Pubs Code Adjudicator

Notice of imposition of a financial penalty under section 58(2) of the Small Business, Enterprise and Employment Act 2015

Decision of the Pubs Code Adjudicator to impose a financial penalty, following the investigation into Star Pubs & Bars Limited and its compliance with the Pubs Code etc. Regulations 2016

1. Notice of imposition of a financial penalty

1.1 This is a notice of imposition of a financial penalty ("**Penalty Notice**") under section 58(2) of the Small Business, Enterprise and Employment Act 2015 (the "**Act**" or "**2015 Act**"), addressed to Star Pubs & Bars Limited ("**Star**").

2. Background

2.1 On 10 July 2019 the Pubs Code Adjudicator and Deputy Pubs Code Adjudicator (together the "**D/PCA**") announced that they would be commencing an investigation into Star. Star is the entity responsible for operating the pub estate business of Heineken UK Limited ("**Heineken UK**" or "**HUK**").

2.2 The investigation was launched to consider whether, and if so how, Star failed to comply with the Pubs Code etc. Regulations 2016 (the "**Code**" or "**Pubs Code**") by using unreasonable stocking terms in certain of its proposed MRO tenancies, and what impact any failure to comply with the Code has had on Star's tenants. The period under investigation was from the introduction of the Code, on 21 July 2016, to 10 July 2019, the date the investigation was launched.

2.3 The specific terms within the scope of the investigation included:

(a) stocking obligations which require that, unless permission is given by Star for the tenant to stock competitor brands, all (or virtually all) of the keg beer stocked by the tenant be produced by the Heineken group (Star being a member of the Heineken group);

(b) stocking obligations which in reality can require the tenant to stock an unreasonably high proportion of brands covered by the terms;

(c) stocking obligations which relate to beer produced not only by Star, or by entities that are group undertakings in relation to Star, but also by other entities in which either Star or a group undertaking in relation to Star has a shareholding interest or has entered into any joint venture, partnership agreement or similar arrangement (a "group undertaking" in relation to Star means an undertaking which is: (a) a parent undertaking or subsidiary undertaking of Star; or (b) a subsidiary undertaking of any parent undertaking of Star); and

(d) stocking obligations which may influence the re-selling price of products covered by the term.

2.4 The relevant legislative provisions relating to the reasonableness of stocking requirements in MRO proposals are regulation 29(3) of the Code (read together with section 43(4)-(5) of the Act), regulation 31(2)(c) of the Code and section 68(7) of the Act. In addition, the PCA investigated potential breaches of regulation 34(2) of the Code.

3. Outcome of the investigation

3.1 The PCA's investigation is now complete. The PCA's investigation report has been provided to Star, and published on her website on 15 October 2020.

3.2 The PCA's full findings on Star's breaches of the Code are set out in paragraphs 15-20 of the Investigation Report.

3.3 The PCA's assessment of Star's conduct is set out in her investigation report and is not repeated here, except insofar as it is relevant to the decision to impose, and the level of, the financial penalty.

4. The PCA's enforcement powers

4.1 If, as a result of an investigation, the PCA is satisfied that a pub-owning business has failed to comply with the Pubs Code, the PCA may take one or more of the following enforcement measures:

(a) make recommendations;

(b) require information to be published;

(c) impose financial penalties.[1]

4.2 The PCA may use her powers individually, or in combination. In all cases, the PCA's decision on the most appropriate form of enforcement will be guided by the Macrory Principles on Regulatory Sanctions.[2]

4.3 Following the investigation, the PCA considered whether to use the formal enforcement powers she has available as a result of finding breaches of the Code. She has issued recommendations to Star, and required Star to publish information. The details of these enforcement measures are outlined in the PCA's investigation report.

4.4 In addition, the PCA has decided that it is appropriate to impose a financial penalty on Star.

5. The PCA's power to impose financial penalties

5.1 Where the PCA chooses to impose a financial penalty, that means imposing a penalty on the pub-owning business (or "**POB**") of an amount not exceeding the permitted maximum.[3] The permitted maximum penalty in respect of Star is discussed at paragraphs 7.1-7.5 below.

5.2 The PCA's Statutory Guidance on Investigation & Enforcement (the "**Statutory Guidance**") explains that the PCA will use the power to impose a financial penalty on a POB to reflect the seriousness of the breaches of the Code.[4]

5.3 The PCA may choose to impose a financial penalty where she considers that this will constitute a serious and effective deterrent, both to the specific POB concerned and to any other POB, against future breaches of the Code.

5.4 The PCA may take into account whether:

[1] 2015 Act, section 55(1).
[2] Professor Richard B. Macrory, Regulatory Justice: Making Sanctions Effective (Final Report; November 2006). Available from https://www.regulation.org.uk/library/2006_macrory_report.pdf.
[3] 2015 Act, section 58(1).
[4] See paragraphs 4.13-4.15 of the Statutory Guidance.

(a) the POB acted deliberately or was wilfully negligent;

(b) the breach relates to the fairness and no worse off principles underpinning the Code;

(c) the breach affects a large number of tenants; or has a disproportionately adverse impact on the affected tenants.

6. Grounds for imposing the penalty

The nature of Star's breaches for which the penalty is being imposed, in the context of the Code

6.1 The PCA is mindful that a financial penalty is one of the most punitive forms of enforcement and should be imposed where other enforcement measures alone are inadequate.

6.2 Star's breaches of the Code were particularly serious because they frustrated the core Code principles of fair and lawful dealing in relation to tied pub tenants, and that tied pub tenants should be no worse off than if they were not subject to any tie.

6.3 The MRO process is the critical route by which the "no worse" off principle can be delivered, and by which tied pub tenants can instigate meaningful negotiations with pub owning businesses in respect of their tied and free of tie options. The process is dependent upon compliant MRO proposals forming the foundation upon which fair negotiations between tied pub tenants and POBs can occur. The offer of non-compliant MRO terms compromises that foundation and undermines the effective working of Code. The PCA's full findings on Star's breaches of the Code are set out in paragraphs 15-20 of the Investigation Report. The PCA considers that the following specific aspects of those infringements amount to particularly serious examples of non-compliance, in respect of which the PCA will impose a financial penalty:

(a) Star's inclusion of 100% keg stocking terms in 96 MRO proposals from 2 August 2016 to 22 August 2018 was unreasonable and non-compliant in all cases. These terms served as an absolute prohibition on stocking competitor keg products. Star would have known that this was not compliant from receipt of the DPCA's March 2018 arbitration awards, however it failed to change its approach;

(b) from receipt of the DPCA's March 2018 arbitration awards, Star breached the Code requirement to seek to agree a tenancy that is MRO-compliant in all cases where it continued to seek to impose 100% keg stocking terms;

(c) from September 2018 to July 2019, Star failed to consider the circumstances of individual pubs beyond taking a crude, tiered approach, which was not sufficient to ensure compliance. Star breached the Code requirement to propose MRO terms that are reasonable in individual cases, and did not deviate from this pattern of conduct in its MRO full responses;

(d) the stocking terms included in Star's MRO proposals issued between September 2018 and May 2019 gave rise to breaches of the Code requirement to propose MRO

terms that are reasonable. This was particularly the case where tenants with low or zero existing representation of Heineken products at the time of the MRO notice would be obliged to increase their Heineken keg brand representation to 60% within one year;

(e) Star's approach to including "must stock" terms between September 2018 and July 2019 gave rise to breaches of the Code requirement to propose MRO terms that are reasonable. This was particularly the case where such terms resulted in substantially higher stocking obligations in practice than were stated in the tenancy, or did not take into account the circumstances of the pub and were wrong for the pub, which may have been more likely where tenants had never stocked the relevant products;

(f) from 2 August 2016 to 20 April 2018, Star's inclusion of 60% cask stocking obligations in its MRO proposals, gave rise to breaches of the Code requirement to propose MRO terms that are reasonable. Given the surrounding circumstances, the 60% requirement would have been likely to be unreasonably high in almost all individual cases.

6.4 The PCA has considered Star's conduct in the round: individual penalties have not been calculated in respect of each specific example of non-compliance.

6.5 The examples at paragraph 6.3 above were not the only serious breaches committed by Star. In other cases, Star knew that certain of its template MRO tenancy terms were non-compliant, yet continued to issue such terms for months after the DPCA's awards. For example, Star issued MRO proposals containing non-compliant definitions of "Landlord Brands" for nearly four months after the ruling in Helliwell 2 that these were non-compliant (see paragraphs 3.2(i) and (j) above). The PCA has not taken into account such breaches when calculating the level of the financial penalty; she considers that the negative impact of this conduct is adequately addressed via her recommendations.

The scale of the harm caused by Star's breaches

6.6 When considering the scale of any Code breaches, the PCA will take into account not only actual harm caused, but also any harm the breach was capable of causing. When assessing impact on tenants, the PCA will assess both the number of tenants or groups of tenants that were or could have been affected, and the extent of the impact on individual tenants or groups of tenants.[5]

6.7 The number of tenants who are known to have requested MRO (122) amounted to around 5.5% of Star's tenanted estate (2,226). However, Star's policies applied across its whole tied estate, and had the potential to impact upon any tied tenant who had the right to request MRO. Negative impacts create a disincentive to individual tenants seeking to exercise their statutory right to MRO. These impacts ripple out to other tenants seeking MRO, and then more widely into the pool of tenants who might in the future consider this option, but may be deterred by the experiences of other tenants. For many individual tenants, decisions about whether to exercise a right to go free of tie are major business decisions and life choices. Non-compliant behaviour by regulated POBs such as Star undermines the ability of tenants to exercise their Code rights in a fair and informed way.

[5] Statutory Guidance, paragraph 3.15.

6.8 One of the PCA's main concerns from the evidence she reviewed has been the deterrent effect of Star's proposed stocking terms. An unreasonable stocking term allows the POB to distort the negotiating process, by impeding the ability of the tenant to have a commercially viable free of tie tenancy or to use the MRO offer to negotiate fairer tied terms at rent review, and creating a disincentive to tenants who are considering exercising their statutory right to MRO. This frustrates Parliament's intention to create a viable alternative to the tied option.

6.9 It is not possible to determine definitively the reason why any of Star's tenants chose to withdraw from the MRO process, or why others may have settled on the tied terms that they did, or decided not to pursue the option altogether. Star's use of standard approaches across its whole tied estate was bound to give rise to breaches in individual cases, and this was therefore foreseeable. The PCA received documentary evidence from Star of its interactions with individual tenants in negotiations and arbitration proceedings, supported by accounts from a wide range of tenants who had requested MRO, demonstrating that tenants perceived detrimental impacts from Star's stocking terms. The PCA is satisfied that Star's proposed terms served as a structural barrier to MRO.

6.10 Some examples of the ways in which Star's conduct affected particular tenants include:

(a) between the D/PCA's two arbitration awards in March 2018 (which Star did not appeal) and mid-September 2018, at least six tenants made arbitration referrals on the basis that Star's "full responses", which all contained identical 100% keg stocking terms, were unreasonable. Dispute resolution over MRO terms carries a cost, time and stress burden (while the relevant tenants remain subject to tied rent and prices). It is unacceptable that these tenants had to resort to dispute resolution to defend their Code rights, when Star should have accepted the principles from arbitrations concluded months earlier;

(b) in at least two cases, both involving former Punch Taverns tenants, Star proposed 100% keg stocking obligations to tenants who did not stock any Heineken group products at the time they received the MRO proposal. In response to the PCA's call for evidence, those tenants and their representatives claimed that they would have been required to change every keg tap on the bar if they accepted Star's stocking terms, risking a loss of custom and potential wastage if there was low customer demand;

(c) in some cases, tenants with low or zero existing representation of Heineken products at the time of the MRO notice were obliged to increase their Heineken keg brand representation to 60% within one year. Further, one MRO proposal that omitted the term explicitly allowing the tenant one year to build up their representation of brands – in contravention of Star's stated policy at the time – had the effect of requiring the tenant to move to 60% representation immediately;

(d) for a small number of pubs, the limited number of keg taps on the bar meant that the tenants would be required in reality to stock a higher percentage of Heineken keg products than specified in the tenancy. For example, one tenant with four keg taps received a MRO proposal containing a 60% keg stocking requirement with three "must stocks" specified. To comply with this obligation, the tenant would have needed to stock not less than 75% Heineken keg products;

(e) respondents to the call for evidence told the PCA that Star's cask product range was very limited, and that particular brands within the range were a poor choice for their pubs. On at least two occasions, Star issued 60% cask stocking terms to tenants who at the time stocked no Heineken cask products;

(f) evidence of Star's correspondence with tenants during negotiations and arbitrations, and comments from respondents to the call for evidence, suggested that in some cases Star did not listen to concerns that the proposed stocking terms would be inappropriate for the nature, size, location and customer bases of various pubs;

(g) by its act or omission, Star failed to be transparent with tenants, exploiting asymmetries in information and demonstrating a lack of fair dealing:

(i) despite accepting the principles of three rulings by the D/PCA issued between March and May 2018 that found a 100% keg stocking term was not a stocking requirement, and therefore non-compliant, in ongoing arbitrations in respect of the same term Star failed to concede its non-compliance. Furthermore, during two sets of arbitration proceedings in August 2018 and October 2018, Star amended its 100% keg stocking offers to tenants in what it claimed to be '***a spirit of compromise***' or ***'spirit of negotiation'***. Similarly, on 19 September 2018, a Star Estates Manager sent an email to a tenant during the MRO negotiation process, claiming that they were '***willing to negotiate***' away from a proposed 100% keg stocking term. What Star presented as ***'compromise***' proposals were in a number of individual cases misrepresentations of the position by those negotiating on its behalf – it merely stopped acting in a way that it already knew was non-compliant;

(ii) Star failed for months to inform tenants of its version control errors, which had meant that it issued non-compliant terms that had been removed from its template MRO tenancy. This resulted in wasted time and costs for tenants. Star was aware of some of the specific tenants affected from at least July 2018, yet took two and a half months in one arbitration to notify the tenant, and in other proceedings served a Statement of Case without acknowledging that it was defending the wrong tenancy template. It was not for Star to make the judgement on behalf of tenants as to what was material to the tenant's choice. Such information might have caused a tenant who was about to conclude a new tied tenancy because the MRO offer on the table was unacceptable to reconsider that decision; and would have been relevant in all cases to the tenant's negotiation strength and to costs.

6.11 Finally, it is important to note that a number of tenants within Star's estate are already subject to non-compliant terms. These include MRO tenancies that require tenants to stock at least 60% Landlord Cask Brands, and other stocking terms that are likely to be unreasonably high. While the PCA considers that her recommendations (and in particular recommendation 8 of the report) are designed to remedy the potential for future harm arising from these obligations, it is appropriate to reflect the fact that certain tenants will have been subject already for years to non-compliant terms.

Star's awareness of its breaches

Finding 1: Star's inclusion of 100% keg stocking terms in 96 MRO proposals from 2 August 2016 to 22 August 2018 was unreasonable and non-compliant in all cases. These terms served as an absolute prohibition on stocking competitor keg products. Star ought to have been aware that this approach was non-compliant from early in the life of the Code, and in any event did know from receipt of the DPCA's March 2018 arbitration awards. Efforts made by Star to comply with the Code were not credible, and it refused or failed to change its approach after relevant D/PCA rulings in awards.

Finding 2: from receipt of the DPCA's March 2018 arbitration awards, Star breached the Code requirement to seek to agree a tenancy that is MRO-compliant in all cases where it continued to seek to impose 100% keg stocking terms.

6.12 Star's adoption of a uniform, template approach to keg stocking was non-compliant with the Code. The PCA engaged with POBs, including Star, on this matter, in:

(a) the PCA's letter to the British Beer and Pub Association (of which all six regulated POBs are members) on 28 October 2016, which stated in relation to stocking requirements included in MRO proposals that ***'to adopt a blanket approach may not be reasonable in every case'***;

(b) the PCA statutory advice on Stocking Requirements, issued in March 2017, which noted that ***'where a tenancy/licence includes a stocking requirement, it could be considered unreasonable in the particular circumstances of the case.***'

(c) three un-appealed arbitration awards between 13 March 2018 and 2 May 2018. In all of these the D/PCA found consistently that Star's approach failed to consider all the circumstances of each case and breached the Code requirement of reasonableness; and

(d) the PCA's bi-annual meeting with Star on 26 April 2018, where the then-PCA reiterated to Star that the facts of each case would be relevant when considering the reasonableness of terms included in MRO proposals.

6.13 It is correct that the 2015 Act and Pubs Code were new legislation, and that Star was open with the PCA in May 2016 about the broad approach it intended to adopt.[6] Star should have understood that the advice it obtained on its approach was wrong when the PCA indicated that a test of reasonableness applied to stocking requirements, and that POBs could not take a blanket approach. The PCA notes that Star had successive opportunities to reconsider any initial misunderstanding that it held, but did not change its approach until September 2018.

[6] Albeit, as the Office of the PCA made clear its position in a letter to the Code Compliance Officers of all POBs in August 2016:

'c) At this point we do not intend to agree to anything which might have the effect of restricting the rights of tied tenants in relation to any part of the Code.

d) Similarly, notifying us of an intent to interpret the Code in a particular way should not be read as having our agreement to that interpretation.'

6.14 Moreover, the PCA made findings that a 100% stocking term failed the statutory test for a stocking requirement, and was therefore non-compliant with the Code, in:

(a) the DPCA's Helliwell 1 award on 13 March 2018. This concluded that being a prohibition in conflict with Parliamentary intention, and not within the definition of a stocking requirement, the 100% stocking term was unreasonable and therefore non-compliant in all of the circumstances; and

(b) two subsequent arbitration awards in March and May 2018, which reiterated this principle.

6.15 Star was entitled to appeal these awards, but chose not to do so.[7] It accepted the rulings in those arbitrations and from at least March 2018 it cannot have been unaware that its approach was non-compliant. Despite this, it continued for several months to include in its template MRO tenancy and issue terms to the same effect, and to defend such terms in negotiations and arbitration proceedings. Star accepted in its response to the PCA's draft investigation report that it could and should have responded more quickly to the rulings in the March 2018 arbitration awards and their impact on the iteration of Star's stocking requirement that was then in use.

6.16 Star also failed to keep records of any individual MRO proposals issued to tenants prior to September 2018. It is clear that Star lacked the systems and processes that were essential to ensuring the compliant conduct of a regulated business. It is impossible to see how Star could have satisfied itself that its MRO proposals were compliant in the first two years of the Code, without accurate records of the offers made to tenants. In its response dated 3 October 2018 to queries from the PCA, Star did not inform the PCA about the full extent of its record-keeping issues, or that this meant that it had made assumptions in its account to the regulator about the terms included in proposals issued to tenants.

Finding 3: From September 2018 to July 2019, Star failed to consider the circumstances of individual pubs beyond taking a crude, tiered approach, which was not sufficient to ensure compliance. Star breached the Code requirement to propose MRO terms that are reasonable in individual cases, and did not deviate from this pattern of conduct in its MRO full responses.

Finding 4: The PCA finds that the stocking terms included in Star's MRO proposals issued between September 2018 and May 2019 gave rise to breaches of the Code requirement to propose MRO terms that are reasonable. This was particularly the case where tenants with low or zero existing representation of Heineken products at the time of the MRO notice would be obliged to increase their Heineken keg brand representation to 60% within one year.

Finding 5: The PCA finds that Star's approach to including "must stock" terms between September 2018 and July 2019 gave rise to breaches of the Code requirement to propose MRO terms that are reasonable. This was particularly the case where such terms resulted in substantially higher stocking obligations in practice than were stated in the tenancy, or did not take into account the circumstances of the pub and were wrong for the pub, which may have been more likely where tenants had never stocked the relevant products.

[7] Star was entitled to seek leave to appeal the awards on a question of law from the Chancery Division of the High Court under section 69 Arbitration Act 1996 as applied to these statutory arbitrations by section 94 of that Act but did not do so.

6.17 Unlike a 100% stocking term, the terms covered by these findings would not fall outside of the statutory definition of a stocking requirement by virtue of imposing absolute prohibitions on stocking non-landlord products, as they permitted the stocking of competitor products.

6.18 The D/PCA told Star in eight arbitration awards between March 2018 and April 2019 that it must take into account all the circumstances of the pub, and listed certain non-exhaustive factors relevant to this assessment. Each pub will of course have its own relevant circumstances, which are likely to include some or all of those identified in the awards.

6.19 Having purported to rely on its internal discussions, dialogue and a collaborative approach to the verification of compliance, Star was unable to disclose any documentation showing how it devised its "tiered" approach to stocking from September 2018 to July 2019. This meant that the PCA had no sight of Star's rationale for arriving at its keg stocking percentages, or making decisions in respect of individual pubs.

6.20 In the absence of such evidence, Star could not demonstrate how its policy constituted a proportionate approach to framing a reasonable and compliant keg stocking requirement for each individual case.

6.21 While Star purported in regulatory correspondence and during the investigation that it was forced to take a '***trial and error***' approach to stocking, the PCA does not accept this argument. Star's breaches could have been averted had it heeded the approach reiterated by the PCA, and had evidenced grounds for why its proposals were reasonable in all cases. Star recognised in its response to the PCA's draft investigation report that there were greater measures it could have taken during the period to develop its own understanding of what might be considered reasonable for each pub before issuing its full MRO response.

6.22 In a small number of cases Star's stocking policy created cliff edges, where tenants stocking few or no Heineken products would have faced unduly onerous burdens to comply with the relevant terms. Star ought to have considered the potential for unfairness, and unequal consequences for tenants, created by its policy.

6.23 Similarly, Star ought to have been aware from the concerns expressed by tenants in arbitrations and negotiations, and from the D/PCA's awards, of the risks in relation to future proofing created by the "must stock" terms, and that the degree of differentiation in its approach was insufficient to account for the variations in tenants' circumstances. The PCA acknowledges that Star removed "must stock" terms from its template MRO tenancy in May 2019, which Star purported was a commercial decision in light of the contentiousness of such terms.

Finding 6: The PCA finds that from 2 August 2016 to 20 April 2018, Star's inclusion of 60% cask stocking obligations in its MRO proposals, which was predicated on tenants being able to stock products that it was not entitled to include in a stocking requirement, gave rise to breaches of the Code requirement to propose MRO terms that are reasonable. Given the surrounding circumstances, the 60% requirement would have been likely to be unreasonably high in almost all individual cases.

6.24 As noted at paragraph 6.18 above, the PCA identified non-exhaustive factors relevant to reasonableness in multiple arbitration awards. These included the nature of the landlord's business. Star did not adduce evidence to demonstrate how it determined that the 60% cask stocking requirement was reasonable in the context of the very limited Heineken cask

product range, relying instead on the scope of the range of cask products (including non-Heineken brands) it enabled tenants to stock.

6.25 As was the case with Star's "tiered" keg stocking terms, Star's personnel could not provide the PCA with a satisfactory explanation as to why 60% had been chosen as the appropriate percentage for its cask brand stocking term, nor was there any documentary evidence to support how the percentage had been arrived at and agreed.

The reasons why the PCA has decided that other enforcement options are inadequate

6.26 Sanctions must be responsive, and consider what is appropriate for the particular offender and the regulatory issue.[8]

6.27 The PCA considers that issuing recommendations and information requirements alone are inadequate to address Star's conduct, because Star has been a repeat offender in respect of serious infringements. Throughout the period under investigation Star received opportunities to set itself on a compliant path, but failed to do so. It failed to heed statutory advice, the PCA's regulatory engagement, and learnings from arbitration awards. It did not engage frankly and transparently with its tenants, or meet the standards required of a regulated business when engaging with the PCA. Where it did change its approach, the efforts it made to comply were for the most part inadequate. Throughout the investigation, Star maintained a stance that it had always sought to be compliant, yet its internal approaches to compliance verification meant that it could produce little evidence to support the decisions it took.

6.28 Star must change its mind set, to be proactive in its approach to compliance. This can best be achieved through the imposition of a sanction that will serve as a deterrent to future non-compliant conduct by Star and other POBs.

7. The amount of the penalty

The permitted maximum penalty

7.1 The permitted maximum penalty the PCA can impose is 1% of the pub-owning group's annual turnover.[9] The "pub-owning group" is defined as the POB and its group undertakings.[10] "Group undertakings" have the meaning given by section 1161 of the Companies Act 2006.[11][12]

7.2 The pub-owning group's annual turnover is determined by taking the turnover from the group's last accounts published in the 12 months preceding the notice of financial penalty.[13]

[8] Statutory Guidance, paragraph 3.4.
[9] The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016, regulation 5(1).
[10] Ibid, regulation 5(5)(b).
[11] Statutory Guidance, paragraph 4.16.

[12] In the Companies Act 2006, "group undertaking", in relation to an undertaking, means an undertaking which is (a) a parent undertaking or subsidiary undertaking of that undertaking, or (b) a subsidiary undertaking of any parent undertaking of that undertaking. A company is a "subsidiary" of another company, its "holding company", if that other company: (a) holds a majority of the voting rights in it, or (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or (d) if it is a subsidiary of a company that is itself a subsidiary of that other company.

[13] The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016, regulations 5(2) and 5(3).

7.3 Where accounts have not been published during this period, but the pub-owning group has applicable turnover for each of the 12 months ending with the month preceding that in which the relevant notice is given, its applicable turnover for those 12 months is to be used instead.[14]

7.4 The applicable turnover is the income receivable in the 12 months covered by the accounts by the POB or any group undertaking of the POB, attributable to the group's various UK activities, after deduction of trade discounts, value added tax and other taxes based on that income.[15]

7.5 In response to the PCA's Sixth Disclosure Notice, Star disclosed that the applicable turnover of the pub-owning group in this case was £1,221,486,855. On 2 November 2020, the PCA received a letter from Star's solicitors, DLA Piper, to correct an inadvertent error in the turnover figure provided, and noting that the correct figure was £1,232,577,038. The permitted maximum penalty is therefore £12,325,770.38.

Step 1: the initial amount

7.6 The statutory framework does not specify a particular starting point amount. The PCA considers that there is a margin of appreciation in determining the initial amount of the penalty, aside from that the PCA must assess this amount based on the seriousness of the breaches of the Code.

7.7 For the reasons set out at paragraph 6.3, the PCA considers Star's breaches of the Code to be serious.

7.8 Star's breaches frustrated the fairness and no worse off principles that underpin the Code; and the breaches affected a large number of tenants. Star also ought to have been aware of a number of its breaches of the Code.

7.9 The PCA's assessment of the impact of Star's conduct focused primarily on the deterrent effects across Star's estate of terms that represented unreasonable obstacles to the MRO option, as well as on the detriment to individual tenants. Reflecting in the amount of the penalty only the number of tenants directly affected by these breaches of the Code would fail to penalise the conduct of Star in having effected structural barriers to the MRO process across its whole tied estate, with the potential to impact any tenant at the point at which they have the right to serve a MRO notice. The gain to Star is increased revenues from MRO pubs that are subject to unreasonably high stocking terms, the advantages to its estate of tenants remaining tied and on potentially inferior terms (this is a foreseeable consequence of Star's conduct, whether or not this was Star's intention), and the potential ability to change the market in its use of unreasonable stocking terms, including those that fall outside the statutory definition of a stocking requirement.[16]

[14] Ibid, regulation 5(4)(a).

[15] Ibid, regulations 6(1) and 6(2).

[16] There are practical difficulties in quantifying any exact financial benefit to Star, or verifiable loss to tenants, as a result of the infringing conduct. This is because:

(a) only a limited number of Star's tenants have executed MRO tenancies, and fewer have done so on Star's original proposed terms. Any attempt to quantify gain or loss from unreasonable stocking terms actually agreed would consequently fail to serve the punitive and deterrence functions of a financial penalty;

7.10 In spite of the serious nature of the infringements, and the extensive impact both in terms of the time that non-compliant terms have spent in the market and the number of tenants affected, the PCA considers it appropriate to exercise restraint in this case. In particular, it is noted that this is the PCA's first such investigation, and the first occasion on which the PCA has had cause to impose a financial penalty. Star's MRO stocking terms were only one element of its overall approach to the MRO process, though an important one.

7.11 In the light of these factors, the PCA considers an appropriate initial amount to be 20% of the permitted maximum, amounting to £2,465,154.08.

Step 2: adjustment for aggravating factors

7.12 The PCA is required to adjust the initial amount of the penalty to take account of any aggravating factors, such as:

(a) the extent to which the breach or failure was intentional;

(b) whether there had been repeated or multiple breaches or failures;

(c) whether the breach continued following receipt of a recommendation from the PCA;

(d) where the breach was considered to be the result of negligence on the part of the POB, and the extent to which it could reasonably have been avoided.

7.13 Where relevant, some of these factors were taken into account in determining the seriousness of the breach, and therefore no increase as a result of these particular considerations is applied at this stage.

7.14 A 5% increase has been applied on account of Star's failure to engage frankly with the PCA during the period under investigation. In particular, Star made statements to the PCA about matters of importance that were inaccurate and inconsistent, such as:

(a) on 3 October 2018, Star told the PCA in regulatory correspondence that after identifying that some tenants had received the wrong template terms, it '***sought to replace the lease*** […] ***as soon as possible following the issue becoming apparent and has provided an explanation to the tenant***.' However, in reality no standard correspondence was issued to tenants, nor did Star replace the proposal in situations where it did not consider it to be relevant to its negotiations with certain tenants. In some cases where Star did inform tenants of the errors, it took two and a half months to do so after becoming aware of the problem. In one other case, an Estates Manager noted that they would use the correct form of MRO proposal as a ***'negotiation tactic'*** with the tenant;

(b) it is not possible with confidence to estimate how long MRO processes were extended by intransigent negotiating stances (including during arbitration proceedings) in respect of non-compliant offers; nor is it possible to estimate what improved MRO offer, tied rent or other outcome of the MRO process would have been achieved by tenants if they had received a compliant MRO proposal in the first place;

(c) while one tenant did attempt to quantify their losses based on remaining tied during a protracted negotiation process, the PCA did not consider that it was appropriate to rely on the figures provided, or to extrapolate these across Star's estate

(b) on 13 March 2019, Star wrote to the PCA claiming that it had always considered that it proposed and defended the terms of its stocking requirements based on its understanding of the law and policy at the time. In conflict with this assertion, following the D/PCA's awards that Star's stocking terms did not meet the statutory definition of a stocking requirement and were non-compliant and unreasonable, Star had continued to defend identical terms in pending arbitration proceedings, and in ongoing negotiations; and

(c) in the same letter in March 2019, Star gave the PCA a number of unconditional commitments to change various practices identified as being non-compliant. Star did not give effect to these commitments promptly – including by failing to concede the non- compliance of terms that were subject to ongoing arbitration proceedings, and issuing a further MRO proposal several days later containing stocking terms that contravened those commitments. Then, on 29 April 2019, Star wrote to the PCA seeking to make its commitments conditional on further acceptance or approval by the PCA.

7.15 This demonstrated a lack of regard for the core Code principles and for Star's duties as a regulated entity, to the detriment of tied tenants in its estate. Accordingly, the amount after step 2 is increased to £2,588,411.78.

Step 3: adjustment for mitigating factors

7.16 The PCA has applied a 5% reduction to the penalty at step 3 as a result of the following mitigating factors:

(a) Star has co-operated to a reasonable extent with the investigation. Although there were some delays in its responses to the PCA's Disclosure Notices, in particular as regards requests for disclosure of files of arbitration proceedings, the PCA recognises the impact of the COVID-19 pandemic on Star's resources at key points in the investigation. Three senior personnel at Star attended interviews with the PCA across five dates, and provided voluntary responses to limited requests for follow-up information;

(b) although Star did not purport to accept a number of the PCA's provisional findings, it did nonetheless admit to various breaches of the Code. It also appears to understand the need for governance and policy changes to remedy its breaches and failures. While Star has not addressed its infringements at speed, nor has it proposed measures that are completely sufficient, its apparent willingness to amend its approach to compliance warrants a reduction in the penalty.

7.17 Accordingly, the amount after step 3 is decreased to £2,458,991.19.

Step 4: adjustment for proportionality and deterrence

7.18 The final amount of the penalty should reflect the individual circumstances of Star. The PCA considers that the amount of the penalty should be lower, to reflect the likely need for Star to continue to support its tenants during the ongoing COVID crisis, and in recognition of the period of unprecedented uncertainty in the industry.

7.19 On 14 October 2020, the PCA issued a Penalty Notice. The PCA's original Penalty Notice has been varied and re-issued in this amended form. As of the re-issuing of this penalty notice in April 2023, Star accepts that it breached the Pubs Code in the manner set out in the investigation report, and has fully co-operated with the PCA and has implemented the 8 recommendations made by the PCA in the investigation report.

7.20 With these factors in mind, the PCA considers that the amount of the penalty should be decreased, to give a final amount of **£1.25 million.**

7.21 It is of primary importance for the financial penalty to signal to Star and others within the regulated POB community that non-compliance will not be tolerated. A penalty of this amount is in the PCA's view an appropriate deterrent.

8. How the penalty must be paid

8.1 Financial penalties are recoverable by the PCA as a debt. They must be paid into the Consolidated Fund. They will not be used to fund the PCA's activities. Details on how to pay the penalty are set out in the letter accompanying this Penalty Notice.

9. The period in which the penalty must be paid

9.1 The payment should be made to the PCA by close of banking business at the end of three months from the date of receipt of this Notice, or on such date or dates as agreed in writing with the PCA.

Fiona Dickie

PUBS CODE ADJUDICATOR