PCA ref: ARB/105930/ANDERSON

In the Matter of An Arbitration Under

The Small Business, Enterprise & Employment Act 2015
And the Pubs Code Regulations 2016

Between

MR E. ANDERSON
(Tied Pub Tenant and Claimant)

and

THE EI GROUP PLC
(Pub Owning Business and Respondent)

in respect of

The Vine Public House
47 High Street, Cheltenham
GL50 1DX

FIRST AWARD

19 December 2019

1. **THE DISPUTE**

2. This dispute has arisen out of a Market Rent Only (MRO) request under the Pubs Code etc. Regulations 2016 (The Code) between Mr Edward Anderson (Tied Pub Tenant (TPT) and Claimant) and Ei Group Plc (Pub Owning Business (POB) and Respondent).

3. An application for arbitration of the dispute was made to the Pubs Code Adjudicator and by letter dated 1st October 2019 I was appointed by the Pubs Code Adjudicator (PCA) as Arbitrator to determine the dispute.

4. The seat of this arbitration is England & Wales.

5. The Claimant in this case is Mr Edward Anderson acting as a litigant in person and the Respondent is Ei Group Plc represented by Mr R. Hastie of Gosschalks Solicitors who provided expert reports from [redacted] and Mr Andy Bell of Gosschalks. There is also a witness statement from Mr S Gallyot the Group Compliance officer of Ei.

6. **PROCEDURE**

7. I wrote to the parties on 7th October 2019 following my appointment. I was supplied with a copy of Directions issued by the Pubs Code Adjudicator dated 6th September 2019 which had been agreed by the parties and this reference has continued under those Directions.

8. The Directions required the Claimant to submit a Statement of Claim with a reply by the Respondent and then further comment from the Claimant. For future reference the preparation of the Statement of Claim in schedule form only rather than in a narrative form including a schedule is not a particularly easy format to work with and should be avoided.

9. **THE CLAIM**

10. The claim is that the MRO proposal made by the Respondent does not comply with Regulation 29(3)(b) of the Pubs Code as it is not MRO compliant within the meaning of Section 43(4) of the Small Business Enterprise & Employment Act 2015 (the Act).

11. The reason the proposal is not MRO compliant is that the Respondent refused to negotiate. Further, the Respondent insists on an MRO by way of a new lease rather

than a Deed of Variation. Additionally, the draft lease contains unreasonable terms including provision for an authorised guarantee agreement, an increase in the rent deposit and a requirement to pay rent in advance, the inclusion of an upwards only rent review and a requirement to comply with the schedule of dilapidations on the grant of the lease. Finally, the Claimant will incur an SDLT liability, increased administration costs and increased solicitors' costs.

12. The Respondent denies the claim and I will deal with the case for each party under each heading as it arises.

13. On 9th December 2019 I received an open offer from the Respondent changing its position by stating that the Respondent offers the Claimant six months to build up the increased rent deposit and the Respondent will accept the rent payable monthly as a personal concession. The requirement for cyclical rent reviews on a five yearly basis will be withdrawn as the MRO tenancy is to include yearly RPI increases and capping at 4% has been added. Finally, the Respondent will agree to the documents being silent as to dilapidations. Again, I will deal with each of these points in turn.

14. **LEGAL REASONING**

15. In the Statement of Defence, the Respondent refers me to an Award of the Pubs Code Adjudicator published on the PCA website as Quarter 4_1 2018 in arbitration reference Arb/17/Doyle. That Award contains four appendices: -

Appendix 1	Applicable Law
Appendix 2	Unreasonableness
Appendix 3	Vehicle for the MRO Option
Appendix 4	Severing the Tie and Existing Lease Terms

16. The Claimant does not address interpretation of the Act and Code directly but by reference to the various headings in the claim. The Respondent however includes a specific section and it generally accepts the interpretation set out by the PCA as set out above subject to a number of points.

17. **Respondents position**

18. The Code does not specify which terms are to be regarded as reasonable other than the term must be at least as long as the term of the existing tenancy.

19. The purpose of Regulation 31(2)(c) is to enable the market to determine those terms which are reasonable. Without that yardstick the principle of the TPT being no worse off than a free of tie tenant would be impossible to apply. The comparison must be between a TPT in the real world and an FOT tenant in the real world. If the FOT terms are a watered-down version of those common in the FOT market then one is saying that the TPT must be no worse off than an FOT tenant on favourable terms. Alternatively the TPT must be better off than an FOT tenant in the real world and that is not what the Act and Code set out to achieve.

20. If terms are common and negotiated in FOT leases in the market they are likely to be reasonable under the Code as it would not make sense for an FOT tenant in the Open Market to agree to unreasonable terms.

21. The Respondent quotes from an unpublished Award of the DPCA, but I can place no weight on this in the absence of its context.

22. The Respondent accepts terms must be common individually and in combination. The Respondent quotes an example that in Ei FOT agreements created since July 2014, the combination of no deposit and a monthly rent only occurs in 4% of agreements and so would not be common.

23. The terms of an existing tenancy are not relevant in determining whether the terms of the proposed MRO tenancy are common for this purpose. As an existing tenancy is a tied tenancy it is not a relevant benchmark for commonality. The Respondent accepts that the PCA in their advice and Awards does say these clauses may be relevant because they have been individually negotiated for circumstances of particular pubs. This does not mean the standard terms of the tied lease are of relevance.

24. The time at which it is to be determined whether a particular term is not common is when the proposed MRO tenancy is sent by the POB. FOT agreements change and for more historic, a market based FOT is an agreement the less relevant it is.

25. Terms which are not common in FOT leases (for example upwards and downwards rent reviews) cannot be inserted into an MRO tenancy no matter how reasonable the TPT may believe them to be because of Regulation 31(2).

26. With respect to the Respondent, I am not convinced this is a correct interpretation of Regulation 31. The Regulation deals with terms and conditions which are regarded as unreasonable in relation to the proposed MRO tenancy which is in the control of the

landlord. The Regulation deals with several situations which are deemed to be unreasonable, but I do not read the clause as prohibiting a landlord from including an unusual term which is advantageous to the tenant. If the respondent is correct then it would have the effect of preventing any new variation from being introduced for whatever reason as it would not be common. It is still subject to the overriding requirement to be reasonable and the requirement for fair dealing.

27. The Respondent argues that the terms of the TPT's existing lease are not relevant as these have no impact on terms found in the FOT market. It also argues that the fact that the TPT has insufficient funds to pays costs is not relevant so long as those costs are objectively reasonable and finally the comment at paragraph 24 of Appendix 2 that the terms must not be "unreasonable when viewed from either party's perspective" should be qualified to acknowledge that unreasonableness is an objective rather than a subjective test. Taking these factors into account would corrupt the MRO process and lead to the tenancy not reflecting the position of tenants who are FOT.

28. **My Decision**

29. In the ordinary course of events, an Award of an Arbitrator is not binding on any other Arbitrator or indeed on the Arbitrator himself in future cases. However, as the points of interpretation in the Appendices referred to above were published by the Pubs Code Adjudicator and Deputy Pubs Code Adjudicator in statutory arbitrations under the Code, and followed subsequently, I consider they are potentially of persuasive importance provided that I agree with the contents.

30. In consequence, I have considered the contents of those documents in the light of the arguments made on behalf of the Respondent but I agree with the reasoning of the PCA and DPCA and not the interpretation placed on them by the Respondent. I will therefore incorporate the Appendices in this Award and will refer to them where appropriate.

31. I note in passing that in the email dated 9th December 2019 from the Respondent enclosing terms of their open amendments to the MRO proposal, I was referred to a newly published Award from the PCA under reference Quarter 1_2019_17 dated 5th December 2019 between Edward Anderson and Marstons Plc where the same appendices were attached albeit in a different order.

32. Appendix 2 is entitled "Unreasonableness" which is at the heart of this claim. Summarising the points made, in considering unreasonableness, for the reasons set out in the Appendix, the terms and conditions in the offer must not be unreasonable

overall. Uncommonness is merely one way in which terms can be unreasonable. Terms and conditions must not be collectively and individually be unreasonable and the choice of vehicle for delivering the MRO cannot be unreasonable.

33. The legislation imposes on the POB a statutory duty to serve on the TPT a proposed tenancy which is compliant and the choice must not be unreasonable in any case. There is nothing in the legislation which requires the meaning of any term to be determined as if the discussions were between two unconnected parties in the open market entering a new FOT lease. The reasonableness of a decision will be based on all the circumstances as they are, or ought to be, known to the parties and each case turns on its facts.

34. It is proper to conclude that the Code and the Act read together can be interpreted in a manner consistent with the principles of "fair and lawful" dealing by the POB with its TPT's and that a TPT should not be worse off than it would be if not subject to any product or service tie. Fair dealing means that in addition to complying with legislation and private law principles, dealings should be in good faith, equitable and without unjust advantage.

35. The second principle of "no worse off" requires a comparison of the position of TPT's with tenants who are free of tie (FOT). This requires a judgement in each case as a matter of fact and degree. By pursuing the MRO option, the TPT should be in a position to make an informed choice.

36. It is consistent with the Code principles that the proposed MRO tenancy is not on worse terms than would be available to an FOT tenant after negotiation in the open market.

37. **DISPUTED TERMS AND CONDITIONS**

38. **Inclusion of an Authorised Guarantee Agreement (AGA)**

39. **Claimants position**

40. The Claimant considers that the inclusion of an AGA is unreasonable as there is no requirement for one in the present agreement. It is only there as a result of the Respondents insistence on a new lease rather than a Deed of Variation. The Claimant relies on a PCA advice note dated March 2018 entitled Market Rent Only - compliant proposals without specifying the part relied on.

41. The reasons given by the Respondent are not valid or not true. Just because an AGA appears in other leases does not make it compliant. No good reason has been given.

42. Existing terms have not been regarded as the Respondent is using a new lease to impose more onerous terms. The Advice Note clearly states the Respondent may have regard to the existing terms. The imposition of an AGA takes away the effective choice by imposing a potentially expensive clause if the Claimant takes up the MRO proposal. No attempt has been made to reduce the impact of the AGA to make it code compliant. It is offered on a take it or stay tied basis.

43. The imposition of an AGA is not consistent with the requirement for fair and lawful dealings. The claimant asserts that his concerns have been ignored and he has been forced to go to arbitration.

44. The Respondent is taking advantage of the difference in negotiating power; in the open market the tenant could walk away.

45. **Respondents position**

46. On behalf of the Respondent it is asserted that the terms of the existing lease are not a relevant comparable. The existing lease is a typical version of an Ei standard tied lease which for a number of years did not contain provision for an AGA. Almost all of the Respondent's other tied leases do contain AGAs. Since the abolition of the original tenant's liability by the Landlord & Tenant (Covenants) Act 1995, the requirement for an AGA on assignment has become a common provision in tied and free of tied leases. A number of leases are listed in the Scott Schedule but I note that none of the clauses is in evidence. It is argued that the requirement for an AGA is so common that as assignment clause without it would be uncommon and therefore in breach of Regulation 31(2). It is reasonable to require an existing tenant to guarantee the liabilities of an assignee they wish to introduce and could be receiving a premium from. The choice of assignee is within the Claimant's control and they should be able to assess the likely risk they are taking be entering into the assignment and AGA. The Respondent should not be prejudiced in terms of covenant strength.

47. It is further argued there is no expense at the date of the MRO associated with an AGA provision and the AGA does not add to the commitment the Claimant is making to pay the rent and comply with the lease terms throughout the term. The Claimant has a choice whether they assign and if so who to. It is denied that imposing an AGA is contrary to the fair and lawful dealing provision of the Code as the term is not affected by whether the MRO is by Deed of Variation or a new lease.

48. The Respondent argues the Claimant is seeking to be better off than open market free of tied tenants. An AGA has been a standard term in an Ei FOT lease since 2011 and its inclusion has nothing to do with MRO.

49. In support of the arguments relating to an AGA, the Respondent relies on a witness statement of Andrew Bell, a solicitor employed by Gosschalks. Mr Bell is head of Gosschalks commercial property pub team and in addition to Ei has acted for Wellington Pub Company Plc for over 20 years.

50. Mr Bell sets out the history of the current form of Ei standard FOT tenancy which was not drafted in response to the introduction of the Code. The precedent has not changed significantly since its creation and has been used in a large number of commercially negotiated FOT negotiations. In the period July 2014 to December 2018, Ei created 361 FOT agreements which are still subsisting. Gosschalks acted on the vast majority and Mr Bell dealt with many of them. There are minor variations in the terms which have been negotiated but generally no issue is taken with the substantive standard terms.

51. **My Decision**

52. As set out in Appendix 4, the existing lease terms are not the starting point but they are not irrelevant in considering what is reasonable. Taking as a starting point the existing lease terms, these require the payment of a deposit equivalent to a quarter's rent and allows for the provision of a guarantor under clause 39 and schedule 5.

53. The existing tenant, is Mr Anderson, who operates as a sole trader and therefore has unlimited liability.

54. The transfer provisions of the lease at clause 16 give the landlord the right to withhold consent or to impose pre-conditions of two individual guarantors if the proposed buyer is a limited liability company or partnership.

55. The Respondents have included with their Statement of Defence an Expert Witness Report from [redacted] which discusses the requirements of a lease from the perspective of the investment market. At 3.1 of that Report, [redacted] lists the key terms in the context of an MRO and lists a quarter's rent deposit and two guarantors for a corporate tenant as being key terms. It is notable this does not include an AGA.

56. Mr Gallyot is a witness of considerable experience but gained on the landlord side of the fence only. His evidence is directed at what Ei require from their free of tie estate but the report is in general terms and not directed to the specific MRO in this arbitration. It is useful as background.

57. In considering whether it is reasonable in the context of this arbitration for an AGA to be imposed as a condition of the MRO, I take into account the existing relationship between the parties, their knowledge of each other and the protection which a landlord would reasonably require against a tenant default. Additionally, the landlord has the ability to refuse consent to an assignment to a party it considers would be unable to fulfil the obligations under the lease were Mr Anderson to seek to assign it. The incoming tenant would also have to provide a rent deposit and either be personally liable or provide guarantors. I am not persuaded that it is reasonable in the context of this particular transaction for the MRO to require the addition of an authorised guarantee agreement in the event that the lease is assigned.

58. **INCREASE IN DEPOSIT & UPFRONT RENTS**

59. **The Claimant's Case**

60. The Claimant says these issues only exist because of the insistence on a new agreement. No valid reasons have been given for these terms and without a valid reason these terms are not Code compliant.

61. The existing lease terms have not been regarded and no reason has been given for this. The effect of increasing the deposit and requiring rent quarterly in advance takes the effective choice between tied and free of tie away from the tenant by making it too expensive to go free of tie. No effort has been made to consider whether the tenant can afford these. The offer to allow the deposit to be increased over a period of 6 months is arbitrary and takes no account of the tenant's position. It is not fair or reasonable and therefore not compliant.

62. The clauses are not consistent with the core principles of the Code, they are not fair and make the proposal non-compliant. The Respondent takes advantage of the tenant's negotiating position whereas in the Open Market they would naturally have to assess the affordability of their proposal with a new tenant and would not put an arbitrary cap on the time taken to build up a deposit or enforce 3 months upfront rent. This is not fair or reasonably behaviour. The clause is unattractive which has the effect of persuading him to stay tied.

63. **The Respondent's Position**

64. The Respondent argues that the financial circumstances of the TPT are not a relevant factor is deciding whether the terms are reasonable. Otherwise TPT's who are in substantial debt would get better terms than TPT's in a strong financial position which is the opposite of what would happen in the market.

65. In financial terms the Claimant has an existing rent deposit of £5.868.22 and a repair and maintenance fund of £8,099.93 totalling £13,968.15.

66. If the Respondent's proposed rent of £62,000 per annum becomes the new rent, the deposit would be £15,500 and the maximum amount needed to top up the deposit would be £1,531.85. The Respondent has offered to allow that additional deposit to be built up over a 6-month period.

67. Quarterly rent is a fundamental feature of commercial free and tie leases and monthly rent is uncommon. This is confirmed by the evidence of [redacted]. The Respondent will agree a personal concession by side letter allowing the Claimant to pay monthly rents while they are the tenant.

68. **My Decision**

69. I note that the present lease has a requirement for a rent deposit of one quarter's rent. Additionally, there is a repairs deposit which would no longer be applicable. The amount which would be required once the existing rent and repairs deposits have been combined in relatively modest in the grand scheme of things and it will form part of the commercial decision for the tenant as to whether to go free of tie or not. Lease terms are only one factor in this.

70. The proposed short form of deed of variation put forward by the Claimant does not alter the deposit arrangements in the existing lease.

71. I note from the evidence of [redacted] that rent deposits are generally common for individual tenants as we have here and uncommon for corporate tenants.

72. The requirements for rent deposits are tied up with the question of guarantors and authorised guarantee agreements. Taking into account the existing terms and the evidence, I find that a quarterly rent deposit for an individual tenant is not unreasonable and the requirements for guarantors for a corporate tenant is also not unreasonable in

appropriate circumstances. For example, it would be reasonable for an individual operating through a limited company to provide a guarantor but not, for the sake of argument, for a company the size of Ei to be required to guarantee its performance. The offer by the landlord to allow 6 months for the deposit to build up is a reasonable proposal in the circumstances and I note that a personal concession has been offered on monthly rents.

73. **UPWARDS ONLY RENT REVIEW**

74. The Claimant argues that an upwards only rent review proposed in the MRO tenancy is only there because the Respondent insists on a new lease as the vehicle for the MRO. No valid reason has been given for its inclusion which makes it non-compliant with the Code. Existing terms have not been regarded and no effort has been made to mitigate the impact of this advantageous and expensive clause.

75. It is not consistent with the core principle of the Code and it is not fair to impose this condition because he wishes to go free of tie.

76. The Respondent has taken advantage of the tenant's weak negotiating position. This clause was not included when he was free to walk away and they were willing landlords and it is unfair to force it into an agreement now. It is an unattractive clause given the state of the High Street and risks facing the economy and the clause has the effect of persuading him to stay tied. Accordingly, it is not fair, reasonable or Code compliant.

77. Stating that an upwards only rent review is common in other agreements is not a good reason as explained in the PCA advice note. The clause can only have the effect of making his rent different from the market rent that the legislation demands. It goes against the core principals of the Code and is not compliant. My attention is drawn to section 43(2)(b)(ii).

78. **The Respondents Position**

79. The Respondent denies that the upwards only rent review only exists because of the insistence on a new agreement for the MRO as this confuses content with the method of delivery. The Respondent will be seeking the same terms of the MRO tenancy even if this was by Deed of Variation.

80. The Respondent asserts that the existing terms are not relevant. I have already ruled on this argument.

81. The inclusion of an upwards only rent review is a standard free of tie term and consistent with the principles of the Act. Upwards only rent review clauses appear in 94% of Ei's free of tie leases and are common numerous other leases although these are not in evidence. Upwards only rent reviews appear in almost all commercial leases of pubs and tied agreements are not relevant comparables. Upward and downward reviews are only in 6% of 361 new leases granted by the Respondent since July 2014 and in none of 26 leases obtained from the BBPA and in none of the 24 example leases sourced by the Respondent's solicitors. Therefore, upward and downward rent reviews cannot be inserted due the provisions of Regulation 31(2).

82. In their open offer dated 9th December 2019 the Respondent offers to withdraw the proposal for a cyclical rent review if the Claimant agrees to yearly RPI increases capped at 4%.

83. [redacted] Report highlights cyclical upwards only rent reviews as being a key term for the investment market together with any RPI increases but with a cap and collar. [redacted] considers that cyclical upwards only rent reviews are generally common but are becoming less so as landlords prefer RPI uplifts and tenants are becoming more comfortable with this basis of assessment. [redacted] also considers that annual RPI increases are very common but has been less so historically. Tenants see the benefit of such a provision as it provides certainty on future obligations from a business perspective.

84. **My Decision**

85. Starting with a comparison with the present lease, this provides for annual rent reviews in line with the Retail Prices Index except in years where there is a cyclical rent review. The present lease also has 5 yearly rent reviews and 5 yearly reviews of a Fair Maintainable Trade. The reviewed rent may be assessed on an upwards or downwards basis. Volume targets will no longer be relevant under an MRO.

86. The draft rent review clause in the MRO proposal is not a clause which I would consider fair or reasonable on its terms as it appears to impose a headline rent condition and has no disregard of tenant's occupation or improvements. However, as the landlord has offered to withdraw the cyclical rent review provision, I do not need to consider it in detail or invite submissions on the detail. It is true from a tenant's perspective the possibility of the rent going down is removed but on the other hand the proposed indexation capped at 4% puts a maximum on the level of increase and gives the TPT certainty for budgeting. I have no evidence before me of rental trends in the FOT

market but I note that the Claimant does not object to the indexation provisions. I note [redacted] comment that annual RPI increases are very common and that cyclical upward only rent reviews are becoming less common.

87. On balance therefore I find that the revised proposal for the rent to be reviewed annually in line with the RPI capped at 4% is a reasonable one coupled with the deletion of the cyclical rent review provisions.

88. Finally, I note that the proposed term of the lease is approximately 10 years when the lease can be renewed under the provisions of the Landlord & Tenant Act 1954 under which the rent is assessed on an open market basis.

89. **DILAPIDATIONS**

90. **The Claimant's Position**

91. The Claimant is objecting to the Respondent insisting on completion of a Terminal Schedule of Dilapidations because it is choosing to go to MRO by a new lease. If the lease was being amended by a Deed of Variation, terminal dilapidations would not be due for another 10 years. This is unfair and unreasonable and is not code compliant. No valid reason has been given for insisting on terminal dilapidations.

92. Requiring dilapidations at this point imposes a large unspecified cost and takes away the effective choice between free of tie and tied.

93. No effort has been made towards mitigating the effects of the clause, for example by rolling over dilapidations into a new lease.

94. Imposing dilapidations is not consistent with the core principles of the Code and takes advantage of the tenant's weak negotiating position and no good reason has been given. It is an expensive and unattractive consequence of going free of tie by a new lease.

95. **The Respondent's Position**

96. The Respondent denies that it is requiring dilapidations to be carried out before an MRO lease is granted. They claim to have identified breaches of the lease and indicated they expect the works to be done within 12 months. That is not unreasonable.

97. The obligation to repair is a continuing one and the tenant is not entitled to wait until expiry to do repairs. It is denied the completion of works is a condition of the MRO offer. This was explained in correspondence.

98. The evidence of [redacted] is that full repairing and insuring leases are very common and virtually all FOT leases are full repairing and insuring. The tenant takes on full responsibility for the property in return for operational freedom. The challenge for the relationship is that individual operators who are new to the sector or who have previously run a tied pub with less responsibility for the property often don't appreciate the implications of this or have the cashflow to undertake significant repairs if they are needed.

99. **My Decision**

100. In considering this issue I take into account firstly that if the lease were continuing on its present terms it would not be open to the landlord to enforce any dilapidations work except by service of a Section 146 Notice under the Law of Property Act 1925 and by seeking the leave of the Court under the Leasehold Property Repairs Act 1938. However, I do note the terms of the open offer made by the landlord to agree to the documents being silent as to dilapidations in the event that a new lease is granted. Provided this is carried through, then this disposes of the issue.

101. If it falls to me to decide the issue, I would hold that the provision of dilapidations at this point is unreasonable given the length of the unexpired term.

102. **NEW LEASE OR DEED OF VARIATION**

103. **The Claimant's Position**

104. The Claimant says that the Respondent's Business Development Manager has said that a minimum only Deed of Variation is not a valid way to achieve MRO and that this has been arbitrated numerous times by the PCA. The Claimant considers this misleading and breaks the confidentiality of unpublished Awards. The PCA advice note could not be clearer in that an MRO does not have to be in the form of a new tenancy.

105. A new agreement contains too many areas where even minor word changes between existing clauses and new clauses give the opportunity to be unreasonable and make me worse off.

106. A Deed of Variation amending the terms only as necessary to break the tie and make the tenancy code compliant is the reasonable option in this case, it would be low cost and could be done in under a day. No good reason has been given for not achieving this.

107. The Claimant refers to an Arbitration Award of the Deputy Pubs Adjudicator reference Arb/10045/Food Drink Rooms.

108. The Claimant understands that Ei have a preference for new agreements but a large part of the market opt for Deeds of Variation and in the market changes to leases mid-term are invariably done by Deed. A Deed of Variation is a common method of making lease changes and ensures there is far less chance of an unfair or unreasonable term being introduced. The Claimant states he has not been given a single good reason to use a new agreement which includes a number of unreasonable and unfair terms which taken individually or together have the effect of putting him off the MRO option or pricing him out of it.

109. **The Respondent's Position**

110. The Respondent refers me to the comment of the PCA/DPCA in Quarter 4_1 published Award contrasting the tenant's option under the statute to go free of tie with a landlord's unilateral right in some leases to impose a free of tie. The quotation includes the following:

"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 minimum only changes to the existing tied tenancy to release the tenant from the tied trading provisions".

111. In relation to the argument that changes would leave the TPT "worse off" the Respondent considers this to be a misunderstanding of the principle set out in Section 42 of the Act. The principle is the TPT should be no worse off than free of tie tenants. It is not a principle that TPT's are to be no worse off once they have gone FOT than they are under existing tie terms. The TPT must balance taking on more onerous terms against the benefit of removing the tie.

112. The Claimant makes the mistake of confusing content with mode of delivery. The Respondent will be seeking the same terms of an MRO tenancy even if they were ordered to deliver the terms by DOV.

113. The Respondent considers that Deeds of Variation to change to free of tie terms are not common. The list of tenancies created by tied tenants entering into new FOT leases listed in Andrew Bell's statement far exceeds those created by Deed of Variation. The Claimant presents no evidence to support their bold assertion.

114. The Respondent denies no good reason has been given to use a new lease to achieve MRO and refers to the Statement of Defence and Statement of Andrew Peter Bell.

115. The Respondent further goes on to quote from the PCA/DPCA in the Quarter 4_1 published Award:-

"*There is nothing in the legislation which restricts the POB to making only the minimum changes to the existing lease to make it compliant – the terms of the MRO tenancy do not by law have to be the same or substantially the same, but they must be reasonable. The existing lease terms are not the necessary starting point."*

116. If that is the case it makes no sense to use the existing lease as the starting point to draft the MRO tenancy. Under Regulation 31(2)(c) comparables for reasonable terms of an MRO compliant tenancy are the terms of FOT leases. The existing lease is a tied lease and is not a relevant comparable.

117. If the MRO compliant tenancy were created by a Deed of Variation it would have to delete uncommon terms which would involve significant legal work.

118. The proposed MRO compliant lease will be in a reasonably standard form which makes sense from the point of view of avoiding challenges under the Regulations and makes for good estate management. The difficulties of turning the existing tenancy into a line by line Deed of Variation are explained in the witness statement of Mr Bell.

119. The Respondent quotes from an unpublished Award of the DPCA, and as there is no context for this quotation, I take no account of it.

120. In a published Award Quarter _4 -2018_12, the DPCA found at paragraph 38: -

"*The Claimant argues the grant of a new lease would give a rise to a liability for SDLT whereas a Deed of Variation would not." …. The Respondent has calculated the potential liability at the MRO rent of £70,000 plus VAT at £1,013.00. Taking into account the legal costs likely to be associated with a line by line variation of the existing lease by a Deed, in order to render its terms compliant that is not to my mind a figure in and of itself which would put off the tied tenant negotiating a free of tie and does not make the choice of MRO vehicle in this case unreasonable*.

121. When they receive an MRO Notice the Respondent assesses whether SDLT will be over £7,000 once overlap relief is applied and/or whether there is a headlease which imposes restrictions which make it substantially more difficult to grant a new lease rather than a Deed of Variation. In those circumstances the Respondent will send a Deed of Variation by reference which deletes the terms of the existing lease save for term and demise and replaces them with a term of a commercial free of tie lease contained in the Schedule. This would not involve an implied surrender and re-grant. If those circumstances did not apply, the Respondent will send a new lease.

122. The SDLT in this case is a maximum of £2,362 based on the rent proposed in the full response and allowing for overlap relief. The calculation is included in the evidence.

123. The Respondent goes on to quote again from the Quarter 4_1 Award: -

124. "*There is nothing in the legislation which restricts the POB to making only the minimum changes to the existing lease to make it compliant – the terms of the MRO tenancy do not by law have to be the same or substantially the same, but they must be reasonable. The existing lease terms are not the necessary starting point"*

125. If the existing terms are not the starting point for the MRO tenancy then it makes no sense to use the existing lease as the starting point. Under regulation 31(2)(c) the relevant comparables are FOT leases. The lease must also not include terms which are not common in FOT leases. To use a DoV it would have to delete uncommon terms which would involve more work.

126. The proposed MRO lease will be a reasonably standard form which is what the Code anticipates. This avoids risk of challenges under the Regulations and aids good estate management for the reasons explained in the Respondents witness evidence. The Difficulties of converting a lease are explained by Mr Bell. The time would be around 20 hours and the result would be prone to risk of error.

127. If, which is not accepted, the form of delivery of the MRO tenancy is subject to the test of reasonableness under reg 31(2) then the respondent avers there is no form of DoV which is common in FOT agreements.

128. A standard form of MRO compliant tenancy, tested through the PCA process would limit the scope for disputes and costs.

129. **My Decision**

130. I start from the position that the Code does not prescribe the vehicle to be used. For the reasons set out in Appendix 4 I also hold that the existing lease terms are not the necessary starting point, but also, they are not irrelevant.

131. The Claimant has put forward a short form of deed of variation changing the rent and releasing the tenant from all tie obligations. The Respondent says this would leave many uncommon terms in the FOT lease and would not therefore be code compliant.

132. I agree with the Respondent that such a short form would not be satisfactory and would result in a hybrid lease as a number of terms such as the rent review provisions and repair obligations are linked to a tied tenancy arrangement and would not be common in a FOT lease. I also consider that such a vague document invites future disputes as to its meaning. I therefore hold that a short form of deed of variation is not an appropriate vehicle for the MRO proposal in this case.

133. I also agree with the Respondent that a DoV altering the current lease terms on a line by line basis is not appropriate as it would be difficult to use and the risk of errors is high.

134. This brings us to a consideration of whether a deed of variation by reference or a new lease is the more appropriate vehicle. I agree with the Respondent it is necessary to keep a separation between the vehicle used and the substantive terms.

135. The Respondent has stated that if the SDLT payable on a new lease would be over £7,000 then a deed of variation by reference would be offered in preference to a new lease. The arbitrary limit is not explained. I struggle to see why it is an appropriate method in that case but not in the subject case. A deed of variation by reference would not be any more difficult to work with than a new lease by reference to the previous one or indeed a lease with several changes made by a deed of variation or more than one deed.

136. The claimant in this case argues that the level of SDLT payable on conversion on top of an increased deposit would be a significant financial barrier to him taking up the MRO. I have no evidence on the point but equally have no reason to disbelieve the Claimant.

137. A new lease has the benefit of being a straightforward document but the preparation of a schedule to insert into the lease but containing the same terms should not be a difficult document to produce, especially as the evidence indicates this has been done previously.

138. On balance, I consider the appropriate vehicle for the MRO proposal is a deed of variation by reference leaving in place the term and demise and inserting the new MRO terms as offered and accepted or in the open offer of 9 December 2019 or awarded in this arbitration.

139. I am not persuaded by the Claimant that this route will significantly increase administration costs of result in increased legal costs given there will be a saving in SDLT.

140. **REMEDIES SOUGHT**

141. **The claimants position**

142. The Clamant requires that I order the respondent to send a compliant MRO proposal.

143. The Claimant argues the Respondent is not to be trusted to draft terms which are fair and reasonable or to negotiate on that basis. He therefore requires me to draft a compliant short deed of variation.

144. The Claimant requires an order breaking the confidentiality around unpublished awards in order to avoid misleading a TPT. There is no discussion of whether I have the power to do this.

145. The Claimant seeks a ruling that the refusal to negotiate by the Respondents business development manager is a breach of the code and unlawful.

146. The claimant seeks an order for costs.

147. If the award determines that a new agreement is appropriate then it must be code compliant and leave the Claimant no worse off. It should also order the Respondent to pay extra administration cost, legal costs and SDLT payable as a result.

148. **The Respondents position**

149. The Respondent considers the terms and personal concessions offered are fair and reasonable.

150. The Respondent denies it is within the power of an arbitrator to break the confidentiality of unpublished awards in other cases.

151. Whether the BDM negotiates or not is not a matter within the arbitration. The BDM suggested that terms apart from rent are agreed and then the rent based on those terms is discussed.

152. An order the Claimants cost are met is denied

153. If a new lease is ordered then it is denied the Respondent can be made to pay the Claimants additional admin costs, legal costs or SDLT.

154. The comment that the Claimant should be no worse off is a misunderstanding of the principle. It is not the case that TPT's are no worse off when they have gone FOT than under their existing terms. The principle is that a TPT should be no worse off than an FOT tenant.

155. **My Decision**

156. For the reasons set out above I will make an order that revised terms are to be put forward in the form of a deed of variation by reference.

157. The arbitrator will not draft a short form deed as this is not an appropriate vehicle.

158. For reasons set out above I do not need to consider quotations from unpublished awards. I do not therefore need to consider what powers I have in relation to other awards.

159. Whether the Respondent BDM negotiates or not does not affect the validity of the MRO proposal itself. The evidence indicates that negotiations have taken place in any event.

160. Costs are reserved.

161. **AWARD**

162. The Respondent is to provide a revised MRO proposal in the form of a deed of variation by reference leaving in place the term and demise and inserting the new MRO terms

as offered and accepted or set out in the open offer of 9 December 2019 or awarded in this arbitration.

163. Specifically: -

- The MRO will not include an authorised guarantee agreement on assignment.
- The MRO terms will include a 3-month rent deposit and payment of rent in advance. A personal concession will be made by side letter accepting rent on a monthly basis.
- The MRO will provide for annual index linked rent reviews capped at 4% and will not include 5 yearly rent reviews based on the market.
- The MRO will not require any dilapidations to be completed and the money in the repairs and maintenance fund will be transferred to the rent deposit.

164. In the event there remains any dispute over the terms of the MRO further directions must be sought.

165. Costs are reserved to a further award. This award is final as to all matters to which it refers other than the issue of costs. I reserve my award as to the applicable costs of this award including liability for my fees and expenses as between the parties and the fees of the Pubs Code Adjudicator. In all other respects this is my final award.

Arbitrator

Date 19 December 2019

Appendix 1 – Applicable Law

1. Section 42 of the 2015 Act makes provision for the Secretary of State to make regulations about practice and procedures to be followed by POBs in their dealings with TPTs, to be referred to as "the Pubs Code", and subsection (3) provides:

> *The Secretary of State must seek to ensure that the Pubs Code is consistent with –*
>
> *(a) the principle of fair and lawful dealing by pub-owing businesses in relation to their tied pub tenants;*
>
> *(b) the principle that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie.*

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

3. 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).

4. 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.

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

Terms and conditions required in proposed MRO tenancy

30 - (1) Paragraph (2) applies where –

(a) a tied pub tenant is subject to a tenancy ("the existing tenancy") granted by the pub-owning business;

(b) the tied pub tenancy gives an MRO notice to the pub-owning business; and

(c) the pub-owning business sends a proposed tenancy ("the proposed MRO tenancy") to the tied pub tenant as part of a full response under regulation 29(3)
....

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

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

31 – (1) Paragraph (2) applies where—

(a)a tied pub tenant is subject to a tenancy ("the existing tenancy") granted by the pub-owning business;

(b)the tied pub tenant gives an MRO notice to the pub-owning business; and

(c)the pub-owning business sends a proposed tenancy ("the proposed MRO tenancy") to the tied pub tenant as part of a full response under regulation 29(3) or a revised response under regulation 33(2) or otherwise during the negotiation period.

(2) The terms and conditions of the proposed MRO tenancy, taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy, are to be regarded as unreasonable for the purposes of section 43(4) of SBEEA 2015 if they-

...

(c) are terms which are not common terms in agreements between landlords and pub tenants who are not subject to product or service ties.

(3) Paragraph (4) applies where—

(a) the conditions in paragraph (1)(a) to (c) are met, and

(b) the existing tenancy is a protected 1954 Act tenancy.

(4) The terms and conditions of the proposed MRO tenancy, taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owning business in connection with the tenancy, are to be regarded as unreasonable for the purposes of section 43(4) of SBEEA 2015 if they exclude the provisions of sections 24 to 28 of the Landlord and Tenant Act 1954 in relation to the proposed MRO tenancy.

Appendix 2 –

Unreasonableness

The terms and conditions must not be unreasonable overall. Uncommonness is merely one way in which terms can be unreasonableness.

1. Pursuant to section 43(4) an MRO-compliant tenancy cannot contain any unreasonable terms or conditions. Regulation 31 of the Code makes provision for certain terms and conditions which will automatically be unreasonable, amongst them (under paragraphs (2)(c)) terms which are uncommon in tie free leases.

2. It is necessary first to consider whether the terms set out in that regulation are an exhaustive list of all unreasonable terms and conditions, but it is clear from a straightforward reading of the legislation that they are not and are merely particular examples of unreasonable terms. Section 43(5)(b) is a power not a duty, and section 43(4) renders a tenancy non-compliant for any unreasonable terms or conditions in any event, notwithstanding that the Secretary of State might not have chosen to exercise that power to specify descriptions of terms and conditions to be regarded as reasonable or unreasonable. It is still necessary for all terms and conditions in the proposed tenancy to be reasonable in a broader sense.

3. Therefore, determining MRO-compliance is not simply a question of looking at each individual term to decide whether it is uncommon for the purposes of regulation 31, but whether the proposed MRO tenancy contains terms or conditions which are unreasonable. The term or conditions of a lease may be unreasonable by virtue of words which are not included, and not just those that are.

The terms and conditions must not individually and collectively be unreasonable

4. Furthermore, it is not the case that the language of the 2015 Act and Pubs Code requires consideration of each proposed term or condition in isolation. A judgement as to whether an individual term or condition is unreasonable may be affected by the other terms and conditions of the proposed tenancy. Two or more terms and conditions together may render the proposed tenancy unreasonable, for example, where they are inconsistent with each other, or where their combined effect is too onerous for the tenant. Indeed, this is reflected in the normal course of negotiations between parties in the market, in which a tenant may not look at each term or condition in isolation to decide if it is reasonable. A tenant may consider that a number of terms together in a lease may make the proposed terms unreasonable. There may be some particular terms which are make or break, but often some terms objected to may be rendered acceptable by virtue of concessions elsewhere in the negotiation. It is necessary therefore to consider not just whether the individual terms are unreasonable, but also whether that test applies to the proposed lease as a whole.

5. Thus, for example, the payment of an increased deposit, rent in advance and payment of insurance annually in advance would constitute additional costs to the tenant. Other cost considerations at entry may be legal fees and the payment of dilapidations. Where costs, including entry costs, are excessive in total, but negotiated to a reasonable overall, it may not be correct to focus on an individual term or condition in isolation to and decide if that cost is or is not reasonable – it may depend on the context.

6. A tenancy will not be compliant if its terms and conditions, individually or collectively, are unreasonable. That this is the correct approach to considering whether proposed lease

terms are uncommon is furthermore clear from the wording of regulation 31(2), which refers to terms and conditions only in the plural. Therefore, this regulation requires consideration of whether the agreement as a whole is one which is not common in tie free agreements.

The choice of vehicle for delivering the MRO cannot be unreasonable

7. Section 43(4) refers to a tenancy being MRO-compliant if "taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owing business in connection with the tenancy or licence" it does not contain any unreasonable terms and conditions pursuant to subsection (iii). There is no necessity to restrict the interpretation of "contained" to the express terms of the proposed tenancy document alone. This is broad enough to encompass the requirement to enter into a new tenancy. Therefore, the choice of vehicle is subject to a test of unreasonableness.

8. The question of whether the choice of MRO vehicle is unreasonable can correctly be analysed in both of the following two ways. Firstly, the lease terms individually and collectively cannot be unreasonable, and if they are in the form of a new lease which unreasonably imposes an excessive burden on the TPT, then those terms can be unreasonable and non-compliant. Secondly, the fact that the POB offers the proposed MRO tenancy only by way of new lease can amount to an implied condition (precedent) in the lease, in that the MRO option can only be exercised if the TPT agrees to a new lease. The method of delivery would on that analysis be a term or condition which, if challenged by the TPT, falls for consideration under section 43(4) of the 2015 Act and may be unreasonable if there is no good reason for any resulting disadvantage imposed on the TPT (while noting that it is only uncommon terms, not uncommon conditions that fall foul of the wording of regulation 31(2)).

Unreasonableness - meaning

9. The legislation imposes on the POB a statutory duty to serve on the TPT a proposed tenancy which is compliant. Accordingly, it is for the POB to make the choice of terms and vehicle, and that choice must not be unreasonable in the particular case. Communicating those reasons will help to avoid disputes and is consistent with the fair dealing principle.

10. In determining what is unreasonable, it is apparent that there is nothing in the statutory language which requires the meaning of that term to be determined only in light of open market considerations which would affect two unconnected parties entering into a new FOT lease. A term will be judged to be unreasonable or not based on all of the circumstances, as they are known (or ought to be known) to the parties, and each case will turn on its own facts. While a POB might achieve some certainty that particular lease terms are common in the tie free market, what is reasonable in one case for one particular pub may not be reasonable for another.

11. It is necessary to consider whether there is statutory guidance which assists in applying the test of unreasonableness. The starting point to understanding the Pubs Code and the statute which enabled it is the core principles, found in section 42 of the 2015 Act. Parliament's instruction to the Secretary of State in making the Pubs Code (which includes particular examples of unreasonable terms and conditions made pursuant to a power in the 2015 Act) is that she/he must seek to ensure that it is consistent with those principles.

12. The core Code principles are at the heart of the statutory purpose behind the establishment of the Pubs Code regime under the 2015 Act and relevant to the exercise

of discretion or evaluative judgements pursuant to it. Furthermore, since provisions in the Pubs Code (including any regulations made under the power delegated in section 43(5)) are to be interpreted as consistent with the two core principles, if the provisions in the 2015 Act (in this case, as to reasonableness in section 43(4)(a)(iii)) are not, there would be a fundamental incompatibility between these instruments. Were the language in the 2015 Act and Pubs Code not consistent with these principles, the Secretary of State would not have enacted the Pubs Code in its current form.

13. It is proper to conclude therefore that the Pubs Code and s.43(4)(a)(iii) of the 2015 Act, read together, can be interpreted in a manner consistent with the principles of fair and lawful dealing by pub-owing businesses in relation to their tied pub tenants and that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie. If it is necessary to call statutory interpretation principles in aid, this is a purposive approach. Thus, these principles are relevant to my understanding of what terms and conditions may be "unreasonable", and some consideration is appropriate as to what they might mean in practice.

The Pubs Code Principles

Fair and lawful dealing

14. Its long title states that the 2015 Act is "to make provision for the creation of a Pubs Code and Adjudicator for the regulation of dealings by pub-owing businesses with their tied pub tenants" and the Code regulations, pursuant to section 42, are "about practices and procedures to be followed by pub-owing businesses in their dealings with their tied pub tenants." The term "dealings" is not defined in the 2015 Act. I note there is some inconsistency between the Pubs Code provisions at regulations 54 and 55 (which imply that "dealings" with a TPT may take place in relation to the MRO provisions by virtue of certain exclusions provided for) and the Explanatory Note (which does not form part of the regulations).

15. Overall, there is nothing in the statutory language which excludes the POB's conduct in the MRO procedure from being "dealings" with the TPT. The meaning of the term is broad, and it is fit to encompass any of the activities in the business relationship between the TPT and POB regulated by the Pubs Code. The term references the existing commercial relationship between them and includes interactions pursuant to the current lease as well as their business practices with each other in relation to a proposed lease and more generally. The requirement that such dealings are fair means that Parliament intended that, in addition to complying with legislation and private law principles, they should be in good faith, equitable and without unjust advantage.

No Worse Off

16. The second core Pubs Code principle requires a comparison of the position of TPTs with tenants who are tie free, and the former are intended to be no worse off than the latter. It would seem to me to be a judgement of fact and degree in each case whether a TPT is worse off. That judgement would include financial matters, particularly profit, but could it seems also include considerations not directly expressed in financial terms – for example a difference in bargaining power and the reduced risk in having a tied deal, or the business support available to a TPT from a POB may be something of value for the TPT. By pursuing the MRO option, the TPT should be in the position of being able to compare, and make an informed choice between, the two options.

The Application of Pubs Code Principles

17. It is consistent with the Pubs Code principles that the proposed tenancy which is made available to the TPT through the MRO procedure is not on worse terms and conditions than that which would be made available to a free of tie ("FOT") tenant after negotiations on the open market. This is for two reasons. Firstly, if the POB was able to get more favourable terms from the TPT using the MRO procedure than it would on the open market, or than it would offer to a TPT it was motivated for business reasons, not required, to release from the tie, this would not be fair dealing. Secondly, the TPT would be worse off in having a choice to accept terms which were worse than would be available to a FOT tenant, including for example an existing FOT tenant renegotiating terms on lease renewal. In any event, these principles follow from the general concept of reasonableness, taking into account the relative negotiating positions of the parties within this statutory scheme.

18. Furthermore, the proposed new lease would be unreasonable and inconsistent with Pubs Code principles if it represented an unreasonable barrier to the TPT taking an MRO option, and thus frustrated Parliamentary intention. If the POB, in a new letting on the open market made a lease offer, the prospective new tenant would have various options available – including accepting the offer, negotiating different terms, negotiating better terms in respect of a different pub with one of the POB's competitors, or walking away.

19. The commercial relationship between the TPT and the POB on service of an MRO notice is different. The TPT (except at renewal) does not have the right to walk away or contract elsewhere. It only has the right to keep its current tied deal or to accept the offer. Even at renewal, any goodwill earned will be a relevant consideration for the tenant, as will the availability of the County Court's jurisdiction to determine reasonable terms of the new tenancy. The TPT in the MRO procedure is not in an open market position.

20. The test of unreasonableness is the counterbalance to the negotiating strength of the POB, with its inherent potential for unfair dealing towards a TPT in the MRO procedure (or any step to make the tenant worse off than if they were FOT). In addition, an attempt to thwart the MRO process by making the MRO proposed tenancy too unattractive would not be lawful dealing.

21. It must be emphasised that the existing tied deal is one to which the TPT contractually agreed. However, the occurrence of a specified event giving rise to the right to serve an MRO notice in each case is by its nature something which has affected the commercial balance of that deal as between the parties, and Parliament intended that this should give rise to a meaningful right to go tie free. The test of reasonableness requires that the POB, in offering the terms of the purported MRO tenancy, cannot take advantage of any absence of commercial bargaining power on the part of the existing TPT pursuing the MRO procedure.

22. It is in this particular context that a POB must be able to show that its choice of MRO vehicle is not unreasonable. This may be the case if there is a significant negative impact on the TPT arising from that choice, including one which operates as an unreasonable disincentive to taking the MRO option. Furthermore, the POB must be able to show that its choice of terms of the MRO tenancy are not unreasonable, and they may be if they have an impact of that nature. The choice of vehicle and proposed terms and conditions cannot be used to create an obstacle to the TPT exercising the right to an MRO option. There must be an effective choice available to the TPT.

23. Showing that the landlord's choices are not unreasonable naturally includes being able to articulate good reasons for them. This is necessary if the POB is to show it is not taking advantage of its negotiating strength. Communicating those reasons would reduce the chance of disputes (and it would support the fair dealing principle for the POB to provide those reasons alongside the MRO proposal, to aid negotiation). There must be fair reasons for the POB's choice of MRO vehicle, and fair reasons for proposing the particular terms. Where fair reasons cannot be shown to exist, the terms and conditions of the MRO proposal may be considered unreasonable and not compliant.

24. Whether the terms of the MRO proposal are reasonable will depend on the impact they have on both parties. The interests of one party cannot be considered in isolation. The consideration must be balanced and the terms, and choice of vehicle, not unreasonable when viewed from either party's perspective.

Terminal Dilapidations on surrender of the existing tenancy

25. The offer of a new tenancy by the POB instead of a variation of the existing one is therefore a choice and not a legal requirement. Where 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.

26. Terminal dilapidations arise on the termination by surrender of an existing lease. There can be no real doubt however 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.

Appendix 3 –

Vehicle for the MRO Option

1. There has been much debate as to whether the MRO should be delivered by way of a new lease, or by way of a variation by deed of the terms of the existing lease. There is no express provision in either the 2015 Act or the Pubs Code which states that an MRO-compliant tenancy must be provided either by way of a new lease or by way of a deed of variation. Indeed, there is no express provision as to its form at all, only as to its terms.

Interpreting the Legislation

2. In interpreting legislation, it is necessary to ascertain objectively, by reference to the language used in it, what Parliament intended. That language should be given its natural meaning rather than a strained one, and background material must not take precedence over the clear meaning of the words used. Legislation should be construed according to the intention expressed in the language.

3. The word "tenancy" (in and of itself) does not gives any particular guidance; a DOV, when incorporated into the existing lease, will comprise a tenancy just as effectively as a new lease. The statutory language does not suggest that a new and separate agreement must be entered into. There are no clear words which would indicate this - such as the "grant" of a tenancy or its "commencement", or the "termination", "surrender" or "end" of the existing tenancy. The language used, for example "accept" and "enter into" in regulation 39, is consistent with a new tenancy or a varied one.

4. When interpreting the Code, it is proper to have regard to the extent of the rule-making power conferred by the primary legislation. The 2015 Act requires the Code to confer on the TPT a "*market rent only option*" - Section 43(1) of the 2015 Act provides that the Pubs Code must "*require the pub-owning business to offer their tied pub tenants falling within s.70(1)(a) a market rent only option in specified circumstances*". Section 43(2)(a) provides that the "*market rent only option*" means the option for the TPT to occupy the tied pub under a tenancy or licence which is MRO-compliant. Subsection (4) specifies the circumstances in which a tenancy or licence is "*MRO-compliant*". Therefore, the definition of an MRO-compliant tenancy is set out within the 2015 Act, not the Code, other than as delegated under section 43(5), which provides for the matters in respect of the content of proposed tenancy which are delegated by the Act to the Code as follows:

   The Pubs Code may specify descriptions of terms and conditions—

   (a)which are required to be contained in a tenancy or licence for it to be MRO-compliant;

   (b)which are to be regarded as reasonable or unreasonable for the purposes of subsection (4).

5. It is under this section 43(5) power that regulations 30 (regarding lease terms) and 31 (as to terms and conditions regarded as unreasonable) are made, and these are the only regulations in the Code that provide for the form and content of the MRO-compliant tenancy. Neither provision relates to the form or content of the proposed MRO tenancy as being the terms of a new lease or the terms of the existing tied lease varied by deed. It was open to Parliament to make further provision as empowered by section 43(5), but it conspicuously did not.

6. Section 44(1)(a) of the 2015 Act provides that the Pubs Code may "*make provision about the procedure to be followed in connection with an offer of a market rent only option*

(referred to in this Part as "the MRO procedure") ...". This delegates to the Code the procedure in connection with an offer of an MRO option, and not the form or content of the proposal, which is the subject of the separate delegation in section 43(5).

7. Considering the language of the Pubs Code and looking at the way in which the term "tenancy" is used in context within the legislation does not indicate that Parliament intended the MRO option was to be implemented by the grant of a new tenancy only and not a DOV. The provisions referring to a "tenancy" include:

    1. Regulation 29(3) requires the POB to send to the TPT "*a proposed tenancy which is MRO-compliant*"

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

    3. Regulation 30(2) refers to the term of the existing tenancy and the term of the proposed MRO tenancy, which must be "*at least as long as the remaining term of the existing tenancy*". Regulations 34(2) and 37(1) refer to the *"proposed tenancy or licence".*

    4. Regulation 39(2) and (4) (dealing with the end of the MRO procedure) refer to the POB and TPT *"entering into"* the tenancy or licence.

    There is nothing in the language of these provisions that is not appropriate for the execution of a DOV.

8. Considering the following language also provides no grounds to undermine the proposition that the MRO can be the existing tenancy amended by deed:

    1. The definition of "market rent" in section 43(10) of the 2015 Act, which provides for an estimated rent based on certain assumptions, including that the lease is entered into on the date the determination of the estimated rent is made, in an arm's length transaction.

    2. Section 43(4)(a) sets out the circumstances in which a tenancy or licence is "MRO-compliant" and in doing so refers to the "t*enancy or licence" "taken together with any other contractual agreement entered into by the tied pub tenant with the pub-owing business in connection with the tenancy or licence*".

    3. Section 44(2)(b) of the 2015 Act sets out provision for a negotiation period for parties to agree rent *"in respect of the tied pub tenant's occupation of the premises concerned under the proposed MRO-compliant tenancy or licence."*

9. There is nothing in the way that the term tenancy is used in context that indicates that the MRO could only be offered by way of a new lease. There is nothing in the use of the phrases "existing tenancy" and "proposed tenancy" in regulations 30 and 31 to suggest that the existing and proposed tenancy must be different tenancies – i.e. that the latter must bring an end to the former, or that the proposed tenancy must be completely contained within a new document from that of the existing tenancy. Parliament chose not to make provision that a compliant MRO proposal must contain a new tenancy to be granted upon the surrender of the existing one, though it might easily have done so. The provisions relating to the market rent (in section 43(10) of the 2015 Act) relate to the rent under the MRO-compliant lease, but do not inform what those lease terms and conditions are.

10. Furthermore, the draftsman was alive to the need to specify a "new" MRO tenancy to distinguish it from an existing tenancy, if such need existed. This is clear from the expression "new tenancy" appeared in the Code no less than 19 times (within the definition of "new agreement", which refers only to a new tied tenancy). It would have been simple for the draftsperson to have made clear any restriction against the use of a DOV, and the

complete and consistent failure to do so in the language of the Code demonstrates plainly that no such restriction was intended.

11. That the legislation does not by implication require an MRO-compliant option to be given only by way of a DOV seems to be clear however. Regulation 30(2) provides that an MRO tenancy will only be MRO-compliant if its term is at least as long as the remaining term of the existing tenancy, and its term can therefore expire after the date of expiry of the original lease. As a matter of law, where the term of a lease is extended by way of a DOV, it operates as a surrender of the existing lease and a grant of a new lease. Furthermore, if the proposed tenancy was intended to be achieved by variation of the existing tenancy only, there would be no need for the provisions in regulation 31(3) and (4) preserving rights under the Landlord and Tenant Act 1954 where they apply to existing leases, as such protection would be unaffected. Lastly, where the existing TPT is a tenant at will (as per section 70(2) of the 2015 Act) because pursuant to section 43(4)(b) an MRO tenancy cannot be a tenancy at will, the MRO must therefore be a new tenancy.

Background Material

12. Correspondence to the then Secretary of State Vince Cable MP dated 25 October 2013, from CAMRA and others advocating the MRO option, referred expressly to the expectation that the POB would issue a DOV. This serves to illustrate that, having been specifically asked to contemplate a DOV, the Secretary of State did not make regulations which expressly prohibited it.

13. The fact that open language has been used in the Government Consultation on the new Pubs Code (October 2015) does not mean that its meaning is unclear. In fact, it is not. On the contrary, the ordinary meaning of the language is permissive of either a new lease or a lease varied by deed, and this is not a reason to look at other material to seek to interpret the ordinary meaning in a more restrictive way.

14. Such background material must not be allowed to take precedence over the clear meaning of the words used. In *Milton v DPP* [2007] EWHC 532 (Admin), Smith LJ stated at [24] (as cited with approval in *Christian UYI Limited v HMRC* [2018] UKUT 0010) that:

> *"If the meaning is clear, there is no need to delve into the policy background. If the court is uncertain as to the meaning, it may well be helpful to consider background material in order to discover the "mischief" at which the change in the new law was aimed."*

15. Section 9 of this consultation considers the powers to be delegated under section 43(5) in respect of the compliant MRO tenancies, including:

> *9.4 The Government does not propose to prescribe a model form of MRO-compliant agreement in the Code. Rather we expect MRO agreements to be modelled on the standard types of commercial agreements that are already common for free-of-tie tenants.*

16. It is clear that there was no intention to prescribe a form. An expectation as to the form is referenced which is a precursor to the commonness test in regulation 31(2)(c), the meaning of which does not require clarification by reference to this paragraph of the consultation. Notwithstanding the inclusion of the word "commercial" (which does not appear in the legislation) it is not clear that Parliament is intending to exclude a lease varied by DOV, rather than leaving the matter to the market. Given paragraph 9.4, it would be hard to rely on other parts of the consultation to show that the Government did indeed intend to prescribe that the MRO-compliant agreement could not be in the form of a tied lease with a tie release by DOV, rather than to leave it to that to the market to decide.

17. The expression "new tenancy" is not found in other paragraphs of the consultation which refer to a new (MRO) agreement, even in 9.6 and 9.8 where a tenancy has already been referred to in the sentence, and the expression "new agreement", which is not consistently used in the consultation, is not an unequivocal marker of intention. In 6.13 a "new agreement" which will end a rent assessment does not need to be a new tied tenancy after surrender of the old. There should not be too much read into selected words of the consultation or into the Government's response to the consultation dated April 2016, where the expression "new agreement" does not occur in the context of the MRO at all.

18. Powers to make provision in relation to the MRO procedure, delegated under section 44(1), are considered in section 10 of the same Consultation:

> *10.11 However, where the tenant requests an MRO agreement, their intention is to move to a completely new form of contractual relationship with the pub-owning business. Changes to the old tied terms that occur during the MRO procedure will have no equivalent terms in the MRO agreement. It is therefore neither appropriate nor practical to alter the MRO offer to take account of the increased prices paid by the tenant during the MRO procedure.*

19. All that this means is that the "form of contractual relationship" (i.e. tie free) is new, not necessarily that the contractual documentation itself is a wholly new entity. The remainder of this paragraph deals with changes in tied terms during the MRO procedure (and not as a result of it), and the rent.

20. Looking at these passages, they are far from conclusive that only a new lease can be compliant. There is no silver bullet within them. These extracts cannot be viewed too selectively to be understood to point towards a prohibition on a DOV. These are a few of many references in the consultation documents to the MRO agreement. Read as a whole what is obviously lacking is any direct and decisive comment on the permissible vehicle for the MRO, which is consistent with an intention not to make unjustified intervention in commercial dealings between the parties.

21. There is nothing in the legislation which precludes or requires the grant of a new tenancy, and if this had been the intention of Parliament or the Secretary of State, there would be express provision to one effect or the other. Accordingly, either a DOV or a new lease (subject to its terms and conditions) is capable of bringing about an MRO-compliant tenancy.

22. It should also be observed that the legislation, however, in not prescribing the contents of the MRO-compliant tenancy except as set out in section 43(4) and regulation 31, has not expressly required that the terms of the MRO-compliant tenancy remain the same as the terms of the original tenancy, with variation only of the rent and severance of the tie. This is consistent with the MRO vehicle not being restricted to a DOV and is another matter for which there could easily have been provision if that was the legislator's intention.

Appendix 4 – Severing the Tie and Existing Lease Terms

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

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

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

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

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

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

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

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

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

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

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