



Government Response to the
House of Commons Business, Innovation and Skills
Committee's Fourth Report of Session 2013-14:

Consultation on a Statutory Code for Pub Companies

Presented to Parliament
by the Secretary of State for Business, Innovation and Skills
by Command of Her Majesty

June 2014



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Executive Summary

The Government thanks the Business, Innovation and Skills Select Committee for its consideration of the proposals outlined in the consultation on pub companies and tenants¹. The Committee welcomed the Government's proposals to introduce a Statutory Code of Practice enforced by an independent Adjudicator, which the Committee had recommended in 2011.

On 3 June 2014, the Government published its response to the consultation and confirmed that it would be taking forward legislation to introduce a Code and Adjudicator to govern the relationship between pub owning companies and their tied tenants².

Introduction

The consultation document, published on 22 April 2013, set out the Government's desire to promote and support a thriving and diverse pubs sector; while at the same time addressing long-standing concerns about the relationship between the large pub companies and their tenants – not least the balance of risk and reward between those parties.

The scale of the problem has been demonstrated by the extensive evidence presented to the Committee and its predecessors in their four inquiries into the relationship between pub owning companies and their tenants over the course of a decade. This has been supported by a steady stream of correspondence which the Government has received from tenants who are facing hardship and from MPs writing on behalf of their constituents. The cumulative evidence made clear that in too many cases tenants are unable to secure a fair share of risk and reward in their agreements with pub owning companies.

Against this background, the consultation sought to explore the impact of the tied model – in the light of evidence that tied tenants are more likely than those who are not tied to face hardship; and concerns that the tie complicates the relationship and therefore provides additional potential for abuse.

The consultation noted that a self-regulatory approach had been in operation for almost a decade and that improvements had been made. However, following an Autumn 2012 call for evidence the Government had concluded that self-regulation had not sufficiently increased transparency in the

¹ <https://www.gov.uk/government/consultations/pub-companies-and-tenants-consultation>

² <https://www.gov.uk/government/consultations/pub-companies-and-tenants-consultation>

relationship between pub owning companies and tenants; nor given tenants better access to all the information they need to make informed business choices.

With these issues and the extensive evidence gathered by the Committee and its predecessors in mind, the Government stated in the consultation its intention to establish a Statutory Code overseen by an independent Adjudicator to govern the relationship between the large pub companies and their tenants.

The responses to the consultation were published on 13 December 2013³. Based on the evidence received – 1,120 written responses and over 7,000 responses to an online survey conducted in parallel – the Government remains clearly of the view that the unfairness in the relationship between pub owning companies and their tied tenants is continuing and damaging. While self-regulation has brought a number of improvements, such as the industry framework code and dispute resolution services, these changes have taken too long and still have not gone far enough. Too many tenants continue to experience unfair treatment and hardship.

A Statutory Code

The Government is committed to ensuring fairness in the industry, and has therefore concluded that a *Core Code* should be introduced to provide *all tied tenants* with increased transparency, fair treatment, the right to request a rent review if they have not had one in five years, and the right to take disputes to a new independent Adjudicator.

An *Enhanced Code* will additionally require pub owning companies with *500 or more tied pubs* to offer parallel tied and free-of-tie rent assessments carried out in line with Royal Institution of Chartered Surveyors (RICS) guidance to potential or existing tenants, if they request them, when they are considering taking on a pub tenancy or at the time of their regular tied rent review. A tenant would have the right to request this parallel free-of-tie rent assessment once the parties had been unable to reach agreement on a tied rent offer following a period of negotiation, and will pay a fee of £200 for the assessment. Pub owning companies have long held that ‘tied tenants are no worse off than free-of-tie tenants’. For the first time in the history of the tie, tenants will now be shown whether that is true through the free-of-tie rent assessment provision. It will strengthen the negotiating position of the tenant and incentivise pub owning companies to ensure they are offering a fair share of risk and reward in their tied agreements.

An Independent Adjudicator

A new independent Adjudicator will enforce both the *Core* and *Enhanced* provisions of the Statutory Code with powers to arbitrate disputes, investigate systemic breaches and provide guidance on the Code. The Government also

³ <https://www.gov.uk/government/consultations/pub-companies-and-tenants-consultation>

intends that the Adjudicator will have the power to impose sanctions - including financial penalties - if it finds that the Code has been breached.

The Government believes that this set of measures provides a proportionate and targeted response which ensures that all tied tenants are protected. The new Statutory Code and Adjudicator, combined with the right to a parallel free-of-tie rent assessment, will provide tenants with the information and power they need to negotiate a fair tied deal. Pub owning companies that are already behaving responsibly have nothing to fear; this is not abolition of the beer tie. The Government supports the tie as a valid business model where it is used properly and is not abused. It will enable pub owning companies to demonstrate what should already be the case, namely that their tied agreements offer a fair share of risk and reward and that their tied tenants are no worse off than free-of-tie equivalents.

In responding to the Committee's report, the Government has commented specifically on the recommendations made. Further detail about the Government's plans can be found in the Government Response to the consultation.

BISCOM's Recommendations and the Government's Response

The Government's proposals for enhanced self-regulation

1. We welcome the fact that the Government is now consulting on a Statutory Code of Practice for the pub industry. We also welcome the fact that the Government now agrees with the Committee that the OFT's response to the CAMRA super-complaint is no bar to statutory intervention. Having previously agreed to act, it is regrettable that the Government has taken over a year to come to this decision.

The Government is grateful to the Committee for the crucial work it and its predecessors have done over the years to raise awareness of this issue. The extensive evidence presented to the Committee and its predecessors in their four inquiries over the course of a decade contributed to the cumulative evidence base which led to the Government's decision to consult.

The Government acknowledges the Committee's regret over the time it has taken to consult on statutory intervention and to respond to the consultation and to the Committee's report.

But it was important for the Government to give the industry time to change before proposing a statutory solution, which should always be a last resort. As the Government noted in its response to the Committee in November 2011, 'legally binding self-regulation can be introduced far more quickly than any statutory solution and can, if devised correctly, be equally effective.' At that time, the Government supported a self-regulatory approach following the industry's commitment to implement a range of reforms.

It was also right that the Government did not rush into a decision following the close of the consultation and that we allowed time to process, evaluate and assess all of the responses to ensure that intervention was proportionate and targeted.

It is right to say that the Government does not see the Office of Fair Trading's (OFT) findings in 2010 as a barrier to statutory intervention. As we made clear in the consultation, the pubs market is highly competitive and the Government is not intervening on competition grounds, but rather to address the unfairness in the relationship between pub owning companies and their tenants; in its October 2010 response to a super-complaint from CAMRA, the OFT found no evidence that the beer tie results in competition issues that cause harm to consumers.⁴

The Framework Code of Practice and legal enforceability

2. For too long the question of certainty over the enforceability and legal status of company codes of practice has remained unresolved. Again, BBPA assurances appear to have been undermined by its own members. Such confusion reinforces the argument that only statutory intervention will put the legal status of the codes of practice beyond doubt.

The Statutory Code will provide that where a company code is produced, nothing in the company code will exclude or otherwise affect the rights of a tied tenant and duties of the pub owning companies set out in the Statutory Code.

The overarching principles

3. There is general agreement that the Statutory Code should include the Government's overarching principles of fair dealing and that a tied tenant should be no worse off than a free-of-tie tenant. However, clarity on how this will be enshrined in law is necessary. We look to the Government to provide us with early detail on how these principles will be achieved through legislation.

In the consultation, the Government stated its intention to base the Statutory Code on the core principles that a tenant should be treated fairly and lawfully; and that a tied tenant should be no worse off than a free-of-tie tenant.

The Government considers that these core principles are critical to building on the current requirements of the industry framework code to address the imbalance in risk and reward between pub owning companies and their tenants.

However, on the basis of the evidence submitted to the consultation, the Government recognises that the formulaic parallel rent assessment originally

⁴ http://www.offt.gov.uk/shared_offt/super-complaints/OFT1279.pdf

proposed in the consultation does not provide the appropriate means for ensuring that tenants are no worse off under a tied agreement than they would be under a free-of-tie agreement.

As outlined in more detail in the Government's response to the consultation, the Government has accepted the feedback that the design of the parallel rent assessment as proposed in the consultation has drawbacks. It could lead to rent adjustments to tied agreements where the pub owning company is already providing a rent subsidy. It also is problematic to account for the different risk factors involved in a free-of-tie agreement as opposed to a tied agreement when applying the suggested approach in a single formulaic approach across the industry. A more specific pub level approach can better account for these variables.

The *Enhanced Code* will therefore require that pub owning companies with 500 or more tied pubs prepare, on request, a parallel rent assessment that focuses on the circumstances of each pub and it will not mandate an automatic formulaic rent adjustment. The Government expects that the parallel rent assessments, which will be carried out in line with Royal Institution of Chartered Surveyors (RICS) guidance, will show that the tenant will be no worse off under the tied agreement than if he or she were free-of-tie. In doing so it will directly address the incentives on pub owning companies to ensure they take a fair share of the profits from a tied pub business. A tenant would have the right to request this parallel free-of-tie rent assessment once the parties had been unable to reach agreement on a tied rent offer following a period of negotiation.

These core principles will be enshrined in legislation. The Government believes that the provisions of the Statutory Code and the improved enforcement provided by the Adjudicator, combined with the right to a parallel free-of-tie rent assessment, will deliver the core principles that a tenant should be treated fairly and lawfully and that a tied tenant should be no worse off than a free-of-tie tenant.

Additions to the Framework Code

4. The mandatory free-of-tie option is seen by many lessee organisations as a key tool to address the imbalance in risk and reward. It is also the option which is resisted most vigorously by the BBPA. It is for the Government to decide, on the balance of evidence, whether this should be included in a Statutory Code. We have not previously recommended the abolition of the tied model but we do support a free-of-tie option. If the tied model is proved to deliver significant benefits to the lessee, then the option would not be taken up, and the tied model would remain.

The Government has concluded that the Statutory Code should not give tenants the automatic right to choose a free-of-tie agreement. The Government acknowledges that such a mandatory free-of-tie option – also known as the market rent only option – might arguably offer the simplest way

of ensuring a tied tenant is no worse off than a free-of-tie tenant, and that it is popular with many tenant groups. It would have required companies above the threshold to give their tenants adequate information to decide whether they would be better off under a tied or free-of-tie agreement and then allowed the tenants to go free-of-tie if they wished.

However, the Government is concerned at the potential negative consequences the inclusion of such a provision in the Code could cause, including the impact on investment and the economies of scale from which pub owning companies benefit. In particular, it seems clear that this option would cause uncertainty for pub owning companies and this would have an unpredictable impact on the wider pub sector. Faced with a significant number of their tenants going free-of-tie, pub owning companies may take the decision that it makes business sense to leave the tied market. This is of course less likely for brewers but is a realistic option for the three large companies that are non-brewers. Some tenants may be content to see the tie broken but from the responses to the consultation, we believe that even among the voices in the industry that are most critical of pub owning companies, many support the principle of the tie. While the mandatory free-of-tie option has undoubted attractions, the evidence suggests that the wider impact on the pub industry is difficult to predict and could pose a risk to the tied market as a whole.

The 500 threshold

5. We understand the rationale for setting a threshold for the Statutory Code. However, we see merit in including a level of flexibility in any Bill to allow the Secretary of State subsequently to alter the threshold in the interests of the industry.

The Government intends that the legislation will provide for the Code and Adjudicator to be periodically reviewed by the Secretary of State, initially after two years, as with the Groceries Code Adjudicator Act 2013. This would enable the threshold for the *Core* and *Enhanced* provisions in the Code to be kept under review. The Secretary of State will have the power to make amendments to the Code, including to the minimum threshold above which the Code applies, following a review; and any changes to the threshold would be subject to scrutiny and approval by Parliament.

6. We accept the argument that the Statutory Code should only apply to pub companies with leased and tenanted pubs and recommend that the Department reflect this in the Bill.

The consultation said that the Government intended to take a proportionate approach to the introduction of the Statutory Code. It proposed that the new regulatory regime should apply only to pub companies with 500 or more pubs; and that, for those companies within scope, the Statutory Code should apply only to their non-managed pubs.

Based on the balance of the evidence from the consultation, the Government considers that the Statutory Code of Practice should consist of *Core* and

Enhanced provisions. The Government intends that the *Core Code* should apply to all tied lease and tenancy agreements operated by all pub owning companies so that all tied tenants are protected. For the avoidance of doubt this also includes any tied agreements i.e. agreements with a purchase obligation, so pub agreements marketed as ‘franchises’ are also included. Micro-businesses will be exempt from the Code.

The *Enhanced Code* will contain the requirement to offer parallel tied and free-of-tie rent assessments, which will enable tied tenants to judge whether they are being offered a fair tied deal. This would apply only to tied agreements operated by companies with 500 or more tied pubs.

Having listened to the responses to the consultation, the Government considers this approach is more targeted (by applying only to tied pubs and applying the parallel rent assessment requirement only to pub owning companies with 500 or more tied pubs and only if a potential or existing tied tenant requests it once the parties have been unable to reach agreement on a tied rent offer following a period of negotiation) whilst at the same time ensuring that all tied tenants are protected by a Code and have recourse to an independent Adjudicator (which was not the case under the consultation proposal).

Self regulation and arbitration

7. Both PICAS and PIRRS have been positive developments in the pub industry but we are unclear as to how they will fit into a new statutory landscape. The Government needs to ensure that, whichever route it takes, the role of these two arbitration bodies is not lost as a result of a statutory/non statutory split in the oversight of the industry.

The Government recognises that there has been some progress with self-regulation. The consultation noted the positive role that PICAS and PIRRS have played in resolving disputes and the Government’s view that it did not wish to discourage these from continuing to operate after the proposed Adjudicator was established.

The Government sees the merit in tenants having a choice of arbitration mechanism but whether PIRRS and PICAS do continue is essentially a question for the industry. Given the persuasive evidence from the consultation that self-regulation may lapse after the introduction of a Statutory Code and Adjudicator, the Government intends to ensure statutory protection for all tied tenants through the *Core Code* and Adjudicator.

Powers of the Adjudicator

8. When we undertook pre-legislative scrutiny of the draft Groceries Code Adjudicator Bill, we recommended that the Adjudicator have the power to fine. The Government accepted this recommendation during the Bill’s passage through Parliament. We recommend that the Government provide similar powers to this Adjudicator.

The Government intends that the legislation to take forward a Pubs Code and Adjudicator will contain a similar power to that contained in the Groceries Code Adjudicator Act 2013, enabling the Adjudicator to impose a financial penalty on a company if, following an investigation, the Adjudicator finds the company has breached the Code and considers that a fine is the most appropriate sanction.

Legislative Timing

9. We believe that with the right level of commitment from Government, a Bill could be introduced in this Session of Parliament. At the very least, the Government must bring one forward at the start of the next Parliamentary Session. We will expect the Department, in its Response, to provide us with a timetable for its introduction. There must be no more delays in resolving this matter. To start the Parliament with an undertaking to act and end without any change would represent an unacceptable failure.

The Government intends to take forward the proposals outlined in its response to the consultation to establish a Statutory Code and Adjudicator through primary legislation. To this end we will be seeking to legislate at the earliest opportunity.

Conclusion

The Government acknowledges the impact of Parliamentary scrutiny in driving reforms in the pubs industry in recent years and is grateful to the Committee for its consideration of the Government's consultation proposals. While self-regulation has brought a number of improvements, such as the industry framework code and dispute resolution services, the Government considers these changes have taken too long and still have not gone far enough. Too many pub tenants continue to experience unfair treatment and hardship and do not have confidence in the independent nature of the dispute resolution services.

The Government agrees with the Committee that statutory intervention is now needed and the Government will seek to legislate at the earliest opportunity to establish a Statutory Code of Practice and an independent Adjudicator to enforce the Code, to govern the relationship between pub owning companies and their tied tenants.

The Government has consistently demonstrated its support for a healthy pub industry, including bringing an end to the beer duty escalator in last year's Budget and cutting beer duty for the second year running this year. A healthy pub industry also requires fairness for all the businesses involved. With the key protections of the Statutory Code and Adjudicator in place, the Government is keen to see the British pub and brewing industry build on its proud heritage – and for a sustainable and fairer industry to enable pubs to remain as a mainstay of our communities.

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