
From:**Sent:** 14 June 2013 17:36**To:** Pubs Consultation Responses**Subject:** Pub Consultation - Response**Attachments:** 13-718RF-pub-companies-and-tenants-a-government-consultation-response-form WS.pdf

Dear Sir or Madam,

Please find attached my response to the Pub Company consultation. I am a Punch leaseholder of years. I have taken the liberty of including introductory remarks based on this experience. I would be more than happy to expand on the submitted response either in writing or in person. This includes figures, where required, to substantiate further all facts disclosed.

My response is based on the belief that the code must ensure long term investment in the sector as well as fairness and equality for tenants compared to their free of tie equivalents. Lack of investment, as Pub Company money pays off unsustainable debt, is the fundamental problem existing today. I believe that forcing the tie to be competitively renewed after the first five years would allow a substantial but ordered evolution of the industry. In parallel fair rent reviews must also be set within the boundaries of a Pubs historic revenue and not projected "efficient operator" levels.

Without growth fuelled by investment the Pub Company sector will collapse. An effective code must urgently address this.

The report suggests that a concern is the long term stability of the Pub Companies. I believe this concern must be discarded as either the Pub Companies must evolve or the traditional pub sector's decline will be terminal.

The industry has a straightforward problem definition:

- The Pub Companies are heavily indebted and their duty to shareholders, bondholders and banks is in conflict to the investment required to preserve the traditional Public House sector which they largely own.
- As a result The Pub Companies portfolio has been underinvested throughout their ownership. A disproportionate amount of tenant revenue is directed towards the Pub Companies and specifically their debt holders.
- Without investment the Pub Company owned sector is in decline as other Companies provide better invested venues. Such venues have more modern facilities and often cheaper prices than leased pubs can afford. Intense competition from supermarkets, alternative entertainment forms plus cost increases driven by escalating utility charges, Government taxation policy and the minimum wage have also impacted the sector.
- The Pub Companies in their current form do not serve the best interests of the sector and are an unintended consequence of the 1989 Government beer orders. There is a need for legislators to correct the errors their predecessors are responsible for.
- The Beer Tie serves no purpose to long standing lessees. In the short term the Pub Companies invest in empty venues to attract new lessees, this justifies the low cost of entry argument. However, this argument is diminished over time as the freeholder does not invest in the ongoing business.
- The historic relationship of a beer tie is abused by the Pub Companies as they do not deliver the investment benefits traditionally expected.
- The competition authorities are correct, there is not a lack of competition in the industry. However the traditional Pub Company owned sector is not competitive as beer prices are artificially high due to

excessively high tied pricing.

In responding to this consultation I agree that the outcome should include:

- The establishment of a Statutory Code and an independent Adjudicator to enforce that code
- Proposals as to how a “tied tenant should be no worse off than a free-of-tie tenant” *although this should not be limited to rent calculation, it is also about free market competition.*
- The code should apply to all Pub Companies with over 500 pubs *but with appropriate safe guards to prevent the gaming of the code.*

Additionally I believe that there should be a clear statement of intent:

- The code should ensure that where the Beer Tie is retained, by mutual agreement, Pub Companies must provide a transparent, genuine and quantifiable Special Countervailing Advantage (SCORFA) that ensures on-going investment in the tied tenants business. Retention of a beer tie should be based on a competitive process.

The economies of scale obtained by Pub Companies are used to service debt rather than invest in the sector. There is long term abuse of the historic intent of a beer tie that needs to be corrected. A statutory code must ensure that where the Beer Tie exists it is associated with investment (SCORFA). In a free of tie competitive process, a Brewer, for example, in return for tied deals over a period of time would invest in a leased business; Pub Companies currently direct such money towards debt repayment and do not invest in long term lessee’s businesses.

While SCORFA can be mandated there is a compelling argument that this will not drive the free market efficiency to revive the sector. Pub companies when competing free of tie offer attractive pricing (Spirits, Soft Drink and Wine from Punch for example). By needing to win business, rather than enforcing uncompetitive renewals, the companies would themselves become more efficient and develop into partners improving the competitiveness and long term sustainability of their tenants business.

Proposal. Ties must be competitively renewed after the first five years of a tenant’s tenure.

After five years the original Beer Tie would cease and a fair rent, based on achievable sales, for a venue agreed. For clarity, when the code is introduced, the five years would be the length of a tenant’s occupation not an existing lease. Tenants would be able to work with Pub Companies, Breweries and other’s to agree investment proposals for their business by negotiating a renewed tie in a competitive situation. Pub Companies would improve their services to tenants as winning tie renewals would maintain their revenue. The code would require safeguards to ensure the tenant has sufficient time and advice to negotiate new ties and prevent the Pub Companies from using intimidatory tactics. Rent reductions related to maintenance of tie would be transparent.

If mandatory ties are retained, to justify their long term existence of the Pub Companies would need to emulate the competitive behaviour described. Their current inability to adjust behaviour quickly enough suggests this will not happen.

The competitive renewal of tie could also include long term proposals allowing the tenant to purchase the freehold over time. This would allow the low cost of entry mantra to be properly maintained as well as allowing Pub Companies to maintain excessive pricing levels to pay off debt. Rent would reduce in line with the tenant’s share of the freehold.

Proposal. Tied pricing, sales and rent indexation be linked.

It is clear that tied pricing is often excessive. Additionally prices and rent increase each year regardless of a tenant's ability to pay or pass such increases on to customers. The code should link tied pricing and sales to rent indexation. A free of tie tenant would have an ability to renegotiate prices to negate or avoid downturn due to price increases. A linkage of the type suggested would help emulate the free of tie options.

If tied prices increase, based on the tenants purchased goods, by more than the indexation amount then rent increases would have to be reduced based on a formula. Where sales fall, beyond a code set range, rent indexation would not be permitted.

This measure would incentivise Pub Companies to allow free of tie deals as rent indexation would then be guaranteed. Additionally more competitive tied pricing may help sales and preserve rent indexation.

Yours Sincerely

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Department for Business, Innovation & Skills

Pub companies and tenants - A government consultation

Response form

The consultation will begin on 22/04/2013 and will run for 8 weeks, closing on 14/06/2013

When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation response form and, where applicable, how the views of members were assembled.

This response form can be returned to:

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation and Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

Email: pubs.consultation@bis.gsi.gov.uk

Please tick one box from a list of options that best describes you as a respondent. This will enable views to be presented by group type.

Representative Organisation

Trade Union

Interest Group

Small to Medium Enterprise

Large Enterprise

Local Government

Central Government

Legal

Academic

Other (please describe): Tied Lease Holder

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

Consultation questions

Q1. Should there be a statutory Code?

Yes. The imbalance in the revenue share and the failure of the Pub Company model to either invest in the underlying business or be efficiently flexible in a downturn mean that there is no choice.

Q2. Do you agree that the Code should be binding on all companies that own more than 500 pubs? If you think this is not the correct threshold, please suggest an alternative, with any supporting evidence.

I think the 500 is too high unless sufficient safe guards are introduced to prevent gaming by the Pub Companies. It is not difficult to envisage companies floating regional entities, for example, which are serviced by a common support company which is an outsourced central function.

As an alternate to a reduced number, there should also be a mechanism, open to tenants, to force a small Pub Company to adhere to the code if it is clearly and continually abusing it.

Q3. Do you agree that, for companies on which the Code is binding, all of that company's non-managed pubs should be covered by the Code?

Yes. However the code may need to address the issue of forced migration from leased to managed businesses. If the code is sufficiently robust Pub Companies may use interim time scales before it takes effect to force economically challenged tenants towards managed houses.

Q4. How do you consider that franchises should be treated under the Code?

I believe they must be covered by the code. Failure to do so creates an opportunity for a Pub Company to evolve its operations and by pass the code.

Q5. What is your assessment of the likely costs and benefits of these proposals on pubs and the pubs sector? Please include supporting evidence.

Based on 25 years of experience I believe that there needs to be a movement of 10% of revenue from the Pub Company to the tenant. The benefit of this will be a sustainable Pub Sector but it will force an inevitable evolution of the Pub Companies.

The consultation document states clearly that to do nothing will see continued decline of the Pub Sector as owned by the Pub Companies. The Pub Companies are finance created vehicles that, without reform, can only manage to one end result; the closure of many more Pubs and their own bankruptcy. Consequently not to introduce a code of practice will prolong, but is unlikely to prevent, the demise of the large Pub Companies as they exist today. The evidence for this is clear in the on-going revenue decline reported in the Pub Company financial results. Most specifically the age of the Pub Company estate is of deep concern, the inability of lessee's to finance the necessary levels of repair and renewal are a significant reason for failure.

Ironically, it is my expectation that although these proposals may force the Pub Companies into a refinancing, that may reduce or eradicate current shareholder value, they are more likely to emerge as companies that either evolve to be a positive force for their sector or, in an orderly fashion, dismantle themselves. This is better than terminal decline. Share and Debt holders will be more realistic with the existence of a statutory code that enforces a long term view.

The fundamental cost of this, or any other corrective proposals, will be to force share and bond holder recognition that the assets they own are not able to fund current debt levels. They only have themselves to blame, in no other industry would such a blatant failure to invest in maintaining and evolving assets be acceptable.

[Although my response focuses on evolution, it can be argued that the best result for this sector is to mandate an orderly dismantling of the Pub Companies. With brewery backed investment to enable lessees to become freeholders the industry would potentially become the one envisaged by the original 1989 beer orders. The various Government led banking investment schemes may be utilised to enable this result, most likely via breweries. This would be an ambitious undertaking by government to address the unintended consequence of the 1989 beer orders]

The survival of the traditional Pub Sector is dependent on the current imbalance in the revenue flow between pub company and lease holder being *urgently* corrected. The cost benefit to the sector if this is done on a competitive basis, focused on investment rather than a simple flow of cash, will be significant as it will restore growth.

As regards the beer tie, the so called economies of scale benefits that Pub Companies bring do not benefit lessees. If so competitive pricing and investment in long term partnership with lessees would be evidenced. I believe that if the tie is to be retained it must also deliver investment to each lessee's business. The ability of a free of tie lessee to develop a long term relationship with one of more brewers/suppliers must be introduced or replicated.

The Pub Companies are competitive outside of tie. A convincing argument can be made that by eliminating the automatic renewal of a tie, after five years, the Pub Companies would further develop such competitiveness. By competing for their tenants business they would operate more like a brewery or other supplier in offering incentives and competitive prices to retain business. These incentives when in the form of investment could better ensure development of the estate, allow more competitive pricing and lead to revenue growth.

Q6. What are your views on the future of self-regulation within the industry?

Self-regulation only works when there is a fear of statutory regulation if it fails. The flawed finances of the Pub Companies mean that their shareholders will not agree the necessary changes required to save the pub industry unless forced. The regulations must be imposed and the debt holders will need to determine how the Pub Companies evolve.

Q7. Do you agree that the Code should be based on the following two core and overarching principles?

i. Principle of Fair and Lawful Dealing

Yes.

ii. Principle that the Tied Tenant Should be No Worse Off than the Free-of-tie Tenant

Yes.

iii. Principle that the Pub Company operating a tie and collecting rent must reinvest a minimum percentage of its revenue in its existing estate.

This principle would ensure that the long term investment problem is addressed. I believe that competitive renewal of tie is the most effective way to drive this but a requirement to invest must be a condition of a Pub Company being allowed to charge Wet and Dry rent.

iv. Principle that long term lessees, where a tie is in place, should have a right to buy the freehold overtime

In responding to this consultation I also float a fourth principle that would be of long term benefit to the industry. Arguably the over payment of dry/wet rent currently occurring could by agreement continue if a share of the freehold was owned over time (reducing the rent over time to the point ownership was achieved). This justifies the tie as a genuine low cost of entry vehicle for pub tenants while providing a window for debt holders to be repaid.

Q8. Do you agree that the Government should include the following provisions in the Statutory Code?

i. Provide the tenant the right to request an open market rent review if they have not had one in five years, if the pub company significantly increases drink prices or if an event occurs outside the tenant's control.

Yes. Although significantly should be defined, potentially drink price increases should also be linked to rent indexation.

A change of economic circumstance should be explicitly accepted as an event outside of the tenant's control, e.g. a set reduction in revenue, defined in the code, should trigger a market rent review at the tenant's request.

The introduction of the code of practice should trigger, on request, a rent review wherever sales are less than those envisaged by the Pub Company at review.

ii. Increase transparency, in particular by requiring the pub company to produce parallel 'tied' and 'free-of-tie' rent assessments so that a tenant can ensure that they are no worse off.

Yes. However, these reviews remain flawed, for example they overstate revenue and yield while understating maintenance and refurbishment costs.

As a lessee I can evidence this:

- Fair rent review in states that an efficient tenant would achieve

- revenues 20% higher than current and greater than any achieved since 2007.*
- Fair rent review did not allow for stock loss*
- Fair rent review included an AWP tie*
- Fair rent includes maintenance costs that are less than the five year average*

(Some reduction in first year rent was agreed to address some maintenance issues)

A rent assessment should not be able to assume revenue in excess of that achieved over the average of the previous five years of trading unless there are significant reasons to justify this. As an example redecoration cannot be classed as significant while a full refurbishment can.

iii. Abolish the gaming machine tie and mandate that no products other than drinks may be tied.

Yes. The use of this tie is flawed. Gaming Machine revenue is overstated and erratic. The Pub Company does not contribute to the cost, maintenance and collection overhead. Machine Games Duty has increased this overhead.

Overnight forcing the elimination of this tie, without allowing Pub Companies to impact rents, would help address the revenue imbalance between Pub Company and Lease Holder. Where the tie is not eliminated a full, code backed, rent review should be triggered.

iv. Provide a 'guest beer' option in all tied pubs.

Yes. This does already exist but should be extended to all Cask Ales. The Beer Tie forces excessive prices to be paid for most remaining tied cask ales, and includes "pump charges". Collectively this negates some of the benefit of having guest ales. By eliminating the Cask Ale tie or associated "side" charges there would be benefits to local breweries whose products would be sold more broadly.

Alternately a set proportion of draft pumps (e.g. 25%) should be free of tie. This would force Pub Companies to offer more competitive tied prices.

v. Provide that flow monitoring equipment may not be used to determine whether a tenant is complying with purchasing obligations, or as evidence in enforcing such obligations.

Yes. The removal of such equipment would allow cost reductions that the Pub Company could use to reduce tied prices.

i. Are there any areas where you consider the draft Statutory Code (at Annex A) should be altered?

Yes.

Part 3.

The the Pub Company should not get a free pass for existing tenants until the next rent

review so I would recommend an additional qualification for a review:

16 (d) an existing tenant has an AWP tie or tied sales have declined by more than 5% (like for like volume) since the last rent review.

The six months in item 17 is too long. I suggest:

17. If a rent assessment is requested by the tenant and one of the conditions of paragraph 16 is met the Pub Company must complete a rent assessment within three months.

Indexation should also reflect the existence of a beer tie. A free of tie operator would have the opportunity to try and offset rent increases by looking at alternate wet suppliers. Equally the indexation should not happen if sales estimates at the rent review were inaccurate and potentially a rent review should be forced. I suggest the following additional elements for Part 3 section 19:

19. (e) where a beer tie is in place and tied prices have increased by more than the index, rent indexation rights must be waived. In this instance the tied prices will refer to those paid by the lessee not a general Pub Company indexation.

19. (f) where a beer tie is in place an indexation increase can only occur if like for like volume sales have remained steady or increased.

Part 4.

It is unclear whether the following:

25. (a) the national prices charged for these products

refers to the Pub Companies Prices or those easily obtainable by checking national suppliers. In my view it should be the latter.

Guest beers without penalty, e.g. a pump charge or excessive tied prices, can help change the viability of a business and enable a transfer of profit. Note the Pub Company will own the cellar equipment (or the relationship with the principle brewer who maintains it) so must enable the serving of a guest beer. The strengthening of this clause would enable negotiation.

27. Where drinks are supplied under a tied agreement, the Pub Company must provide the Tenant with at least one "Guest Beer" option. This is to be interpreted to mean that the Tenant should be allowed to purchase and be enabled to sell at least one draught beer, or cider, from any source without control or restriction being imposed by the Pub Company. There should be at least one "Guest Beer" for every three tied draught beers or ciders. This option may be waived if the tenant chooses, in return for quantifiable Special Countervailing or Financial Advantage (SCORFA)

Part 6.

Delaying the incorporation of the code until a rent review gives the Pub Companies a free pass to continue to ignore mandatory changes. Suggested wording is:

33. (a) The Pub Company must incorporate the Code into all new lease and tenancy

agreements following the Code coming into force.

33. (b) The Pub Company must incorporate the Code into all existing leases following the Code coming into force at no later than:

i) The next rent review

ii) Or, where an AWP tie exists or tied sales have declined (like for like volume) since the last rent review within three months at the request of the lessee

The Pub Company must offer the changes as an amendment to the lease. If it wishes to offer a new lease it must meet all legal charges, including the lessee's costs and stamp duty.

Annex A

There needs to be explicit protection for overstated future revenue used commonly by Pub Companies:

(vi) include projected sales and gross profit margins, with separate figures for: draught ales; lagers; ciders; wines; spirits and soft drinks. Projections for tied sales cannot exceed either the previous year or the average for the preceding five years, indexed for inflation, whichever is higher. This may be waived in writing by the tenant based on clear justification from the Pub Company. If this justification is later shown to be unfounded a rent review may be requested under section 6 (c) treating this as an event outside of the Tenant's control.

Q9. Do you agree that the Statutory Code should be periodically reviewed and, if appropriate amended, if there was evidence that showed that such amendments would deliver more effectively the two overarching principles?

Yes.

Q10. Should the Government include a mandatory free-of-tie option in the Statutory Code?

Yes. I do however believe that this option would be exercised much less frequently if the code enforces investment and forces the linkage of rent and beer price indexation to sales.

Q11. Other than (a) a mandatory free-of-tie option or (b) mandating that higher beer prices must be compensated for by lower rents, do you have any other suggestions as to how the Government could ensure that tied tenants were no worse off than free-of-tie tenants?

Develop the tie renewal principles to enforce competitive tie renewal and investment.

(c) Enforce competitive tie agreements and renewals.

This could include:

- Free of tie rent fairly set as baseline for a competitive tender.
- Tie with a principle brewer or Pub Company or other supplier
- Limiting of the tie to principle brands
- Tie renewal with 5% of all sales to be reinvested in works to maintain the free hold building and grounds.
- Tied Principle Brewer relationships, direct or via the Pub Company, developed to ensure explicit investment. E.g. Sky Discounts, Cooler systems, Fridges, Pumps.
- A specific marketing budget for promotional material, local advertising, and social media

should be provided relating to sales.

- Enable principle brewers to directly financially incentivise tenants to sell tied product lines.

Where ties remain ensure that implications to rent indexation and assessments are in place:

(d) Prevent rent indexation increases where tied sales fall.

(e) Trigger fair rent reviews if tied sales fall more than 5% below those assessed at the rent review.

(f) Bound the extent of the tie

This would include:

- Limit the amount of mark up a Pub Company can apply to micro-brewery products to 20% except where the breweries published list price is matched. Currently this can exceed 100%. This is intended to force Pub Companies to retail micro-brewery prices at reasonable levels (e.g. not £105 for a £65 free of tie 9g Cask). Potentially force Pub Companies to extend agreements with local micro-breweries to enable pass through ordering.
- Force a rent review where Pub Company revenue (Tied sales, rent, etc) exceeds 40% of turn over.
- Mandate that incentive targets for tied sales should be attainable. Current contracts include unobtainable targets which offer no attainable target.
- limit the tie to core brands only.

Q12. Should the Government appoint an independent Adjudicator to enforce the new Statutory Code?

Yes. The Pub Companies continually exercise their muscle otherwise.

Q13. Do you agree that the Adjudicator should be able to:

i. *Arbitrate individual disputes?*

Yes.

ii. *Carry out investigations into widespread breaches of the Code?*

Yes

Q14. Do you agree that the Adjudicator should be able to impose a range of sanctions on pub companies that have breached the Code, including:

I. *Recommendations?*

Yes.

II. *Requirements to publish information ('name and shame')*

Yes.

III. *Financial penalties?*

Yes. Including compensation to injured parties.

Q15. Do you consider the Government's proposals for reporting and review of the Adjudicator are satisfactory?

Q16. Do you agree that the Adjudicator should be funded by an industry levy, with companies who breach the Code more paying a proportionately greater share of the levy? What, in your view, would be the impact of the levy on pub companies, pub

tenants, consumers and the overall industry?

Yes. However the Pub Companies should be explicitly prevented from passing this on to tenants and consumers. The levy's impact on the Pub Companies is insignificant compared to their debt levels. By forcing the Pub Companies to evolve or dismantle to ensure the traditional Pub Sector survives the Government will have achieved a considerable feat at minimal cost.

Addendum. Response to sections of the consultation document.

5.33 The Beer Tie does have a long and honourable history in the British Pub sector and I agree that where operated to mutual benefit it can be a powerful tool. However the tie as operated by the Pub Companies is not for mutual benefit, it does not deliver competitive pricing or investment to the tenant.

5.34 The Pub Company beer ties protect the large brewer's not medium sized ones. The free of tie option would benefit small and medium sized brewers as it would eliminate excessive surcharges, of up to 100%, and open up the market to them. This would likely encourage local employment as the market for regional products would increase. This would also improve the relationship between Pub and Brewer.

5.37 a) Pub Companies do not pass on the advantages of their economies of scale to the tenant. A competitive approach to the tie would address this concern. The industry would evolve as efficient operators would win tied contracts.

5.37 b) A free of tie option would force more competitive investment proposals rather than dis-incentivise. As a tenant I find it difficult to accept the argument that a mandatory tie incentivises Pub Companies to invest. To the contrary they have failed to invest and consequently the value of their shareholders estate has declined and their debt repayments are at risk.

5.37 c) This argument is converse to the reality. The Beer Tie does not champion micro-beers it prices their products out of the market. When the tie is waived, guest beers for example, it is to the benefit of the local brewers.

5.37 d) The exit of a major pub company could be of significant advantage and could encourage investment. The potential for tie-ups between breweries and existing lessee's to create a genuine free pub trade would be a desirable outcome. The Government could anticipate this re-structure and encourage a climate to embrace the opportunity.

5.37 e) The argument that major brewers would suffer substantive market share loss needs to be evidenced. Publicans are unlikely to remove major brands unless the brewery proceeds to be uncompetitive out of tie. In fact brewers would probably negotiate ties with individual pubs in turn for investment and guaranteed prices which would be beneficial to both parties. This would restore the traditional beer tie.

6.17 Risk of companies passing on levy to pubs. It is consistent practice for pubs to pass on costs to lessees (e.g. licence renewal, building insurance, rate review, etc). In

this instance they should be mandated not to do so; however to ensure that this is not built into the rent model more safe guards may be needed.