 03 May 2020.

2. The PCA's role is to encourage and enforce compliance with the Pubs Code etc. Regulations 2016 (the Pubs Code) which came into force on 21 July 2016. The Pubs Code supports two overarching principles:

    - Fair and lawful dealing by pub-owning businesses (POBs) in relation to their tied pub tenants (TPTs);
    - That TPTs should be no worse off than they would be if they were not subject to any product or service tie.

3. The pub companies regulated under the Code are those that own 500 or more tied pubs in England and Wales. There are currently six such pub companies, collectively operating around 8,619[4] tied tenancies:
    - Admiral
    - Greene King
    - Marston's
    - Punch Pubs
    - Star Pubs & Bars
    - Stonegate (trading name of Ei Group)

[4] Number as of June 2021

4. The PCA has a statutory power under section 61 of the 2015 Act to publish guidance about the application of any provision of the Code and on the steps that POBs need to take in order to comply with the Code. The PCA must consult any persons it thinks appropriate before publishing statutory guidance. The PCA must take account of its published statutory guidance when carrying out its functions.

5. This consultation relates to proposed guidance in relation to a POB's statutory obligations in connection with the offer of a proposed Market Rent Only option.

Consultation details

Issued: 29 October 2021

Respond by: 10 December 2021

Enquiries to: office@pubscodeadjudicator.gov.uk

Office of the Pubs Code Adjudicator
4th Floor
23 Stephenson Street
Birmingham
B2 4BJ

Consultation reference: Pubs Code guidance consultation

Audience:

We are seeking views from those with an interest in the operation of the Pubs Code, in particular those who may be directly affected by proposed statutory guidance such as tied pub tenants and pub-owning businesses. This also includes, but is not restricted to, representative organisations, trade bodies and any legal organisations familiar with administrating the provisions of the Code.

Territorial extent:

This consultation will potentially inform statutory guidance about the operation of the Pubs Code etc. regulations 2016 in England and Wales.

How to respond

A response form is available online.

Email to: office@pubscodeadjudicator.gov.uk

Write to:
Office of the Pubs Code Adjudicator
4th Floor
23 Stephenson Street
Birmingham
B2 4BJ

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the UK General Data Protection Regulation, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

Please note that the Pubs Code Adjudicator intends to publish all responses to this consultation subject to any redactions we may make for legal reasons. If you want the information that you provide to be treated as confidential, please tell us, preferably giving reasons, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.
We will process your personal data in accordance with all applicable data protection laws. See our privacy policy.

We will publish all responses, subject to any redactions made for legal reasons, together with a summary on GOV.UK. The published information will include a list of business names or organisations that responded, but not people's personal names, addresses or other contact details.

The Proposals

Chapter 1: Proposals of rent in the MRO process

1. The terms of the proposed Market Rent Only (MRO) tenancy are either agreed through negotiation between the pub owning business (POB) and tied pub tenant (TPT) or settled as a result of arbitration undertaken in accordance with the Pubs Code by the Pubs Code Adjudicator (PCA) or a nominee. During the negotiation period the parties can negotiate the rent associated with those terms. If the parties cannot reach agreement on the rent, the TPT can ask an Independent Assessor (IA) to determine the “market rent”. The IA determines that “market rent” based on the proposed MRO lease or licence.

2. It has been custom and practice for the POB to send a proposed rental figure to the TPT alongside the proposed MRO tenancy terms. The PCA expects that the parties will, during the MRO procedure, negotiate a rental figure in good faith and seek to reach agreement on a compliant MRO tenancy in line with the duty on the parties in regulation 34(2) of the Pubs Code. The Pubs Code provision for an independent expert determination of the rent ensures that a “market rent” can be put in place where no such agreement can be reached, however that determination process will add further time and cost to the MRO procedure. It is therefore preferable for the parties to be able to reach agreement wherever possible without recourse to independent assessment of the rent. The PCA considers that where a POB can demonstrate to the TPT how its MRO rent proposal has been calculated, including how figures for different income streams have been reached, the TPT will be better able to assess the offer against its own trading and properly consider the MRO proposal and its own negotiating position. Where a TPT is in an informed position this will enable them to have confidence in considering their statutory right to seek the MRO option and make an effective choice about the tied or free of tie model for which the Pubs Code provides.

3. When proposing and negotiating a MRO rent, the POB should act consistently with the principle of fair and lawful dealing in relation to their TPTs. An offer being made on a transparent basis, and the TPT being fully informed of the basis on which a POB has calculated their MRO rent offer, will assist in facilitating meaningful negotiation and avoid unnecessary delay. This is consistent with the principle set out in the Pubs Code that the POB and TPT should, until the end of the MRO procedure, seek to agree a MRO-compliant tenancy. A TPT should be able to understand the rationale for a rental offer made by the POB alongside the proposed MRO tenancy terms and make a judgement on the appropriateness of the offer and decide on any steps they wish to take in the MRO procedure; whether that be to accept the MRO offer, accept a tied offer, negotiate further from an informed position, or ultimately refer the matter to an IA. Providing this information at the start of the MRO process can aid transparency and understanding and facilitate agreement on rent as early as possible.

4. The PCA is aware that some information supporting the MRO rent offer is currently provided to TPTs by POBs; but the clarity and completeness of such information

varies amongst POBs. It is important that there is some consistency of approach across the regulated businesses and that TPTs can have confidence in what information they will receive from their POB. The PCA seeks the views of the industry on potential provision of statutory guidance on appropriate and/or minimum levels of information to be provided by a POB when they make an offer of proposed rent to be paid on a MRO tenancy to ensure appropriate and clear information is provided. The underlying reasoning is for this information to demonstrate clearly how the rental offer has been calculated so that the TPT can understand or negotiate the proposed rent in an informed manner. Such detail may include the documents which the Pubs Code requires a POB provide to the IA when they make their rent determination[5]. Suggested information could include some or all of the following:

4.1 Information held by the POB which provides evidence of the tied pub's level of trading in the last 3 years;
4.2 Information held by the POB which presents a reasonable forecast of the tied pub's level of trading for the next 3 years;
4.3 Information held by the POB which describes any special commercial or financial advantages provided to the TPT under the terms of the tenancy or licence;
4.4 A detailed profits valuation showing relevant heads of income (with associated gross profit ratios), staffing and other costs, allowance for tenant's capital and tenant's bid;
4.5 Barrelage assumptions in relation to wet turnover with an explanation where these materially differ from the actual barrelage figures;
4.6 An elemental breakdown of, and justification for, levels of any additional turnover such as food, rooms, gaming machines etc;
4.7 Details of any comparable evidence supporting the rent proposal.

Questions

1. **Would an obligation to provide transparent information in support of a proposed MRO rent offer be useful to TPTs in understanding and/or negotiating the proposed rent in an informed manner? Would this better facilitate the progression of the MRO procedure?**

2. **Does the above represent useful and appropriate information needed to understand how a proposed MRO rent has been calculated and so enable a TPT to better understand and/or negotiate the proposed MRO rent?**

3. **Would any other supporting information be considered helpful and, if so, what?**

[5] The Pubs Code places a duty on both the POB and TPT to provide information to the IA. To be clear, the PCA would not propose that the POB seeks information from the tenant at this stage.

Chapter 2: Removing uncertainty of potential financial barriers in the MRO procedure

1. Experience to date of tenant experiences indicates that there are certain financial issues which have the potential to hinder tenant access to the MRO option, whether actual or as a perceived uncertainty. These include:

    1.1 the size of rental deposits and when they are to be paid;
    1.2 the number of months rental payments potentially being required in advance; and
    1.3 terminal dilapidations at the premises when the MRO proposal is offered by way of a new tenancy.

2. The impact of upfront costs on a TPT's decision whether to access the MRO procedure has been apparent to the PCA since the earliest days of the Pubs Code. The first PCA Tenant Survey conducted in 2017 found that barriers to submitting MRO included the perception that the costs were too high. Participants were surprised at the high upfront costs (for instance a requirement to pay deposits and/or property funds/maintenance costs) and the majority of tenants surveyed by telephone did not agree that they had opportunities to make a genuine choice between tied and MRO proposals.

3. Findings from in depth interviews of participants in the second PCA Tenant Survey conducted in 2019 included feedback that cost was a key barrier to accessing MRO and cited reasons included an anticipation that MRO would be unaffordable. These participants felt that there was no genuine choice between MRO and tied rent offers because MRO would simply be too expensive.

4. Over time there has been a shift in the practices of individual POBs as a result of awards in arbitrations and regulatory intervention by the PCA. As a result, some flexibility is seen by some tenants with regard to upfront costs, either within the MRO proposal or in subsequent negotiations. However, there is no consistency of approach between the POBs. Such consistency is considered by the PCA to be important so that there is simplicity and clarity for all tenants and the MRO process appears a more accessible option.

5. The PCA recognises the commercial issues which must be taken into account; when a TPT takes the MRO option they are entering into a commercial relationship with the POB and that relationship is different to the one under the tie and different lease terms may be reasonable and appropriate. Amongst other factors, the tenant's current contractual relationship with the POB may be relevant to consideration of whether a change in rental periods and deposit is reasonable.

6. The PCA is considering how to remove barriers, and/or the perception of a barrier, to MRO for TPTs while balancing commercial issues. The PCA is therefore considering guidance to provide transparency and consistency on issues that may be considered a financial barrier to accessing MRO.

Rent payments/ rental deposit

7. As set out above, in the PCA's view, where a POB seeks a deposit and/or rent in advance as a term or condition of a MRO tenancy, such upfront costs can be a barrier to TPTs accessing the MRO option.

8. All terms and conditions of a MRO proposal must be reasonable, including its term. The PCA has confirmed that reasonableness is to be considered in all the circumstances of the case both individually and in combination. It cannot therefore be presumed reasonable in all cases for a POB to propose an increased deposit or to move to less frequent rental payments as a matter of course. However, these requirements have been noted as actual or potential barriers to accessing MRO.

9. The PCA is considering guidance on the following:

    9.1 Where a POB in all the circumstances reasonably proposes that the MRO tenancy includes terms providing for an increased deposit, or to move from more frequent rental payments to less frequent payments (e.g., from monthly to quarterly rent in advance), it should provide for a period after the MRO lease is entered into during which the requirement is built up to from the existing position under the tied lease. The period of build-up must be reasonable taking into account the additional sums involved. Only in exceptional circumstances could it be reasonable within the meaning of the Pubs Code to propose such terms without a reasonable period for transition. In the PCA's view a transitional period of not less than a year may be appropriate.

Questions

1. **Where an increase in deposit and/or rent in advance terms are reasonable, would an incremental approach to reaching that increased rent deposit and/or rent in advance, other than in exceptional circumstances, provide stability for the POB in the management of its estate?**

2. **Is a period of not less than a year appropriate as a reasonable transition period for the build-up of rent deposit and/or rent in advance payments? Otherwise, what minimum period may be appropriate?**

3. **Would such an approach provide clarity for a TPT on what to expect from the MRO procedure and afford them better access to the MRO option?**

4. **Are there other considerations the PCA should take into account in considering this issue?**

Dilapidations

10. The PCA wants to see consistency across the tied industry in the approach to dilapidations where they interact with a Pubs Code right, so that TPTs understand

how dilapidations will be managed if they exercise a Code right. POBs have moved a long way since the early days of the Code where terminal dilapidations were required as a matter of course when a TPT sought to consider the MRO option. However current practice is not consistent across the industry. If what TPTs can expect in the MRO process is simple, clear and consistent, they are more likely to be confident in using that process. For example, some POBs are no longer proposing terminal dilapidations where MRO is requested. If a TPT knows that there won't be a crystallisation of dilapidations at the point they serve a MRO Notice, that may assist the TPT in accessing that right.

11. The PCA is of the view that requiring terminal dilapidations at the point the MRO option is exercised can create a barrier to exercising that right. It may be considered unfair for there not to be a consistent approach for all tenants, except in exceptional circumstances. POBs already have rights to deal with repairs and dilapidations under the existing tied lease, and will have new rights under any new MRO tenancy that may be entered into. The PCA therefore considers it may not be reasonable to require terminal dilapidations when a TPT exercises the right to request a MRO option and is therefore minded to prohibit this action being taken in response to a request for a MRO option, other than in exceptional circumstances. The reasonableness of dilapidations as a condition of the MRO has been considered by arbitrators, including the PCA, in Pubs Code arbitration awards. Those awards were made based on the facts and arguments put forward by the parties in those cases. When considering the issue in the broader regulatory context now, consideration can be given to all of the circumstances at a point in the life of the Pubs Code when it is possible to better assess the impact of terminal dilapidations on a TPTs appetite for MRO.

12. In cases where statutory compliance issues remain outstanding at the point a TPT requests a MRO option, the PCA is of the view that these may be enforced over a reasonable period of time, other than in exceptional circumstances. As these will be terms in the existing and new MRO lease, completion or agreement to a plan for completion need not be a condition of entering into a MRO tenancy.

Questions

1. **Are there any reasons why the PCA should not, other than in exceptional circumstances, prohibit as unreasonable terminal dilapidations during the MRO procedure and/or prohibit the requirement of completion or agreement to completion of statutory compliance as a condition of entry into a MRO tenancy?**

Chapter 3: Transparency and fair dealing with decisions in respect of the Landlord and Tenant Act 1954 in connection with the MRO process

1. One of the events permitting a TPT to serve a MRO notice is the service of a notice starting the statutory renewal procedure of a tenancy protected by the Landlord and Tenant Act 1954 (the 1954 Act) (where the investment exception does not

apply). The MRO notice may be served where the TPT has received the landlord's notice under s.25 of the 1954 Act or the landlord has received the TPT's notice under s.26. In both cases, the date of termination of the tenancy must be between twelve and six months after the notice, which cannot be given before the last year of the term. In effect, the notice starts a procedure which will end either in the tenant being granted a new lease, or in the tenant vacating the premises.

2. A landlord can oppose the grant of a new tenancy on a number of specified grounds set out in section 30(1) of the 1954 Act, including that the landlord intends to occupy the premises for the purpose of carrying on their own business – that is, taking the pub back to run it as a managed operation. To rely on this ground takes more than mere assertion and the landlord must have an evidenced intention towards that end.

3. The MRO provisions have the potential to result in substantive changes to the market, including a change in operating model of the POBs towards managed estates rather than regulated tied pubs. Other potential changes in the market resulting from the Pubs Code may include reliance on more new tenancies without statutory protection, or on shorter initial terms.

4. The Secretary of State made the following general comment on the potential for market changes in paragraph 7 of the report on the Statutory Review of the Pubs Code and Pubs Code Adjudicator:

   "It is worth noting that pub-owning businesses covered by the Code have legitimate rights over their property and a responsibility to their shareholders and investors to secure returns. It is not unexpected that businesses might adapt operating models in response to regulation and, if there have been increases in pub management models that are not covered by the Code (such as conversion to managed premises), this is not unreasonable provided those models do not result in the kind of unfair treatment that led to the establishment of the Code."

5. The PCA is however aware of concerns expressed, including within arbitration referrals, by TPTs and other stakeholders about the potential for decisions to take back particular premises at statutory renewal to impact upon the TPT's right to serve a MRO notice under the Pubs Code.

Demonstrating Code Compliance

6. The interaction in the operation of the 1954 Act regime at renewal of the tenancy and the event at regulation 26 of the Pubs Code allowing a TPT to serve a MRO notice is built into the Pubs Code (and recognised in court rules as to the management of renewal proceedings co-existing with an ongoing MRO procedure), but this does have the potential to cause issues. For example, where a POB seeks to oppose renewal of a tenancy in order to take back premises for its own occupation and a tied pub tenant wishes to seek the MRO option the rationale for taking back may not always be clear to the TPT and may give rise to concerns that they are being subject to a detriment connected to their intention to seek the MRO

option. The PCA is considering measures to assist the industry in the interaction between these co-existing rights, including requiring greater transparency by POBs in their dealings with TPTs in this area. Written records of decisions made by POBs on taking back of premises may facilitate the regulator in checking that process for Code compliance if issues arise in the interaction between a TPT's MRO rights and the landlord's 1954 Act rights.

7. The PCA is mindful of section 71A of the 2015 Act which requires the PCA to make a report to the Secretary of State in respect of any practice engaged in by a POB in order to avoid, to the detriment of TPTs, the operation of the Code. However, the exercise of a legal right to take back properly exercised is a lawful act which may not amount to action that is unfair in the individual circumstances.

8. Regulation 50 of the Pubs Code requires that the POB must not subject a TPT to any detriment on the ground that the tenant exercises, or attempts to exercise, any right under the Code. This duty would likely be breached if, as a result of the service by a tenant of a MRO notice at renewal, or discussions between the tenant and Business Development Manager (BDM) preparatory to the service of a MRO notice, the POB made a decision to oppose renewal which it would not otherwise have made had the TPT not exercised its Pubs Code right.

9. It is noted that, where the POB does not serve a s.25 notice but awaits service by the tenant of a s.26 notice, it may well be aware whether the tenant has decided to serve a MRO notice (the deadline being 21 days from the pub company's receipt of the s.26 notice) before it must communicate its decision whether or not to oppose renewal (the deadline being two months of the service of the s.26 notice). The possibility therefore arises that a decision at that point to oppose renewal may be perceived by a TPT as appearing potentially linked to the decision to serve a MRO notice. This may lead to dissatisfaction in the process, a feeling of powerlessness by the tenant in subsequent negotiations in respect of tied renewal or alternative outcomes, and the necessity for arbitration proceedings if the TPT seeks to challenge the decision to oppose renewal as detriment under regulation 50 and a breach of the Code. The same concerns may arise where the service of a s.25 notice to take the property back follows discussions with the BDM preparatory to the tenant serving a MRO notice if the tenant believes, rightly or wrongly, that the decision to serve the hostile s.25 notice was linked to the TPT's preparations for MRO.

10. Therefore, given the overlapping statutory procedures, there is the potential for perception by TPTs that the decision by a POB to oppose lease renewal could be a response to an attempt by the TPT to exercise their right to seek the MRO option, whether or not this is in fact the case. In considering this guidance the PCA does not take a view that there has been a decision made to oppose a lease renewal causally linked to a decision or attempt to serve an individual MRO notice in any particular case. However, regardless of whether such a concern is justified, that perception resulting from the interaction in timelines between the renewal and MRO regimes may cause TPTs to lack confidence in seeking to exercise their Pubs Code rights.

11. Despite the protection afforded by regulation 50, greater transparency as to the making of business decisions in respect of renewal and in communications with TPTs may assist the TPT to identify circumstances, if any, in which the decision to oppose renewal could be related to the service of a MRO notice, or to know that this was not the case, and to assist the regulator in doing the same. This may help the TPT to have more confidence in the MRO process.

12. The PCA is considering ways in which to provide a greater level of transparency including the following:

    12.1 Requiring POBs to keep a written, contemporaneous, record of when decisions around opposing renewal of a tied tenancy are made in respect of any particular tied pub and including in that record the business reasons for that decision in each case. Such records could therefore be made available to the PCA upon request and could also form evidence if appropriate in any subsequent arbitration or court proceedings. Where a POB had failed to keep sufficient, contemporaneous records of decisions to take back premises or otherwise oppose lease renewal, the PCA may in the exercise of regulatory functions, consider it more likely to draw an adverse inference against the POB in respect of reasons why such a decision was made where it is alleged that it was connected to a TPT's attempts to exercise a right under the Pubs Code.

    12.2 POBs must ensure that their BDMs keep full and accurate notes of all conversations with a TPT about either lease renewal or the MRO option. The Pubs Code provides that a POB's BDM must deal with a TPT in a way which is consistent with the principle of fair and lawful dealing and that they must keep written notes, to be agreed by the TPT as accurate, when discussing matters related to the TPT's current or future business plans. Existing PCA statutory advice to POBs already requires that those notes are a full and accurate account of the MRO discussions and that those notes are offered to the TPT for agreement as to accuracy[6]. Guidance would make clear that a BDM should not in these conversations give the TPT information which is not consistent with the POB's recorded decision on whether to oppose a lease renewal, and the notes should record accurately what the BDM communicated on this issue.

13. Those notes and internal records could, where appropriate, be available to the PCA or an appointed arbitrator in order to have an oversight of the process and assess whether there was any non-permitted connection between a decision to

[6] See the Regulatory Compliance Handbook: Demonstrating Compliance with the Pubs Code issued by the PCA: https://www.gov.uk/government/publications/regulatory-compliance-handbook-market-rent-only-proposals

oppose renewal and any attempt by a TPT to seek the MRO option. Such transparency could give TPTs greater confidence that reliance on taking back could not be used against them in breach of the Code when considering the MRO option and that the PCA would be better equipped to take regulatory steps in relation to any such possible link.

Questions

1. **Would these proposed requirements for recording of decisions and BDM conversations on taking back provide greater assurance for TPTs in considering whether to seek the MRO option?**

2. **Are there any other potential transparency requirements that would provide greater assurance for TPTs in considering whether to instigate the MRO process?**

Chapter 4: MRO rent – considering disregards for tenant's improvements

1. If the POB and TPT cannot agree a rental figure for a MRO-compliant tenancy, the matter may be referred to an IA who will determine what the "market rent" is for that tenancy. Part 7 of the Pubs Code sets out the process by which the IA will determine what the "market rent" is for the MRO tenancy in that case. Once the "market rent" has been determined (subject to certain rights of appeal) the TPT will then have the option of entering into the MRO tenancy and paying that rental amount, or not doing so, and they may still elect to remain under their tied agreement.

2. "Market rent" is defined in s.43(10) of the Small Business, Enterprise and Employment Act 2015 (2015 Act) as follows:

   "In this Part "market rent", in relation to the occupation of particular premises under a tenancy or licence which is MRO-compliant, means the estimated rent which it would be reasonable to pay in respect of that occupation on the following assumptions—
   (a)that the tenancy or licence concerned is entered into—
   (i)on the date on which the determination of the estimated rent is made,
   (ii)in an arm's length transaction,
   (iii)after proper marketing, and
   (iv)between parties each of whom has acted knowledgeably, prudently and willingly, and
   (b)that condition B in section 68 continues to be met."

3. The IA must therefore assess the "market rent" against these criteria when making their assessment. The IA will use their experience as a surveyor, and also the relevant industry guidance, to assess the "market rent" to the above criteria. As

provided by regulation 37(4) of the Pubs Code, the IA must conduct the determination of the "market rent" in accordance with any guidance issued by the PCA.

4. The definition of "market rent" at s.43(10) of the 2015 Act contains no express reference to any disregard for improvements that the TPT themselves may have made to the premises during the tied tenancy, and which result in an increase in the rental value of the premises. If there is no such disregard applied in the rent under the MRO option, this could mean that a tenant could have to pay an initial MRO rent which takes into account improvements which they have paid for and carried out at the premises at their own expense which, had they stayed tied, might not have been taken into account when considering the rent under the tied agreement.

5. The question of the absence of a statutory disregard for tenants' improvements was the subject of comment from some stakeholders in the statutory review, on which the Secretary of State commented:

   "Greater alignment with the Landlord and Tenant Act was proposed, particularly in respect of the definition of 'market rent' so that the effects of goodwill and capital investments made by a tied tenant to their pub was disregarded during a rent assessment under the MRO process."

6. The key mechanism by which a TPT is able to judge whether they are no worse off is by comparing their existing tied deal with a free of tie arrangement (obtained through the MRO process) so as to decide which is best for their business. The process for comparison is therefore predicated on an existing relationship between POB and TPT, with the TPT able to consider going free of tie, with rent reviews and lease renewals as triggers for the service of a MRO notice.

7. A comparison between a tied rent which disregards the value of tenants' improvements with a MRO rent which includes value attributable to improvements carried out by the tenant does not appear to be a fair comparison.

8. The PCA has no power to alter processes set out in the 2015 Act and Pubs Code, including as this relates to calculation of rent. However, a TPT having an informed understanding of whether and how a POB has taken into account the value of any tenant's improvements may aid transparency in the process and could assist TPT's in understanding how the proposal is calculated and better compare the MRO option with a tied deal.

9. In order to ensure that a TPT understands how a proposed MRO rent has been calculated and to enable them to understand or negotiate the proposed MRO rent, the PCA is consulting on potential guidance that:

   9.1 When proposing the MRO rent a POB should be clear as to whether it considers the TPT to have undertaken any improvements to the premises and, if so, whether its MRO rent offer takes into account or

disregards the rental value relating to those improvements. If the POB does not disregard the rental value relating to any improvements, it could be required to explain in the proposal the reasons for this; and

9.2 As part of its duties of disclosure to the IA, a POB should (i) advise the IA of the statement it made to the TPT in respect of tenant's improvements when proposing the MRO rent, (ii) advise the IA whether or not the POB agrees that the IA should disregard value attributable to the tenant's improvements, and (iii) advise the IA whether there is agreement between the POB and TPT on what improvements if any should be disregarded.

Questions

1. **Would requiring a POB to be clear as to how it is treating tenants' improvements in any MRO rent proposal assist in TPT understanding and in reducing undue delay and potential uncertainty in the MRO process?**

2. **Should the POB's position in respect of tenants' improvements be made clear to the IA where a referral to the IA is made?**

3. **Are there circumstances in which it would be appropriate to not disregard the value attributable to relevant tenant improvements in respect of a proposed MRO rent?**