Response to the Consultation on proposals to amend the Pubs Code

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This response is based on research [Redacted] into the operation of the Pubs Code Regulations 2016. An associated output from this project - forthcoming in *Legal Studies*[1] - is available publicly on SSRN: "The "Code Adjudicator" model: The Pubs Code, statutory arbitration and the tied lease".

Drawing on this research, we deal with each of the questions detailed in the consultation document in turn.

1. What are your views about Parallel Rent Assessments for prospective tied tenants?

We would welcome the introduction of a Parallel Rent Assessment (PRA) process to prospective tied tenants. Our research supports the concerns raised in the consultation that – for many prospective tied-tenants – there is a lack of informed decision-making at their entry into a tied lease.

Our reasons for supporting the introduction of a PRA process are that:

i. PRAs supports the underpinning Pubs Code principle that "tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie."[2]
ii. PRAs could make it easier for a tied tenant to access an MRO deal without having to wait for a trigger event. This will make a MRO agreement an option from the start of a tenancy period. In our sample, we had tenants entering a tied-arrangement solely as a means of leveraging a future MRO option.
iii. As tenancy offers are now typically shorter (many with a period of five years or less), this considerably reduces the risk to a PubCo of a PRA **process** – a trigger event would emerge within 5 years in any event.
iv. Introducing a PRA process removes disincentives that arise from having to enter a tied-arrangement beforehand – for instance, differential treatment of tied and MRO tenants for rent reductions during the COVID-19 crisis, or problems with the back-dating of MRO agreements.

However, there are potential limitations that may arise in the operation of a PRA process. In particular, we would suggest that:

[1] [Redacted] 'The "Code Adjudicator" model: The Pubs Code, statutory arbitration and the tied lease' (Forthcoming, 2022) *Legal Studies*

[2] s.42(3) Small Business, Enterprise and Employment Act 2015.

v. If the PRA is not subject to independent scrutiny, there is a danger that the proposed rent levels do not provide an accurate reflection of the market rate for the property, and that similar problems which impact on MRO rent determinations generally impact adversely on the MRO process.
vi. Special Commercial or Financial Advantages should be itemised and costed to allow tenants to make an informed choice.
vii. If access to a BDM is listed as a benefit, then the regularity of meetings with the BDM and performance indicators should be listed. If the tenant feels that the advice they are getting from the BDM is not cost effective for their business then they should be free to get this advice from elsewhere, as in any other professional business service.
viii. If parallel assessments are available to prospective tenants, then they must also be made available on the same terms to tenants who have come to the end of one tenancy period and are in negotiations about a further tenancy.

2. What are your views about encouraging a trial period – for example 3 months – to help a prospective tied tenant familiarise themselves with the running of a new tied pub before entering into a commercial contract?

We would welcome encouraging trial periods provided that precautions are taken and that the process is transparent. Taking on a new tied tenancy poses a number of significant risks to the tied tenant – trial periods may in turn help prospective tenants to understand more about running their own pub business on the terms offered by the PubCo.

We consider therefore, that encouraging "trial periods" is part of a broader goal of ensuring transparency in the dealings between PubCos and prospective tenants. Taking on a tenancy represents a significant cost to the tenant outside of any agreement with the PubCo. For example, a tenant may need to move into accommodation connected to the pub, which is costly both in financial and personal terms. With this in mind, the timetables and likely costs involved at every stage from initial enquiry to signing a tenancy agreement at the end of a trial need to be available. This should include:

i. A schedule of when agreements will be negotiated and signed. This schedule should include a period from which the rental figure is negotiated, with time left in the negotiations to draw up the tenancy agreement at the end of the 3 months.
ii. When payments for training, fixtures and fittings, legal fees, stocktaking, brokers, insurance, security deposits, and so on, will be paid.

We suggest that PubCos should provide these in writing to the tenant weeks before the moving in date.

In terms of the operation of trial periods themselves, we suggest that:

i. Income and actual costs during this three-month period – noting likely seasonal adjustments – can inform the profit and loss account in the course of the rent assessment.

ii. Tenants should be encouraged to access independent tax planning to understand accurately their forecast profit/loss from the three month trial period, and the likely overall yearly profit for a tenant operator based on these data.
iii. The three months should be used for the tenant to report maintenance issues with the pub so that any repairs needed have been carried out by the Pubco when the tenancy is signed and there is a mutually agreed written statement of repairs.
iv. The establishment of a detailed, easily available timescale for taking over a tenancy presents the opportunity to clarify:
    a. Energy costs
    b. Energy efficiency of the unit
    c. Ventilation
    d. Licencing
    e. Maintenance and testing obligations for tenant and PubCo
    f. Known issues with maintenance
    g. Known licencing and crime issues
v. Costs, such as payments for fixtures and fittings, need to be only payable once the tenancy is signed to reduce the financial risk to the tenant.

3. What are your views about reducing the current 6-month period in the previous qualification period? Do you think that a 3-month period in the previous financial year would be appropriate or would you support a different period?

We would welcome the shortening of the qualification period to three months. Reducing uncertainty for tied-tenants in affected, newly qualified PubCos is important – reducing the qualifying period is one way of helping to ensure they can exercise Code rights quickly and predictably.

As illustrated in the consultation document, the application of the qualifying period is made more complex by reference to the "previous financial year", leading to delays of up to 18 months. In order to ensure clarity in the application of the Code for tied-tenants, we would recommend revisiting the inclusion of this criterion, and operating a simple 3 month period.

4. What are your views about a requirement for the landlord selling the pub to notify the PCA of any tied tenant(s) with extended protection? Should the PCA be informed when extended protection has ended?

We would support introducing a requirement for notifying the PCA of tied tenants with extended protection. The PCA should be aware of how many tenants fall under its protection – the fact is does not currently have access to this data, or the power to mandate such notifications, raises concerns that a considerable number of tied-tenants may not be having their Pubs Code rights adequately enforced.

More broadly, if a tied-tenant is to have their pub sold from under them, they must have an expectation that they should be able to trade under similar conditions and have a similar deal

with the new landlord. An appropriate analogy would be with the Transfer of Undertakings (Protection of Employment) Regulations 2006.

It is concerning that MRO rights fall outside of this protection. Given the importance of the Pubs Code rights in ensuring these vertically integrated business models operate fairly, we would consider rolling over these protections to be a proportionate interference with the property rights of the new owner: especially as they would have been aware of such Pubs Code protections and the point of purchase.

5. What are your views about a Parallel Rent Assessment at the rent assessment or lease (or licence) renewal stage for tenants with extended protection? What type of information should be set out in a PRA? Should there be a right to refer disputes related to the PRA to the PCA and, if so, on what grounds?

In line with our answer to Question 4, we do not consider that the PRA process for tenants with extended protection warrant differential treatment from those outside of extended protection. We would support a right to refer to the PCA, based on access to information currently laid out within the Pubs Code Regulations 2016 for tied rent assessments[3] and issues we raise in answer to Question 1.

6. What are your views about the examples set out above and what might work or what might not work? Do you have other suggestions on how the MRO process could be changed using existing powers?

We welcome revisiting the process and timescales associated with the MRO option. In our view, both alternatives are an improvement on the current process. As the second example provides an opportunity for the tied-tenant to raise issues (connected to the reasonableness of terms) at the start of the negotiation – and to require a response from the PubCo at the point at which a MRO offer is made – we would prefer this second route.

Within our research, other issues emerged with the MRO process that warrant attention.

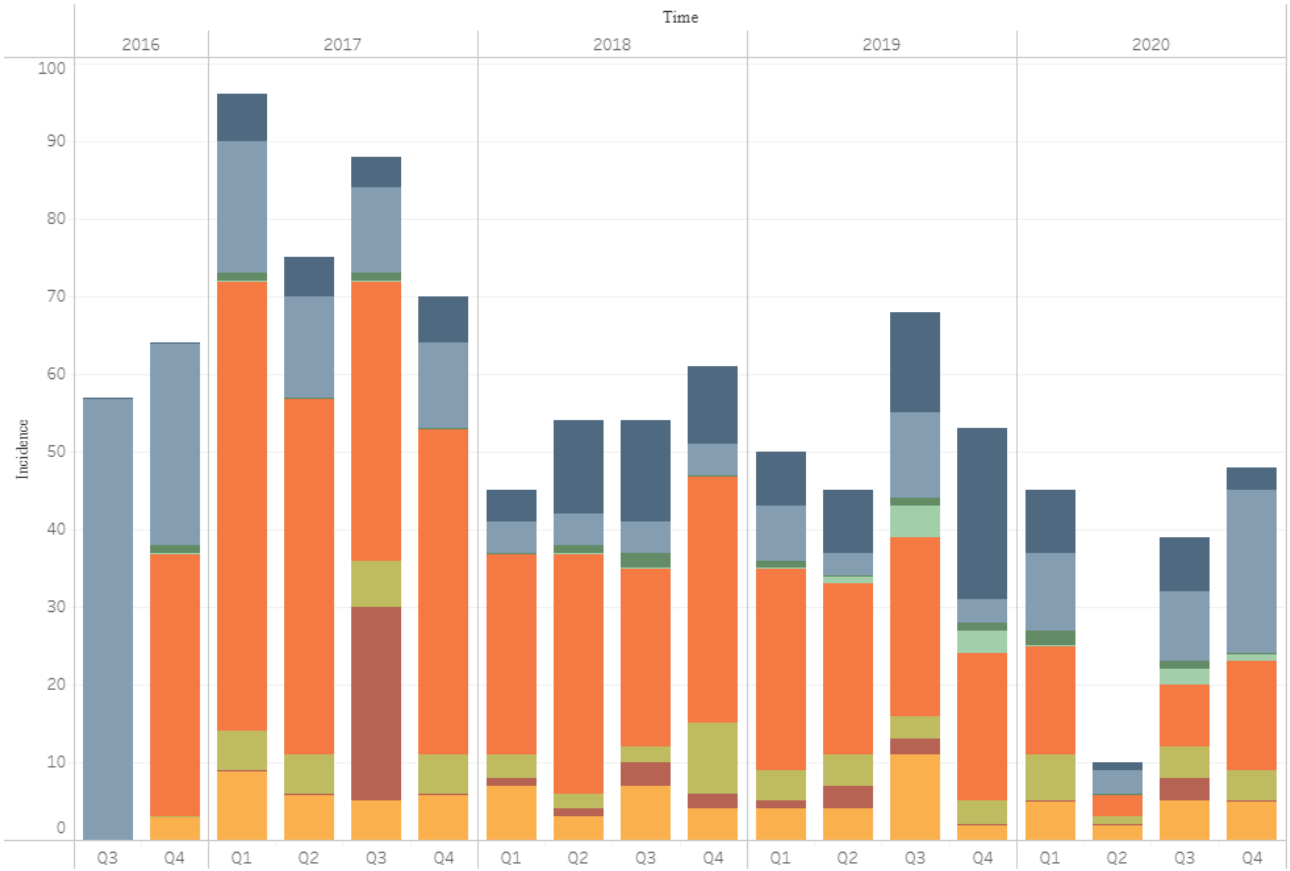
i. Increase in referral window

We agree that the timescales laid out within the Code are currently unduly restrictive. We think there are good reasons for providing longer time periods and more flexibility in timescales for tied-tenants, over-and-above those for PubCos, given the relative lack of resources and in order to provide more time for gaining independent advice on the terms of the MRO offer, and in some circumstances, revised terms offered for tied-arrangements. This is particularly true for the 14-day window for acceptance or referral – **we support a doubling of this to 28 days.**

The restrictive referral window may be a partial cause of the high number of referrals dealt with via an agreement outside of the MRO process (as reflected in **Figure One** below).

[3] Under Sch.2 Pubs Code Regulations 2016.

Figure One: Outcomes following an MRO request from the introduction of the Pubs Code Regulations 2016 to the end of 2020. Raw data available via the BBPA. Interactive version available at: https://tinyurl.com/n6v3bjzw.



Within our interview data, the tied referral windows did emerge as a key barrier for tenants seeking PCA arbitration involvement. This was particularly in the context of concerns over missing key dates laid out within the legislation:

> One of the things that started scaring me was that there were what seem to be very restrictive timelines, during which you must complete certain factors, certain parts of it, which I personally feel are not highlighted enough, and not brought to your attention, like "you must do this".[4]

The MRO data therefore suggests that reforms to referral windows for tied-tenants looking to dispute an MRO offer – laid out within Reg.37 and Reg. 38 of the Pubs Code Regulations 2016 – would likely support tied-tenants in their negotiations with a PubCo following an MRO trigger; especially for those without resources for full legal representation.

[4] Participant Three.

Given the inherent resource and information imbalances between the parties – and the problems caused by delays and cycles of arbitration dealt with below – we would support **different timescales for tied-tenants and PubCos, providing the former with more time, but maintaining current windows for the latter.**

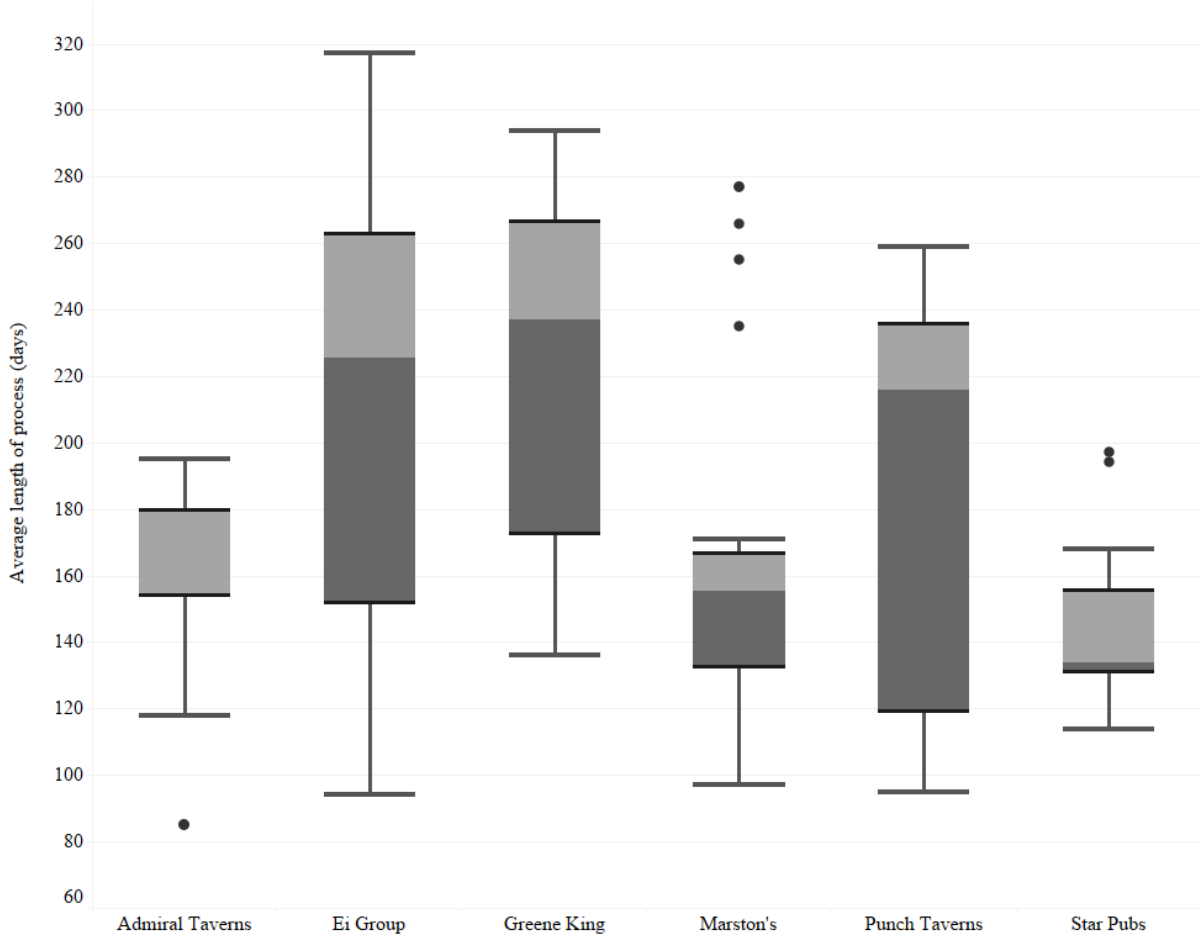
ii. Delays and cycles of arbitration

The time taken to resolve a dispute is an important key performance indicator of any dispute resolution model. This is especially true in instances where there are inherent resource imbalances between the involved parties. Within the Pubs Code Regulations, protracted processes and delays can disproportionately deplete the resources of the smaller party, which in turn provides an incentive to delay the process for PubCos.

Contributors to the Government's statutory review of the Pubs Code pointed to problems with the length of the process between triggering an MRO right and a negotiated outcome, leading both to the costs associated with arbitration and the "delay in seeing the benefits of a new tied agreement or MRO."[5] Data on MRO processes in **Figure Two** illustrates that there is considerable variation between PubCos, with a median of 164 days from triggering the process to an outcome. However, particularly for Ei Group and Greene King, it is not usual for this period to be far longer, with median timescales of 226 and 237 days respectively.

[5] Department for Business, Energy and Industrial Strategy, 'Statutory Review of the Pubs Code and the Pubs Code Adjudicator: 2016-2019' (2020) at https://tinyurl.com/mz3nvkmu.

Figure Two: A box-plot illustrating the average delay average delay between MRO applications and outcomes between 1st July 2017 to 1st January 2020. Raw data available via the BBPA. Interactive version available at: https://tinyurl.com/y7kph4e9.



There are structural reasons within the Pubs Code which may exacerbate these delays. Principally the power of an arbitrator to direct the inclusion of specific terms within an MRO lease. This was the focus of a referral to the High Court under s.69 Arbitration Act 1996 in *Punch Partnerships v [Redacted]*[6], in which the court considered whether an arbitrator could direct a particularly term – in this case, a specific lease length – into an MRO offer in order to avoid protracted litigation between the parties. At the initial arbitration, the PubCo had argued that the power of the arbitrator (in this case, the PCA themselves) under regulation 33(2) of the Pubs Code Regulations 2016, only allowed them to direct a revised MRO response: not

[6] [2020] EWHC 714 (Ch))

to specify what terms should be included in such a response. In the original arbitration, the PCA noted that:

> "[The PubCo's] interpretation of my powers under regulation 33(2) is such as to provide the potential for locking a tied pub tenant into a cycle of litigation. Such delay would place a greater burden on the tenant than on [the PubCo] as a huge international brand with deep pockets."[7]

This danger of the revolving door of litigation was noted by the High Court, which accepted that such an interpretation of the arbitrator's powers poses "a risk of further delay, cost and attrition involved in repeated offers and arbitration" that "might harm the Tenant more than the [PubCo]".[8] However, although the Pubs Code provides the PCA with the power to require a PubCo to issue a revised response, they could not determine the terms within that response: that is to be left to the PubCo, and then subject – if needed – to further arbitration. The permissive language in reg.33 was not enough to "empower the arbitrator to interfere with the economic and property interests of the parties" – for the court to be satisfied that such a power exists, it needed to be more clearly expressed in the underpinning legislation.[9]

Therefore, we would recommend that the Regulation 33 power should be revised to clarify the powers of the arbitrator to direct MRO terms where required.

7. What are your views about requiring the inclusion of rent in an MRO proposal?

Rent figures are already included in most MRO proposals and we would support making this a requirement: knowing the proposed rent is fundamental to ensuring that the MRO proposal is a tangible alternative to ongoing tied arrangements.

It should be made clear to the tied-tenant that:

i. The MRO rental figure is the one that has been estimated by the surveyor engaged by the PubCo. It is, therefore, not definitive but part of the negotiation.
ii. Tied-tenants should be notified that they can engage their own surveyor. that the rental figure is up for negotiation and that a prospective tenant may wish to engage their own surveyor.

8. What are your views about removing the requirement that terms should not be 'uncommon'?

We agree with the contention in the consultation that the interaction between "reasonableness" and commonality can be complex, and that this in turn causes problems for both tied-tenants (where, for instance a tenant may request terms that are uncommon) and for PubCos (given the very significant variation in estates). We would therefore support the removal of the "uncommon" requirement - relying on the overall principle of "reasonableness".

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[7] para 62 of the PCA award, detailed in [28]. *Punch Partnerships (Ptl) Ltd v [Redacted]* Ltd [2020] EWHC 714 (Ch)).

[8] [Redacted] at [107]. [9] [Redacted] at [102].

9. What are your views on amending the definition for the 'comparison period'? Please provide the reason(s) for your answer including, where available, views and evidence on whether pub-owning businesses are adopting a 13-month pricing period and the impact this has on business planning.

We would support the changes suggested in the consultation document. They resolve an inconsistency with how the comparison period currently operates.

10. What are your views on excluding taxes and duties from the significant price increase calculations?

Where these exclusions are limited solely to the cost of the associated duty/tax rise themselves (i.e. not associated with impacts on pricing more generally, and resulting changes to the profit/loss account), then we are indifferent to this change.

However, although such exclusions are understandable given the Code rights at play, it does illustrate that the Pubs Code should do more to ensure that the risk transfer between PubCos and tied tenants should not be "one way". For instance, in the event of a tax cut (such as a cut in beer duty), there is nothing to protect savings being passed onto tenants, whereas this change does ensure that tax rises do not form a price-based trigger event.

11. What are your views about excluding other unavoidable costs from the significant price increase calculations?

Aside from the tax duties, we would not support an expansion of the exclusions to include other avoidable costs. We agree with the assertion in the consultation document that the current operation of the Code is sufficient on this front - it allows for modest uprating of costs in line with CPI inflation. Indeed, it is entirely consistent with the Pubs Code's underpinning principles that increases outside of this envelope would constitute cause to trigger the MRO process.

12. Do you think there should be an alternative appeal route to the current High Court or should the latter be retained?

13. If you believe that the appeal route should be changed, what do you think it should be changed to? Are there other ways to make an appeal more accessible and potentially less costly without changing the appeal route?

Appeals to arbitration awards under the Arbitration Act 1996 pose a number of challenges for tied-tenants. Most notably, challenges under s.67, 68 and 69 may heavily delay the realisation of a tied-tenant's Pubs Code rights - particularly where a PubCo is challenging an arbitrator's award on an MRO proposal (as is the case for most High Court referrals to date).

Moreover, the propensity to remit the issue back to the arbitrator concerned by the High Court - often with a view of inviting further submissions from the parties - generates additional cost and delays.

We would therefore support an alternative route for appeal, but appreciate the complexities involved. We would support the less burdensome appeal routes and broader remit that could be realised under an appeal route to the First Tier Tribunal - especially if this could be accommodated within the Property Chamber, where expertise on leasehold matters is strongest.

14. Are there any other ways that could be adopted to make the appeal route more accessible and potentially less costly without changing the appeal route?

In all of our tied-tenant interviews, the need for impartial, independent advice was highlighted. Small business owners, whether running a pub or in another sector, need to have access to advice to know and understand their rights. Briefing notes published on a website are not sufficient for this. An advice service, similar to ACAS, needs to be established so that all small business owners can easily access advice on their legal rights in what can be a complex area where the resources of the involved parties are inherently imbalanced.

Please do not hesitate to contact us if we can be of further assistance with the consultation.

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