

Pubs Code and Pubs Code Adjudicator Statutory Review: 2019



British Beer & Pub Association Response
July 2019

The British Beer & Pub Association is the leading trade body for our sector, representing companies across the UK, which between them own around 20,000 pubs and brew over 90 percent of beer sold in the UK. Member companies have many different ownership structures, including UK PLCs, privately-owned companies, independent family-owned brewers and UK divisions of international brewers.

The brewing and pub industry in the UK make a major contribution to the local and national economy. The sector generates £23 billion of economic value, £13 billion in tax revenues and supports 900,000 jobs. It provides vital work and career opportunities for one in fourteen young adults currently in employment.

Our members include five of the six pub owning companies regulated under the Statutory Code. We work closely with the sixth. The remainder of our members who operate leased and tenanted pubs, continue to operate the voluntary code of practice and offer the independent dispute resolution bodies overseen by the Pub Governing Body. In all cases, the majority of tenants and lessees are satisfied with their pub company and would recommend them to others.

Part A: The Pubs Code

1. How well do you think the Pubs Code has operated between 21st July 2016 and 31st March 2019? What evidence do you have to support your view?

We believe that, bearing in mind the complexity of the legislation and the lack of any transition period, most aspects of the Code are now working well. There are, however, some important aspects that still must improve to provide clarity and certainty to all parties and reduce spiralling costs¹. In particular this relates to the work of the Adjudicator. Many initial teething issues that arose from the introduction of new systems, processes and the significant information requirements and associated training have been resolved and both pub owning companies and tenants are seeing the benefits of this. However, following its late introduction in the parliamentary process, continued differences in expectations and interpretation and the fundamental change in the business relationship that this entails, the MRO-option has proved more challenging in these first three years. Importantly though, the majority of tenants/lessees are satisfied with their pub company overall and, perhaps most importantly, are more likely than not to recommend their pub company to another licensee². Licensees continue to place a great deal of importance on the expertise and wide range of business support services provided by pub owning companies. In relation to licensees' views of the quality of their Business Development Managers, the average score is 7.6 out of 10³.

The six pub companies, with the support of BBPA, commissioned a major piece of independent analysis from Europe Economics on the impacts and workings of the Code since its inception. A full copy of this report accompanies this submission and forms much of the basis and evidence for our responses to the review questions. We would urge BEIS to consider fully this work which not only assesses the impact of the Code but also:

- applies the economic rationale and theory that supports the operation of the tied pub (“partnership”) model (and similar agreements) in a competitive market;
- examines the key benefits of that model and how it balances the capabilities and needs of the two parties; and
- considers any ongoing evidence of market failure.

Ahead of the BEIS Select Committee last year, we also gathered evidence from the six pub companies subject to the Code, which suggests that:

- Both the average length of occupation and the number of enquiries regarding new tenancies have increased.

¹ The PCA's net levy costs have increased from £1,405K in 2017/18 to £1,749K in 2018/19, an increase of 24%. This equates to approximately £180 per Code-regulated pub.

² Kam Media Licensee Index (Autumn 2018):

³ Kam Media Licensee Index (Autumn 2018): Licensees score the vast majority of pub company support across knowledge and training, business support, property support, credit control, marketing and advertising at 7 out of 10 or more in terms of importance.

- New tenancy options are being introduced into the market, giving prospective tenants a wider range of choice on how they operate to suit their financial position and operating experience.
- The increased transparency in the market as a result of the Code has meant that recruitment of licensees is more robust and more efficient. For example, tenants cannot be recruited without them providing an adequate business plan.
- The number of younger applicants taking on a lease has increased since the introduction of the Code.
- Internal procedures within pub owning companies have been refined (and continue to be refined) which have resulted in better services for licensees and better licensee-recruitment processes.
- The advent of the Market Rent Only (MRO – explained below) model has seen licensees gain a broader understanding of the risks and rewards of relative pub models, e.g. the lower risk partnership model versus the higher risk and upfront cost of the MRO agreement, which is very similar to a lease to run a shop.
- But there is ongoing uncertainty about the terms of MRO agreements with the continued refusal of the PCA to accredit MRO agreements for the six pub companies and the subjective view taken in individual cases, rather than providing ‘golden threads’ on which pub owning companies and tenants can rely.

In March 2018, the Pubs Code Adjudicator carried out an extensive survey of pub tenants which found that:

- 72% of tenants are aware of the Pubs Code.
- 63% of tenants were aware of the right to request Market Rent Only agreement at certain trigger points.
- 69% of tenants said they felt they had all the information required about their pub owning company Business Development Manager.
- 64% of newer pub tenants surveyed stated that they would definitely want to remain as a tenant for at least five years.

The PCA has issued a similar survey for 2019 and we await the results, although pub company commissioned independent research also highlights strong and increasing awareness levels⁴ which has been aided by the ongoing activities of the pub companies’ Code Compliance Officers and Business Development Managers in promoting the Code and its provisions to their tenants. This remains an iterative process, thanks in part to the lack of a transitional period and no time for bedding-in the system. Interaction with the Code and its provisions will also continue to grow as remaining tenant agreements come up for renewal or at 5-year rent review cycles. The PCA and pub companies are however, seeing fewer complaints and inquiries in and this is backed up by the PCA’s own data⁵.

⁴ Kam Media Licensee Index (Autumn 2018)

⁵ ‘Pubs Code Adjudicator: Parliamentary Written question – 250428’, Department for Business, Energy and Industrial Strategy, May 2019 (<https://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/commons/2019-05-02/250428>)

The recent commencement of the publication of arbitration awards (previously confidential) by the PCA provides further transparency and will allow all parties to understand better the PCA's decision-making in previous cases. However, as well as often being very complex, as each case "will turn on its own facts". It may be that this provides limited additional value in itself without at least a short summary of each and, as more awards are published, some drawing together of 'golden threads' that has been advocated by all parties. It is also critical that all awards are published and that parties cannot stop publications due to an unfavourable outcome as this will only give a partial picture and therefore limit the ability of the sector to understand what the PCA sees as fair and reasonable.

This links to a broader point on the need for greater clarity and guidance on aspects of the Code to provide greater certainty and help avoid unnecessary arbitration referrals. Whilst it is acknowledged that it is still very early days in terms of this complex and new primary legislation, it is vital that there is certainty across all key aspects of the Code and the accreditation of pub company MRO-agreements could go a long way towards achieving this.

The Market Rent Only option

It is important to note that the Pubs Code was not introduced with the aim of increasing the number the number-of-free of tie agreements, its aim was to ensure tied tenants are no worse off than free-of-tie tenants.

The MRO-element of the Code does however enable tenants to move from their existing tied agreement with their pub owning company to a free-of-tie-agreement on commercial terms where they can buy beer and other drinks from a third party. This option is available at certain trigger points during the lease and at renewal for certain agreements. It would result in the tenant moving to an agreement in which they are paying a market rent for the pub and no longer receiving the other benefits and support associated under a tied lease or tenancy. It is important to note though that the success or failure of the Code should not be judged solely on how many MRO deals come into being, as this is only one element of the Code, not least because taking on a commercial lease with higher risk, greater upfront costs and less support may not suit the financial resources or operational expertise of the tenant or lessee. There are also a number of free-of-tie agreements which have been agreed outside the MRO process. Without doubt there are now many more types of agreement on offer from pub owning companies than there were before the legislation was introduced. These agreements are intended to suit the financial position of lessees and the skills they have when they take on an agreement.

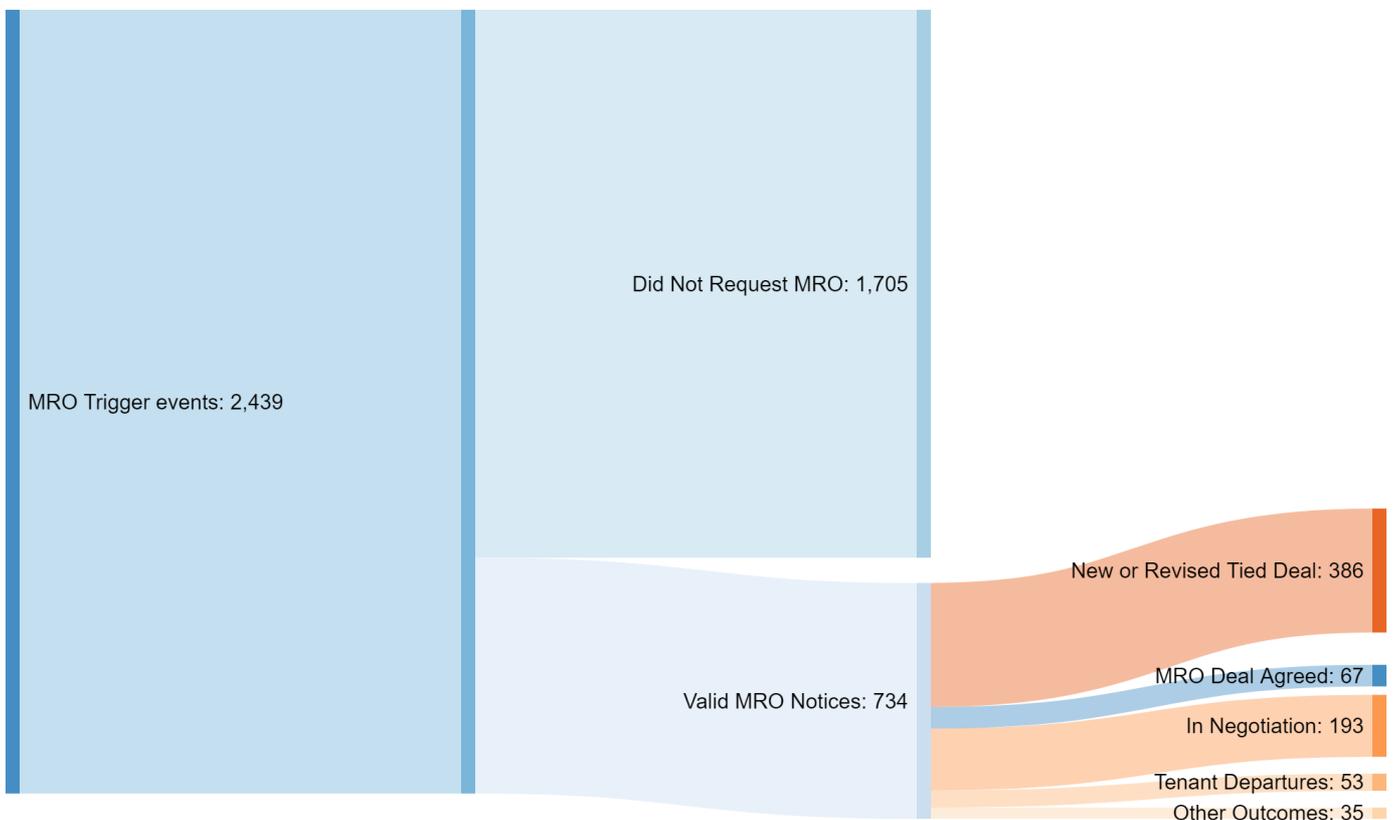
Europe Economics also raised concerns around the unintended consequences of the MRO-option. Whilst it increases the negotiating power for tenants, where one-party no longer has certainty of contract, it is likely that the number of such agreements offered will diminish to the detriment of new entrants and market choice. Secondly, any transfer of value away from pub owning companies to tenants and third-party suppliers is likely to be detrimental to investment by pub owning companies in their tied pubs in the long term. This may impact those remaining tenants who benefit from the model and ultimately the sector overall, as the resilience of the tied model to fluctuations in the economic cycle can be critical in difficult trading periods. The MRO-option may also be used by tenants and their

advisers as a tool solely to negotiate an improved tied offer. Europe Economics concluded that, ultimately, this is not sustainable and could lead to the effects outlined above.

These unintended consequences will become more apparent if the Adjudicator determines that the MRO-agreement offered by a pub owning company to an existing tenant/lessee at a trigger-point, must be more favourable than a similar agreement that would be negotiated with a new tenant on a free-of-tie basis for that same pub on an open market basis. There is concern that arbitrations in some cases are seeking to accommodate what is personally affordable to an incumbent tenant beyond what is reasonable based on the current market. A key benefit of a tied model for a tenant is the low cost of entry compared to other agreement types, such as the free-of-tie model which would have much higher costs of entry. This is a business-critical issue for pub owning companies.

In terms of numbers, 734 valid MRO notices have been submitted to pub owning companies up to the end of March 2019; the chart below sets out the outcomes of these notices.

As can be seen, the majority of those cases resolved so far have resulted in a new or revised lease or tenancy deal with a supply agreement between the tenant and pub owning company. Since the Code came into operation, there were an estimated 2,439 trigger points where tenants could have triggered an MRO negotiation, but less than a third chose to do so and around half of those that did, used the opportunity to compare the tied deal with the free-of-tie alternative and negotiated an outcome which best suit their requirements and circumstances.



Furthermore, despite the very short time to prepare for the Code and put systems in place, and notwithstanding some inevitable teething issues, there have been very few disputes referred for arbitration by the Adjudicator, other than those about MRO applications. Of the total number of 312 valid cases referred to the PCA for arbitration between July 2016 and March 2019, only 36 (12%) have been on non-MRO related disputes. This reinforces the point that more broadly the Code itself is working well and companies are absolutely committed to operating within the spirit of it.

The data collected from the six pub owning covered by the Code since July 2016 shows a higher level of MRO valid notices submitted to them in 2016 (239)⁶, than in subsequent years (235 notices in 2017, 216 notices in 2018) suggesting, as expected, a higher rate of application in year one, which then reduces in subsequent years.

The data also shows that, whilst there is significant variation, due to backlog of referrals to the Adjudicator, the average length of the MRO-process from start to finish is around 200 days currently. This timescale must be improved and it would be if the Adjudicator was clearer to all parties about the key principles he has adopted, released more “golden threads” and accredited the individual MRO agreements of the six pub owning companies.

The six pub owning companies and BBPA share the frustrations of other stakeholders around the length of time taken for arbitrations to take place and the associated costs. Greater clarity and certainty on what constitutes an acceptable MRO-agreement and more time for negotiation should reduce the number and backlog of arbitrations. This could be achieved by the accreditation of individual pub company MRO-compliant agreements. The BBPA and pub companies subject to the Code wish to see the Code foster greater levels of collaborative working between tenants and pub owning companies and relationships which serve both parties well and we remain confident this can be the case as it continues to bed down and these issues are resolved.

2. To what extent do you think the Pubs Code is consistent with the principle of fair and lawful dealing by pub owning companies in relation to their tied pub tenants?

We believe the Code is entirely consistent with this principle. The information requirements and transparency for incoming tenants and for existing tenants at rent review and renewals mean that all tenants have absolute clarity on what is being offered and the supporting information behind this. There are clear timescales for key decision-making points and the obligations on companies to deliver against these. The MRO-option arguably goes beyond fair and lawful dealing allowing tenants to move to a different agreement at certain trigger points and giving tenants additional negotiating power. Finally, the PCA and arbitration routes ensure that a tenant has further recourse if any issues, including those in relation to rents and lease terms, cannot be resolved amicably. These structures are funded by the pub companies at significant cost.

⁶ July to December

3. To what extent do you think the Pubs Code is consistent with the principle that tied tenants should be no worse off than if they were not subject to any product or service tie?

This principle has always been somewhat problematic in terms of measurement and we believe, as set out below, that recent interpretation by the PCA has been incorrect. This has been compounded by misplaced expectations in some instances. For example, a three or five-year tied tenancy is a very different agreement to a standard free-of-tie lease. More generally there are different repairing obligations and liabilities, different levels of initial investment required, a different balance of risk and reward and different levels of support and additional services that companies offer as part of tied deals, which are more akin to a partnership/franchise approach. Free-of-tie leases tend to be more arms-length relationships as in other parts of the commercial lease sector. This means that switching a tenant to an MRO agreement is never as straightforward as simply removing the beer-tie.

In chapter 5 (p34-36) Europe Economics explain clearly how the tied model works for both parties in terms of level of risk-taking and investment over the lifetime of a tied agreement and over an economic cycle. With a new entrant or in the early parts of an agreement, the pub company will be taking on greater risk and may invest significantly in supporting the tenant to help ensure the success of the business. The pub company then benefits from greater revenue (through greater beer sales) if the pub is successful and achieves a return on this investment. Similarly, during a downturn in trade, lower fixed costs protect the tenant, but mean lower income for the pub company who then enjoys part of the benefit of busier periods. The nature of the tied arrangement and the knowledge and expertise of the pub company in more difficult times will often mean additional support will be provided to tenants during these periods.

This is all pertinent to the “No worse off” consideration because the balance of risk and reward and the intangible aspects of the tied relationship (often referred to as SCORFA⁷ benefits) versus a free-of-tie lease, are all part of the consideration, but there is no formulaic approach to measuring these and not a like-for-like comparison.⁸ Any comparison must also be considered over the lifetime of an agreement. Essentially the market for the two agreements is different and therefore there will be different costs involved. Some have argued these are unreasonable barriers, when in reality they will represent what the market would expect in the event that the pub was marketed as free-of-tie.

There is real concern, that there remains an expectation by the PCA and some tenants, borne out in recent arbitration cases, that pub owning companies are expected to modify their standard, open-market, free-of-tie agreements to provide additional benefit for current tenants seeking to go down this route. This seems to be on the basis of considering what is personally affordable for the individual tenant. We believe this is a misinterpretation of the ‘no worse off’ principle as the intention of the legislation was not to ensure going free-of-tie meant the tenant is better off than staying tied, or indeed better off than other free-of-tie tenants/lessees entering the market. It also risks undermining the whole tied model as it will become increasingly unattractive for companies to offer tied agreements that could result in this outcome.

⁷ Special Commercial or Financial Advantages

⁸ A report by the Scottish Government in 2016 highlighted that many tied and partially tied tenants undervalued the SCORFA benefits available to them.

If the tied model is working correctly for both parties (and tenants are indeed no worse off), then arguably it would be expected that only a small proportion of tenants would go down the MRO-route. Indeed, the vast majority of MRO applications so far have resulted in the tenant remaining on their existing agreement or on a new tied agreement. However, as highlighted by Europe Economics, there is also the risk that tenants who have benefited from the support and investment from the pub company in the early years of their agreement (or in lean trading times) and are now more experienced operators achieving higher sales, wish to move to a different agreement. This again highlights that the Code and MRO-option can go beyond the “no worse off” principle when considered across the lifetime of the agreement. As Europe Economics note: “over time this may challenge the traditional dynamics of the tied pub model”. This will be compounded if companies are required to offer more favourable terms to an incumbent tenant than they would on the open market to a new tenant.

More broadly, the Code itself supported by the oversight of the PCA and recourse to low cost dispute resolution mechanisms provides significant benefits to tenants that are not available in the free-of-tie and wider commercial lease market.

4. What if, anything do you think needs to change to make the Pubs Code operate more effectively and/or better support the principles

We do not believe there needs to be any significant changes to the Code itself. There are however some important additions required to support the working of key elements of the Code and deliver greater certainty, clarity and consistency.

As noted above, many elements of the Code are working well and it is delivering benefits to tenants across a number of areas. However, the largest area of contention remains around the MRO-option and associated adjudications. Greater clarity is needed here to ensure that all parties have a clear understanding of the legislation in this area and what an MRO-agreement is (and isn't). This is not being helped by a lack of consistency in arbitration awards and the concern previously highlighted that in some instances, common lease terms that are deemed personally unaffordable to a particular tenant and are therefore deemed to be unreasonable by the PCA. We believe, this is going beyond the legislation and creates a distortion in the market. An MRO-agreement must be consistent with what is offered by pub companies in the open market. It also goes back to one of the key benefits of the tied model which is the low cost of entry for a new tenant and hence lower risk option for aspiring entrepreneurs to enter the sector and run their own pubs. To address this concern and ensure greater clarity and certainty for all involved, we continue to urge that that PCA ‘accredit’ pub company free-of-tie agreements, publish ‘golden threads’ from arbitrations awards and provide clearer, timely guidance where there continues to remain differing expectations and interpretation of the Code.

Another aspect that would benefit from a change is the guidance regarding professional advisers. It is important that tenants seek independent advice when entering into negotiations with a pub owning company, for example, when taking on a pub for the first time, or considering a renewal or free-of-tie agreement. That advice should only be provided by appropriately and professionally qualified advisors. There is some evidence however, that in the absence of either guidance from the PCA or a list of

PCA-accredited advisers, some tenants are taking their advice from unregulated advisers and that the advice can be both misleading and not necessarily in the best interests of the tenant. This risks damaging the long-term relationships between tenants and their pub owning company. To address this risk we recommend that, as a minimum, the PCA is directed to publish an advice note for tenants on this issue, setting out what a tenant should look for when seeking to instruct an independent professional advisor, such as the types of professional qualifications an advisor should hold, whether they are regulated by any professional bodies and whether they hold public indemnity insurance in the event that the tenant suffers from any detriment as a result of the advice received.

We also recommend that small but specific changes to the Code could be made, that would resolve issues that have emerged regarding the interpretation and workability of the Code. These are set out in Part C.

Part B: The Pubs Code Adjudicator

5. How effective do you think the Pubs Code Adjudicator has been between 21st July 2016 and 31st March 2019 in enforcing the Pubs Code?

It should firstly be acknowledged that the PCA has had a difficult job, particularly over the first year or so, due to the complexity of the regulations, that there was no transition period and different expectations from parties around what the legislation does and does not allow for. We believe, however, the PCA has sufficient and proper powers to enforce the Code effectively and many regulatory tools at his disposal to do this.

Aside from the MRO-element, we believe the PCA's office has generally performed in a satisfactory manner. Various guidance notes have been issued and communication from the PCA has generally been good with queries responded to a timely manner. There have been a significant amount of additional statistics and pieces of information sought by the PCA, often at relatively short notice, but in most cases a reasonable time period has been provided for where the data is not readily available. There has been good interaction between the PCA office and the BBPA, and the Code Compliance Officers forum has proven to be a positive mechanism for dealing with collective issues arising in relation to the smooth functioning of the Code. There have, however, been important questions raised and points of clarity sought where the PCA has been non-committal or not provided a response which has been frustrating for pub owning companies and tenants alike.

The PCA has also challenged the industry to raise best practice, often beyond the strict requirements of the Code, to give extra reassurance and benefit for tenants. However, we would note that there is a balance to be struck in terms of the cost and benefits in some instances. For example, providing greater clarity and consistency on sediment allowance and operational waste in rent assessment proposals to tenants concerned about this issue was a positive and worthwhile exercise. The complexity however, of the final requirements arguably went beyond a reasonable and proportionate approach to this and may create more confusion than the benefit it seeks to deliver.

The biggest areas for improvement we would argue centre around the MRO-process and what constitutes an acceptable MRO-agreement. Greater clarity on key aspects, consistency of arbitration awards that do not go beyond the original intent of the legislation and risk undermining the tied model itself and providing a greater negotiation period ahead of referral to the PCA (part mitigated for by the recently introduced 'stay' period) are crucial. This clarity and certainty for all parties is required to avoid unnecessary, often lengthy and expensive arbitrations that have been a feature of the first two years. Currently there remains confusion on all sides on this provision within the Code and we believe, this has resulted in some awards that are an incorrect interpretation of the Code.

We believe this can be achieved by the Government giving greater direction to the PCA to improve clarity and understanding on key Code issues rather than making any major changes to the Code itself at this early stage in its existence.

Examples include:

- PCA accreditation of individual pub owning companies' MRO compliant leases so that they can be presented as such to publicans, avoiding the need for time consuming PCA referrals or expensive fees to tenants' advisors.
- The PCA should develop a set of "Golden Threads" drawing key common themes out of individual arbitration awards.
- Clarification on the issue of "affordability" in the context of reasonableness – it is a major concern if MRO arrangements that are not deemed personally affordable to a tenant are deemed unreasonable where these arrangements reflect common terms in a free-of-tie lease. Without doubt, the ideas and innovations identified by many tenants help to create the vitality and uniqueness of the great British Pub, but the leased and tenanted model with a beer supply agreement will not survive if it is over-regulated to the point of no longer being a viable proposition for pub owning companies

Value for money is the other key concern of the pub companies. The existing voluntary Code of Practice and dispute resolution systems currently costs £18 per pub to be administered by the Pub Governing Body and is widely regarded to be working very well. Since the Statutory Code has come into force, annual costs of the levy paid to the PCA are already rising sharply. Aside from compliance costs and costs around arbitrations which are very significant, the levy from companies was £1.5 million in 2016/17, well in excess of £100 per pub⁹. These costs are continuing to rise sharply and there are concerns that outsourcing of arbitrations will add to this; particularly as these are not capped and the PCA has indicated that they will make greater use of external arbitrators going forwards. We would be willing to collate more information and provide BEIS with more detail on the wider costs of the Code to date.

⁹ The levy rose to £1.7 million in 2017/18 and £2.55 million in 2018/19 although rebates for unused spend results in final costs of £1.4 million and £1.75 million respectively. Arbitration costs paid to the PCA in 2018/19 were an additional £146,000.

Finally, we feel that as an accountable body, the office of the PCA should report publicly against a set of meaningful performance indicators, supported by the introduction of service level agreements for both tenants and pub companies.

6. Do you think the regulations relating to costs, fees and financial penalties should be amended? If so, and why?

No. We have no evidence to suggest that these should be changed at this early stage.

Part C: Pubs Code Regulations

7. If you think changes need to be made to the regulations, please explain why and how you think they should be changed.

As noted in Part A, we feel that the Code does not require any major change at this point. It is still very early stages in such a complex piece of new legislation, but key issues have arisen due to differing expectations and the interpretation of the legislation. We believe that these can be resolved within the current regulatory framework. Our concerns around an MRO-option in general remain as they did prior to the introduction of the legislation and like Europe Economics, we believe in the long term this will have a detrimental impact on investment in an important part of the pub sector and therefore reduce opportunities for aspiring entrepreneurs seeking to enter the market through a traditional tenancy or lease agreement. However, Parliament determined that this be part of the Code and therefore our members remain committed to working within this framework and ensuring fair and lawful dealings with tenants across all aspects of the Code. As highlighted earlier, it is critical that application of the MRO-option does not undermine the viability of the tied pub model.

We recommend that small but specific changes to the Code could be made, that would resolve issues and address unintended consequences that have emerged. These include:

- For annual prices the comparison period should be 4-weeks starting on the 12-month anniversary and not ending on the 12-month anniversary. Currently, a price increase 13 months after the previous could be counted as a single “annual” price rise in terms of a trigger event which is not the intention.
- The Code also makes no allowance for tax-related price increases other than Duty. For example, in the case of the introduction of a sugar levy in 2017, the price increase on Coke syrup was greater than the Code would allow pub companies to pass on. In general, there is a lack of clarity over extrinsic price rises. A supplier can pass on a large price to a pub company which it cannot then pass on to the tenant if it is greater than the price rise mechanism dictates, without creating an MRO event.
- Existing tenants are required under the Code to produce detailed business plans for committing to new agreements, even if their business model and the financial terms in the new agreement remain

fundamentally unchanged. This causes them considerable frustration and consideration should be given to a 'fast track' option in such circumstances.

The time frame to negotiate an MRO-agreement between two parties, is arguably too short, resulting in unnecessary referrals to the Arbitrator at a cost to all parties. This, however, has been partly addressed through the introduction by the PCA of a three-month 'stay' period which has gone some way to resolve this concern.

Part D: Impact Assessment and other information

The BBPA, on behalf of the six pub companies, commissioned the economics consultancy Europe Economics to undertake an independent and comprehensive analysis of the performance of the Pubs Code and Adjudicator to date.

The report poses a number of key evaluation questions, assesses the current evidence in seeking answers to these, and then makes a number of recommendations and identifies where further analysis is required. The key findings of the report, split into three main categories (the rationale for the code, the tied pub model itself and the impact of the Code) can be summarised as follows:

The rationale for the Code: evidence

Europe Economics revisited the initial rationale for the creation of the Code and Adjudicator to understand better how to measure its impact and success (chapter 3). The study finds that the original evidence of market failure was not easily quantifiable, with much of it based on a limited number of tenants' specific experiences in the market.

There was no benchmarking with similar issues that are experienced in other industry sectors that operate in a similar fashion.

It is therefore important that any evaluation of the Code should seek to understand further if there is something intrinsically wrong with the tied pub model itself, in order to address proportionately its failures without distorting the market. The study notes that seven in ten tenants say they would sign up again with their pub company which suggests that the majority of tied tenants are satisfied with their current arrangement and their current pub company.

The study revisits four key issues that were identified as potential market failures, which initially lead to the creation of the Code and the extent the code has addressed these:

Asymmetry of information: To ensure greater transparency in the way information requirements were communicated between tenant and owner and so that the pub company is not seen to have more or better information. Europe Economics find evidence that this has improved since the Code's introduction

Market power: To address the unequal power relationship between tenants and owners. Mechanisms such as the Market Rent Only tool can help address this and seek to support the ‘no worse off’ principle. There is good awareness of this, with many tenants exploring this option. However, Europe Economics conclude that this needs to be assessed carefully as it can fundamentally undermine the benefits derived from the tied model.

Behavioural biases: To protect tenants from making irrational decisions, based on different motivations for running pubs. The report finds tenants who may have economically irrational reasons for running pubs (e.g. lifestyle rather than economic reasons), are generally less satisfied than average.

The extent to which the tie unreasonably “locks-in” tenants to their agreements: The report finds that there is no evidence of market failure due to “lock-in” issues and that there has been no developments that would suggest market power of pub companies has increased since the Office for Fair Trading study in 2010, which found that the tied pub market did not result in any competition issues.

An assessment of the tied pub model

The study revisits the tied model itself (chapters 4 and 5), explains how it has evolved and how it should correct for issues arising from asymmetric information which exist on both sides.

Reducing barriers to entry, transfer of knowledge, ongoing support, scale efficiencies and sharing risk and reward are important benefits that underpin the model through the whole economic cycle.

The report (p34-p36) highlights that the two parties are likely to derive most benefit from the tied agreement at different stages of the agreement and/or economic cycle. This justifies the concept of such tenancies, which act as a safety net when pubs are doing less well by balancing the fixed and variable costs over time. The report notes that the tied model lowers barriers to entry for those who want to run a pub and helps ensure ongoing investment in the tenanted pub estate.

The ability of one party to unilaterally switch to another contract is likely to ultimately fundamentally undermine the working of one type of contract, to the detriment of the wider pub market.

Overall impact (chapter 6)

Awareness: The report finds there is good awareness of the Code considering that it is less than 3 years old and the information it has made available (p39-40). Crucially, it finds that awareness will inevitably increase as more tenants/lessees approach contractual trigger points. Awareness of the Adjudicator, however, is lower.

Furthermore, all parties have a desire for greater clarity across key areas of the Code and the operation of the Adjudicator. More needs to be done to improve dispute resolution and confidence in the Adjudicator. For pub companies, the arbitration process remains a major concern in terms of the inconsistency and subjectivity of judgements.

Bargaining powers of tenants (p43-45): The MRO-option is likely to have improved the negotiating position of tenants in the short term. However, estimates of ‘transfer of value’ are problematic to quantify due to the intangible elements involved and as such any attempt to quantify these should be treated with caution. The MRO-option may also be used by tenants and their advisers as a tool solely to negotiate an improved tied offer rather than obtain an MRO agreement. Europe Economics conclude that, ultimately, this is not sustainable and could have key indirect detrimental impact on the tied pub market insofar as it could lead to lower overall investment in leased and tenanted pubs. Europe Economics also caveat this in that it is still early days of the regulation with many tenants still to experience a trigger event.

Dispute resolution (p46): Evidence from stakeholders identifies areas where the Adjudicator is performing well, such as in gradually developing best practice. However, there are outstanding weaknesses that have been raised by many parties, including a lack of clarity on what is in and out of scope of the Adjudicator and more specifically, what constitutes a reasonable MRO agreement. The slow pace of the arbitration process and the resulting awards are also problems.

Unintended Effects

Chapter 7 considers if there are any unintended effects and in delivering on the intended benefits of “Fair and lawful dealing” and “tenants no worse off” that undermine the tied model itself and worsen social outcomes.

Tied pub numbers: One such unintended effect would be the impact on the number and types of tied pubs. With the beer-tie at risk, companies may look to take more pubs back into being run as directly managed, particularly larger, higher turnover leased pubs where the additional overheads are viable. This would leave only smaller pubs and therefore less viable opportunity in the tied market. Pub market data sources (see Annex A) show a decline in tenanted/leased pubs since 2016, but this was also a trend pre-Code due to huge cost pressures and demographic changes facing the sector and particularly smaller community pubs. It is difficult therefore to know how much of this is attributable to the impact of the Code particularly at this stage.

The decline in tenanted/leased pubs since 2016 has though, coincided with a growth in the number of managed pubs in this period which could be consistent with this effect. Again though, decisions on pub operating models will also be impacted by broader economic and strategic considerations. Europe Economics conclude: “the data are an indication at least of the potential impact the Code may be having and the evidence certainly does not contradict the prediction of economic theory that the prevalence of the tied pub model would be expected to decline”.

Market entry is likely to be damaged as a result of this. The tied model provides the easiest route for individuals to enter the pub market, requiring much less in upfront capital and less risk. With less tied pubs, shorter term agreements and a lack of assignability, the market may become less attractive to potential tenants. This may be addressed, at least partly through more recent developments of retail and franchise agreements that also offer an alternative low cost, high support entry model to the pub industry.

Impact on risk and reward, long term sustainability and investment (p51). Europe Economics explain why the decline in the number of tied pubs may also impact on the ability to provide sustainably the same benefits to new tied tenants as the traditional dynamics of the tied model are challenged. Any transfer-of-value away from the pub company can also only be absorbed up to a point and longer term, if more and more pubs exercise their right to go down the MRO-route, costs will be need to be cut or spending and investment diverted towards managed and management contract pubs. The level of support and investment in tied pubs is vital to help drive sales and maintain the viability for these. With less to invest in tied pubs, this is likely to impact the sustainability of smaller community and rural pubs, particularly those where switching to a managed option is not viable. Similarly, those pubs that go down the free-of-tie route may also find access to capital and similar investment from banks more difficult.

Interaction with wide market trends. In the final part of chapter 7, Europe Economics highlight the interaction with wider market trends and the significant pressures that the pub sector is facing. Any impact on investment, and the pub offer, will compound these factors against already growing competition from other leisure outlets and changes in consumer preferences.

Part E: Other comments

BBPA and its members remain committed to making a success of the Pubs Code and working will all parties to achieve this. We wish to see a continued commitment to an effective and efficient Pubs Code and Adjudicator that ensures fair and lawful dealing for tenants but also recognises the benefits of the tied pub model itself and does not undermine the viability of this. To this regard, we hope that the Government will consider carefully the analysis and findings within the Europe Economics report as part of the upcoming review process.

We would also like to see greater direction to the PCA to ensure greater clarity and understanding on key Code issues rather than making any major changes to the Code itself at this still early stage.

We would also note the continued success of the voluntary Codes of Practice under the auspices of the Pub Governing Body and chairmanship of Sir Peter Luff. We firmly believe that this provides the right framework for companies operating less than 500 tied pubs and for their tenants and lessees, in a cost-effective manner. There continues to be no evidence of any issues of concern with the voluntary codes and we would be strongly opposed to any suggestion that the 500 tied pub threshold for the Statutory Code should be reviewed. Much like the Grocery Code, regulation of this sort would be hugely disproportionate for smaller companies.

All pubs remain under considerable pressures from excise duty, business rates and rising employment costs at a time of great uncertainty and where there is intense competition for consumer discretionary spend. It is vital Government continue to support the wider sector at this critical time.

Annex A: UK pub numbers

Background

The two main sources of pub numbers used by the industry are CGA’s drinks places database and the Valuation Office Agency ratings database and its Scottish equivalent (used by BBPA and Oxford Economics). National Statistics also have a tally of pub businesses registered for VAT purposes, but this does not provide a full census of actual pub numbers. Periodically BBPA also collects data directly from members on pub openings and closures and pub numbers by operating tenure.

There is no single definition of a pub and both CGA and rating agency data require a degree of manipulation and assumptions to be made. As information is only available and updated periodically, there will also be significant time lags in terms of the status of individual outlets. Both data sources show a similar trend in overall pub numbers over the last decade, but there remain significant differences on a year-by-year basis. The latest information suggests around 3 pubs per day have closed over the last three years.

	CGA outlets (GB)	Ratings data/BBPA Handbook (UK)	net closures	net closures	per week	per week
	(1)	(2)	(1)	(2)	(1)	(2)
2010	58,985	55,400				
2011	58,252	54,700	733	700	14	13
2012	57,345	53,800	908	900	17	17
2013	55,916	52,500	1,428	1,300	27	25
2014	54,194	51,900	1,722	600	33	12
2015	52,750	50,800	1,444	1,131	28	22
2016	51,532	50,300	1,218	500	23	10
2017	50,373	48,350	1,159	1,950	22	38
2018	49,682	47,600	691	770	13	15
2010-15	-6,235	-4,600	1274	926	24	18
2016-18	-3,068	-3,220	1023	1073	20	21

Pubs by tenure

Assessing pub closure rates by tenure (e.g. tenanted/leased v independent) is even more problematic as pubs may operate under different models during their lifetime and under different ownership. Tenanted/leased pubs include fully tied, partially tied and free-of-tie. Pubs also close temporarily and re-open and in recent years there has been significant growth in hybrid models in the market that fall between traditional leased and tenanted model and managed pubs. These ‘managed operator’ and other franchise style agreements, making classification more problematic. Freehold owners may also lease a pub to a multiple operator who then directly manage the pub. Pubs may become restaurants, new pubs are built and are also converted from other retail units. As noted above, significant time lags in relation to the data updates means caution is required.

Despite this and as shown in the tables below, both CGA and BBPA numbers show a clear trend in declining **tenanted/leased pubs** (whether tied or free-of-tie) over the last decade; down from over 45% of pubs to between one-third and 40% of total pubs, depending on which measure is used. The number of **independent pubs** has also fallen (flat in BBPA measure), but at a slower rate and hence as a share of total pubs has increased. The total number of **managed pubs** had remained fairly constant. However, in the last 2 to 3 years there is been growth in the total numbers of managed pubs. Whilst this has coincided with the introduction of the Statutory Code of Practice for companies operating tied pubs, broader market dynamics will be a factor as well.

It is also important to note that most tenanted/leased pubs will historically have been smaller, wet-led community pubs outside of primary trading areas. They have therefore been particularly hard-hit by changing consumer demographics and trends, regulatory changes and rising tax. A recent study by ONS suggests that these types of pubs are more likely to close. Permanent closures will ultimately be due to the economic viability of the pub as a business and relative asset values, not the operating model. Indeed, as the recent Europe Economics study demonstrates, the tied pub model supports licensees through lean trading periods. This is also reflected by BBPA survey data that shows that most tenanted/leased pubs sold by member companies in recent years have been sold as going concerns although ultimately a number of these have subsequently closed.

Pub Numbers by tenure

BBPA estimates (all pub companies operating less than 30 pubs are classified as independent)

	Managed	tenanted/ leased	independent	Total	Managed	Tenanted /leased	independent
2010	7,700	25,200	22,500	55,400	14%	45%	41%
2011	7,600	23,700	23,400	54,700	14%	43%	43%
2012	7,600	21,500	24,700	53,800	14%	40%	46%
2013	7,500	20,800	24,200	52,500	14%	40%	46%
2014	7,800	19,500	24,600	51,900	15%	38%	47%
2015	8,500	17,800	24,500	50,800	17%	35%	48%
2016	9,200	17,100	24,000	50,300	18%	34%	48%
2017	9,400	16,300	22,650	48,350	19%	34%	47%
2018				47,580			
change	1,700	-8,900	150				

CGA estimates

	Managed	tenanted/ leased	independent	Total	Managed	Tenanted /leased	independent
2010				58,985			
2011				58,252			
2012	9,765	27,224	20,355	57,344	17%	47%	35%
2013	9,719	26,320	19,877	55,916	17%	47%	36%
2014	9,753	24,492	19,949	54,194	18%	45%	37%
2015	9,676	23,569	19,505	52,750	18%	45%	37%
2016	9,826	21,913	19,793	51,532	19%	43%	38%
2017	9,902	21,035	19,436	50,373	20%	42%	39%
2018	10,168	20,195	19,319	49,682	20%	41%	39%
change	403	-6,189	-919				