



House of Commons
Trade and Industry Committee

Pub Companies

Second Report of Session 2004–05



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Report, together with formal minutes

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The Trade and Industry Committee

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated in the form 'Appendix' followed by the Appendix number.

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Summary

We undertook this inquiry at the request of the Federation of Small Businesses, which was concerned about the degree to which public house ownership was being concentrated in the hands of a small number of pub companies (pubcos) and the consequences of this concentration on their tenants. From the large volume of evidence provided by companies and individual public house tenants it was clear that two issues were of particular concern to those tenants: the exclusive purchasing obligation (beer tie) required by pubcos of their tenants, and the basis on which public house rents were calculated.

We were not convinced that the division of the wholesaling and property functions of pubcos, i.e. the removal of the beer tie, as advocated by many witnesses, would necessarily benefit tenants. We felt it likely that in the absence of the tie pubcos would exercise their contractual right to raise property rents to compensate for the loss of income from beer sales. Indeed, if brewers were free to supply all public houses on a wholesale basis it is possible that major brewing companies could achieve a dominant market position to the detriment of individual public house operators.

However, while the majority of public house tenants may be happy with the service provided by 'their' pubco, it is clear from the large volume of evidence submitted to us that many tenants are unhappy with their contractual relationship with their landlord. There is considerable scope for eliminating the root causes of such disputes. All pubcos should be open with their tenants or prospective tenants about the way in which rents are calculated, about how the beer tie will operate in their particular circumstances and about what the contractual obligations are on both parties. A tenant should never be forced or choose to enter into an agreement without taking proper independent professional advice about the basis of the pubco's offer and the significance of the commitment they are asked to undertake. It would appear that the performance of business development managers (BDMs) varies across the industry from excellent to dire. Some seem to be more concerned with the policing of operations in the public houses under their supervision rather than the provision of genuine assistance to tenants.

Many pubcos have adopted voluntary codes of practice which incorporate guidance from the British Beer & Pub Association on the granting and operation of leases. This should be a code of best practice and not a reflection of the lowest common denominator of behaviour within the industry, as any such lower standard would strengthen the argument of those who might call for a statutory industry code. The code of practice should cover areas such as rent reviews; the role of BDMs; complaint and dispute procedures; disclosure and the availability of information; and the taking of legal and professional advice by prospective tenants. At this stage we do not think a legally binding code of practice necessary, but if the industry does not show signs of accepting and complying with an adequate voluntary code then the Government should not hesitate to impose a statutory code on it.

1 Introduction

1. We decided to conduct an inquiry into the relationship between pub companies (pubcos) and their tenants following a request from the Federation of Small Businesses (FSB). During our inquiry it was difficult to find an agreed definition for pubcos. The Association of Licensed Multiple Retailers (ALMR) defined pubcos for us as “companies with no brewing dimension who own their own properties but issue leases to individuals or multiple companies to operate them”.¹ This definition excludes the managed retail pub chains, such as the Spirit Group, as they are exclusively managed operations, and regional brewers, such as Wolverhampton & Dudley Breweries (W&DB), who have managed and tenanted estates and still combine brewing with public house ownership.

2. We chose to define pubcos as all multiple public house owners when looking at competition issues in the market for beer as we were interested in determining whether a single company, be they true pubco as defined by the ALMR, brewer or retail pub chain, held a dominant position in the market. Later, when we looked at the relationship between pubco and tenant, we excluded retail pub chains and the managed estates of brewers in our definition of pubcos, as these are managed and operated by employees or agents and not by tenants.

3. The FSB were concerned about the level of concentration in public house ownership and the consequences this was having for some of their members who were tenants of the pubcos. In particular, the FSB questioned whether the beer tie was still an appropriate business model for the ‘pub trade’, given the changing structure of the industry.

4. The specific issues we were interested in finding out about were: the exclusive purchasing obligations (beer tie) enforced by pubcos on their tenants; the link between the wholesale beer prices charged by pubcos and the rents they charged their tenants; pubcos’ margins with regard to the prices paid by pubcos to breweries and those they charged to their tenants; the difference in the beer prices pubcos charged their tenants and the free market price; and the basis on which pubcos’ tenants rents were set and increased, and their impact on struggling tenants.

5. In the course of our inquiry we took oral evidence from the Federation of Small Businesses (FSB), the Campaign for Real Ale (CAMRA), A.B Jacobs & Co, Ferdinand Kelly Solicitors, the Federation of Licensed Victuallers Associations (FLVA), the Association of Licensed Multiple Retailers (ALMR), the British Beer & Pub Association (BBPA), the Society for Independent Brewers (SIBA) and the Office of Fair Trading (OFT). We also wanted to hear directly from pubcos and so took oral evidence from Punch Taverns, Wolverhampton & Dudley Breweries (W&DB) and Enterprise Inns.

6. In addition, we received over 400 written submissions from individuals and their representatives. Most of the authors requested that their identity remained confidential. Those who did not are listed on pages 67 to 69. We express our gratitude to all those who

¹ Appendix 1, para 4

contributed to this inquiry, but in particular to tenants who took time out from running their public houses to contribute.

2 Development of the UK market for beer, 1989-2004

Background

7. At the end of the 1980s, the market for beer in the UK was dominated by six national brewers (table 1). These accounted for 75 percent of UK beer production, controlled just over half of all public houses, and a substantial proportion of off-licence sales.² Brewer-owned public houses fell into two categories—managed houses, where the publicans and their staff were employed by the brewer, and tenancies where independent publicans rented the public house from the brewer. Under an exclusive supply deal, the ‘beer tie’, these tenants were required to buy their brewers’ products, guaranteeing the brewer an outlet for their product.

8. The remainder of public houses were owned by regional and smaller brewers, such as the Boddington Group, or by individuals whose public houses were described as ‘free houses’, many of whom were still tied for their beer supplies to national brewers by means of ‘brewer loans’, loans made at a favourable interest rate in return for a tie.

The Beer Orders

9. In 1986, the Director General of Fair Trading (DGFT), worried about brewer consolidation and the level of vertical integration in the beer market, asked the Monopolies and Mergers Commission (MMC) to investigate the market. Its report, *The Supply of Beer*,³ found that a complex monopoly existed in favour of brewers who owned tied houses or who had tying agreements with free houses in return for loans (brewer loans) at favourable interest rates. The main recommendation of the MMC was that a ceiling be introduced restricting any one brewing company, or group, from owning more than 2,000 on-licensed outlets (the majority of which were public houses), thereby increasing competition in brewing, wholesaling and retailing.⁴

10. The Beer Orders⁵ modified the recommendations of the MMC report by requiring all brewers who owned more than 2,000 on-licensed premises to dispose of their breweries or release from their ties one half of on-licensed premises above the 2,000 threshold by November 1992. They also allowed for landlords of premises which remained tied to purchase one brand of draught cask-conditioned beer and one brand of bottle-conditioned beer⁶ from any supplier, the so-called ‘guest beer provision’. They also forbade ties on non-alcoholic beers, low-alcoholic beers and non-beer drinks.⁷

² MMC, *The Supply of Beer*, Cm 651, 1989, para 1.9

³ MMC, *The Supply of Beer*, Cm 651, 1989

⁴ *Ibid.* para 1.32

⁵ *The Supply of Beer (Tied Estate) Order 1989*, SI 1989/2390

⁶ Following an amendment in 1997: *The Supply of Beer (Tied Estate) (Amendment) Order 1997*, SI 1997/1740

⁷ The Beer Orders also included *The Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices) Order 1989*, SI 1989/2258, which prohibited brewers from imposing a prohibition on the use of the premises as licensed premises

Table 1: Estimates of public house ownership, 1989 and 2004

1989			2004		
Bass	Mixed (Brewer)	7,190	Enterprise Inns	Leased	8,739
Allied	Mixed (Brewer)	6,678	Punch Taverns	Leased	8,410
Whitbread	Mixed (Brewer)	6,483	Spirit Group	Managed	2,468
Grand Met	Mixed (Brewer)	6,419	Wolverhampton & Dudley Breweries	Mixed (Brewer)	2,112
Courage	Mixed (Brewer)	5,002	Greene King	Mixed (Brewer)	2,100
Scottish & Newcastle	Mixed (Brewer)	2,287	Mitchells & Butlers	Managed	2,077
			Scottish & Newcastle	Leased	1,094
			Wellington Pub Company	Leased	835
			Avebury Taverns	Leased	750
			London & Edinburgh Inns	Leased/Managed	696
Total		34,059	Total		29,281

Sources: 1989 - MMC, *The Supply of Beer*, Cm 651; 2004 - Position as at 1 December 2004 - Based on BBPA, *Statistical Handbook*, 2004 as amended to reflect subsequent acquisitions by certain pubcos.

Table 2: Ownership of UK public houses by type of operator

	1989	2004
<u>National brewers</u>		
tenanted/leased	22,000	0
managed	10,000	0
Subtotal	32,000	0
<u>Regional brewers</u>		
tenanted/leased	9,000	5,972
managed	3,000	2,617
Subtotal	12,000	8,589
<u>Independents</u>		
tenanted/leased	negligible	23,857
managed	negligible	10,268
Freehouses	16,000	16,850
Subtotal	16,000	50,975
Total	60,000	59,564

Source: Appendix 1 Annex 5 para 6

Table 3: Top six brewers in Great Britain

Market Share (Volume), year ending December 2003

Company	Market Share	
	On-trade	Off-trade
Scottish Courage	26%	23%
Coors	20%	17%
Interbrew UK	16%	26%
Carlsberg – Tetley	14%	11%
Diageo	6%	3%
Anheuser - Busch	2%	4%
Total	84%	83%

Source: AC Nielsen

when they disposed of them, required brewers to publish wholesale price lists for beer and not charge higher prices and prohibited them from withholding wholesale beer supplies without reasonable cause.

Figure 1: Beer supply chain 1989

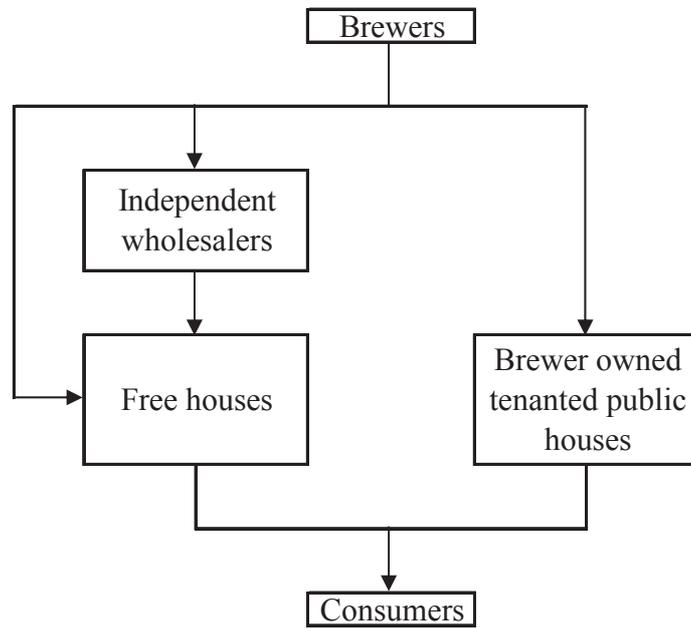
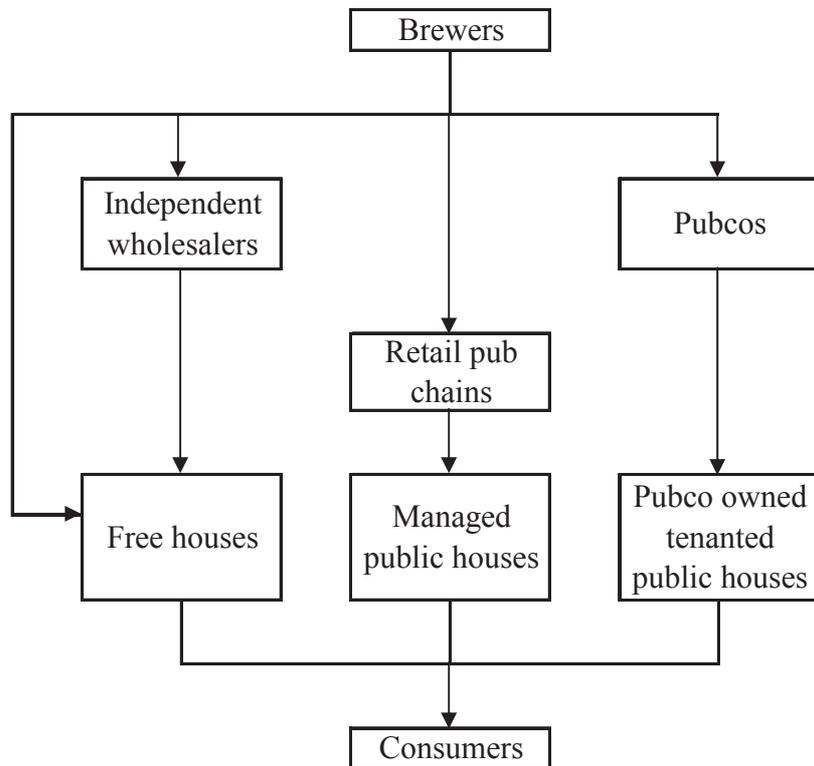


Figure 2: Beer supply chain 2004



11. The Beer Orders aimed to “increase competition in brewing, wholesaling and retailing”.⁸ Prior to their introduction, the UK market for beer was controlled by the vertically integrated national brewers, being at once producer, distributor, wholesaler, and in many cases retailer. This made the supply chain for beer relatively easy to understand (figure 1).

12. The break up of the national brewers following the Beer Orders created increased confusion about the competitive situation in the various sectors which contributed to the supply chain for beer, from brewers, as producers, through to the retail market for the consumption of beer (figure 2).

Public house ownership – the emergence of the pubcos

13. Before 1990, the national brewers, with the exception of Guinness (now merged with GrandMet to form Diageo), all owned substantial tied estates comprising both managed and tenanted public houses. Their estates represented almost 57 percent of the 60,000 public houses and a still greater share of public house sales and beer volumes.⁹

14. Of the six national brewers identified by the MMC in 1989, only one, Scottish & Newcastle Brewers (branded as Scottish Courage Brands) still operates a public house estate (branded as S&N Pub Enterprises). However, they no longer own these public houses. Instead they operate just over a thousand tenancies on behalf of the Royal Bank of Scotland (RBS).¹⁰ The divestment of national brewers’ estates comprising some 32,000 public houses (table 2) happened as they focused on developing their international beer brands in place of controlling access to the retail market.¹¹

15. Not all brewers have divested their public house estates. Regional brewers still own some 8,600 public houses. Many of those highlighted by the MMC in 1989 sold off their brewing concerns to become pubcos instead, for example Boddingtons and Greenalls.¹² Some regional brewers continue to own and operate tied public houses, for example W&DB and Greene King. Around 2,600 of these public houses are managed, where the regional brewer still sets the retail price for beer, for example the Pathfinder Pubs managed estate of W&DB.¹³

16. At the time of the Beer Orders, there were very few pubcos as they would be recognised today. Pubcos were created from the disposal of the national brewers’ public house operations following the implementation of the Orders. Concentration in public house ownership increased through merger and acquisition activity in the 1990s, until by 2000 the first of the ‘large’ pubcos, Enterprise, appeared with an estate of 1,500 public houses.¹⁴ The rate of concentration has accelerated since 2003 with the acquisition by Punch of the

⁸ MMC, *The Supply of Beer*, Cm 651, 1989, para 1.32

⁹ See table 1 and table 2

¹⁰ Appendix 3, para 1.6

¹¹ Appendix 23, para 66

¹² CAMRA, *Good Beer Guide*, 2004, page 12

¹³ Appendix 28, para 1

¹⁴ CAMRA, *Good Beer Guide*, 2004, page 12

Pubmaster estate (3,000 public houses) and the InnSpired estate (1,100 public houses), and the acquisition of the Unique estate (4,100 public houses) by Enterprise.

17. There are currently seven large pubcos¹⁵ (owning over 1,000 public houses) in the UK (table 1). The largest two, Enterprise and Punch, own over 8,000 public houses each. All their public houses are leased to tenants (individuals or small companies) who operate the public houses themselves, subject to the terms of their lease. There are two managed pub retail chains, the Spirit Group and Mitchell & Butlers, two regional brewers, Greene King and W&DB and Scottish & Newcastle's Pub Enterprise division. There are approximately 40 medium sized pubcos (100 to 999 public houses) and 50 small sized pubcos (30 to 99 public houses). There are also a further 200 smaller pubcos (3 to 29 public houses) and an unknown number of operators with two public houses.¹⁶

18. The top six pubcos control almost 40 percent of public houses in the UK. The largest two, Enterprise Inns and Punch Taverns control almost 30 percent of public houses between them, seven percent more than the two largest national brewers did in 1989. Together, all pubcos, under our extended definition, own around 70 percent of UK public houses, with the remaining 30 percent owned by free house operators.¹⁷

19. Under any of the market definitions we have chosen, no one company, be it pubco, brewer or retail pub chain, holds a dominant position in the total market for beer. The largest brewer, Scottish Courage, has a market share of beer supply to the on-licensed trade of 26 percent but only operates a public house estate for the Royal Bank of Scotland (RBS), where their tenants sets the retail price. The largest company in terms of public house ownership, Enterprise, owns just 15 percent of public houses, all tenanted, to whom it acts as wholesaler, and has no brewing or retail operations. There are sufficient different types of public houses: pubco managed, pubco tenanted, and free houses, for us to agree with the Office of Fair Trading (OFT) when they say "there seems to be a reasonable amount of competition between on-trade outlets".¹⁸ There may, however, be higher concentrations of public house ownership in certain towns, areas, or regions.

Changes in the brewing sector

20. In 1989, the six national brewers controlled 75 percent of the production of beer with the balance being accounted for by 11 regional brewers and approximately 200 local and small brewers. The MMC believed that without government action against the national brewers it would be "inevitable that a very small number of brewers will increasingly dominate the supply of beer in the United Kingdom".¹⁹

21. Since the Beer Orders, the brewing industry has undergone structural and strategic changes. None of the pre-1990 national brewers remains intact and some company names,

¹⁵ According to our wider definition

¹⁶ The Publican Industry Report, *The Publican*, January 12 2004

¹⁷ *Ibid.*

¹⁸ Appendix 22, para 7

¹⁹ MMC, *The Supply of Beer*, Cm 651, 1989, para 1.33

such as Bass, disappeared as brewers restructured, merged and grew their market shares in response to the new industry structure.²⁰

22. Contrary to the aims of the Beer Orders, concentration in the brewing industry has increased, rather than fallen. Table 3 shows that at the end of 2003 the top six brewers, all international companies, commanded 84 percent of the on-trade market in terms of supply, the top four 76 percent.

23. Although concentration in the brewing sector has increased since the Beer Orders, the sector appears to be competitive, with the largest international brewer, Scottish Courage, controlling just over a quarter of the market in terms of the supply of beer to the on-licensed trade.

The revocation of the Beer Orders

24. In 2000, the OFT investigated the beer industry again to see if the Beer Orders should be retained. The report by the former Director General of Fair Trading, Mr John Bridgeman, recommended that the majority of Articles in the Beer Orders be removed as none of the brewers covered by the Orders still owned estates of anywhere near 2,000 on-licensed premises.²¹ The Beer Orders were finally revoked in 2003,²² with the Government stating “there is nobody to whom the orders are currently relevant [...] it is a pointless regulation, which will be removed by the order because it does not apply to anything”.²³

²⁰ Appendix 23, para 66

²¹ OFT, *The Supply of Beer*, December 2000

²² *The Supply of Beer (Tied Estate)(Revocation) Order 2002*, SI 2002/3204 and *The Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices)(Revocation) Order 2003*, SI 2003/52

²³ Stg Co Deb, Fourth Standing Committee on Delegated Legislation, 11 December 2002, col 5 10-11

3 EU investigations

25. Competition within the European Single Market is regulated mainly under Article 81 and 82 of the EC Treaty. There have been several instances where the European Commission and the European Courts have considered the arrangements for the supply of beer between national brewers and pubcos, on the one hand, and their respective tied tenants, on the other, under Article 81 (formerly Article 85) of the EC Treaty.²⁴ The judgment of the European Court of Justice in *Stergios Dilimitis v Henninger Bräu*²⁵ provided a benchmark two-fold test for the courts with regard to the application of Article 81 to the beer tie. Only if both conditions are fulfilled cumulatively does such an agreement fall foul of Article 81. If not, EU competition law is considered irrelevant to the agreement in question.

26. The first condition is that of ‘national market foreclosure’, which is measured by the Courts against a series of indicators relating to the economic and legal context in which the agreement must be assessed. These indicators are:

- the existence of a bundle of similar tying agreements of at least several national brewers (more specifically the number of outlets thus tied to national brewers in relation to the number of public houses not so tied, the duration of the commitments entered into, the quantities of beer to which those commitments relate, and the proportion between those quantities and the quantities sold by free distributors);
- factors relating to opportunities for access (the possibility to acquire an existing brewery together with its network of retail outlets, the possibility to open new public houses, the minimum number of houses required to have a viable economic operation, and the presence of independent wholesalers); and
- the conditions under which competitive forces operate on the market (the degree of saturation of the market, customer fidelity to existing brands, and the trends in beer sales in the off-trade).

27. The second condition is that the agreement in question must make a ‘significant contribution’ to the sealing-off effect brought about by the totality of those agreements in their economic and legal context. The Court gave the following criteria: the market position of the brewery in question (market share of the brewing group, number of outlets tied to it in relation to the total number of premises), and the duration of the agreement.

28. Although some old lease agreements have been found by the European Commission and Courts to breach Article 81,²⁶ there have been no instances where the current arrangements underwriting pubcos’ agreements have been found to be anti-competitive.²⁷

²⁴ For example see European Court of First Instance, Case T-25/99 *Roberts v Commission*, 5 July 2001 (OJ (C) 2001 317/24) and European Court of First Instance, Case T-231/99 *Joyson v Commission*, 21 March 2002 (European Court Reports, 2002, II-2085)

²⁵ European Court of Justice, Case C-234/89, *Delimitis v Henninger Bräu AG*, 28 February 1991 (European Court Reports 1991 I-0935)

²⁶ For example see European Commission Decision 99/230/EC, Case IV/35.079/F3, *Whitbread* (OJEC (L) 1999 88/26)

²⁷ For example see European Court of First Instance, Case T-231/99 *Joyson v Commission*, 21 March 2002 (European Court Reports, 2002, II-2085)

Indeed, many multiple public house owners applied for exemption for their agreements. These so called 'block exemptions' were granted in all cases.²⁸

²⁸ For example see European Commission Decision 1999/474/EC, Case IV/35.992/F3, *Scottish & Newcastle*, 16 June 1999 (OJEC (L) 1999 186/28)

4 The complaint from the Federation of Small Businesses

29. Worried about the impact the level of concentration in public house ownership was having on some of its members, the Federation of Small Businesses (FSB) asked the OFT to investigate the market for the resale of beer through tied public houses in 2002. The concerns the FSB expressed were: tied tenants paid too much for their beer; they paid too much rent and did not receive adequate support from their pubcos, especially when levels of trade fell below expectations; and the beer tie itself restricted choice. In relation to the last point, the FSB said “the exclusive purchasing obligations imposed on tied tenants were anti-competitive”.²⁹ More formally, the FSB asked whether the two prohibitions of the *Competition Act 1998* had been breached through pubcos making anti-competitive agreements with their tenants (the Chapter I prohibition)³⁰ or by their abuse of a dominant, or jointly dominant position (the Chapter II prohibition).³¹ They also asked whether there were grounds for referring the pubcos to the Competition Commission under the monopoly provisions of the *Fair Trading Act 1973* (which was shortly to be replaced by the market reference provisions of the *Enterprise Act 2002*).³²

30. The OFT declined to conduct such an inquiry. They explained to us that they considered the beer tie did not constitute an infringement of EU competition law and so were unwilling to investigate these claims further. They found no grounds for withdrawing the benefit of the exclusion from the Chapter I prohibition as, they argued, agreements made between tenants and their pubcos concerned the transfer of land rights—the public house. As such, they took the view that the *Competition Act (Land and Vertical Agreements Exclusion) Order 2000* would apply as it excluded from consideration agreements between businesses which were not vertically integrated. Even if the Order did not apply in this case, the OFT maintained the Chapter I prohibition would still not be applicable to such agreements as pubcos bought drinks from a number of sources rather than predominantly one source, or were too small to contribute significantly to the foreclosure of public houses to competitors.³³

31. When analysing the possible application of Chapter II, the OFT suggested they had significant doubts that public houses constituted a discrete market: in their view the relevant market would include all on-trade premises, including clubs and restaurants. Given this market definition, the OFT considered it unlikely that an individual firm, or group of firms, would be considered to be dominant as “no one pub company, and not even a group of the larger ones, has anything approaching a 40% market share”.³⁴ They were unwilling to refer such cases to the Competition Commission as in their judgement

²⁹ Appendix 22, para 2

³⁰ Chapter I prohibition in the CA1998 applies to agreements between undertakings that have the object or effect of preventing, restricting or distorting competition in the UK and is equivalent to Article 81 of the EC Treaty.

³¹ Chapter II of the CA1998 prohibits conduct by one or more undertakings which amount to an abuse of a dominant position if it affects trade in the UK.

³² Appendix 22, para 16

³³ *Ibid.*, paras 21-22

³⁴ *Ibid.*, paras 18-19

competition appeared to be working well in the on-trade and was not being prevented, restricted or distorted by the pubcos.

5 The impact of pubcos on the sale and distribution of beer

The retail market for beer

32. Defining the final market for the consumption of beer—the premises it is consumed in, who owns them and who the retailers are—is one of the main areas of contention between tenants and competition authorities.³⁵ These are important definitions which are used by competition authorities to determine concentration levels in any particular market and which are the first step in determining whether any one company, or group of companies, holds a ‘dominant position’.

33. The final market for the consumption of beer, the retail market, comprises sales of: packaged products for subsequent consumption off the premises where they are sold (off-licence sales), for example supermarkets and off-licences; and sales of both draught and packaged products for consumption at the point of sale (on-licensed sales)—for example, public houses, hotels and restaurants. Currently, the retail sale of beer and other alcoholic drinks for consumption on the premises requires a licence³⁶ which is granted personally to its holder and not the premises. Three distinct classes of on-licences are currently in operation:

- **full on-licences:** cover premises where a person can buy an alcoholic drink, without being a resident or having a meal. These may include public houses, hotels and wine bars. (There are approximately 88,000 full on-licences in issue);
- **restricted on-licences:** cover premises where it is a condition of buying an alcoholic drink that the customer is either a resident or having a meal. These may include hotels and restaurants. (There are approximately 30,000 restricted on-licences in issue); and
- **clubs on-licences:** covers commercial or non-profit making enterprises of which a person has to be a member before buying a drink. (There are approximately 29,000 clubs on-licences in issue.)³⁷

34. There is no simple relationship between the type of on-licensed premises and the type of on-licence. For example, some restaurants hold a full on-licence so they can operate ‘public house-type bars’, while others hold restricted on-licences so drinks alone may not be served. Some clubs serve a very limited membership or are open only at very limited times and many hotels and restaurants with restricted on-licences serve a different market from public houses.³⁸

35. The reference market used by the European Commission is based on the judgment of the Court of Justice, which stated in the benchmark *Delimitis* case: “the relevant market is

³⁵ For example see Q 3 (Mr Bishop) and MMC, *The Supply of Beer*, Cm 651, 1989, para 2.128

³⁶ Currently licences are obtained from the local courts. From February 2005, under the *Licensing Act 2003*, licences will be obtained from the Local Authority.

³⁷ European Commission Decision 2000/484/EC, Case IV/36.492/F3, *Inntrepreneur* (OJEC (L) 2000 195/49 para 19)

³⁸ MMC, *The Supply of Beer*, Cm 651, 1989, para 2.128

primarily defined on the basis of the nature of the economic activity in question, in this case the sale of beer. From the consumer's point of view, the on-trade, comprising in particular public houses and restaurants, may be distinguished from the off-trade sector on the grounds that the sale of beer in public houses does not solely consist of the purchase of a product but is also linked with the provision of services. It follows that in the present case the reference market is that for the distribution of beer in premises for the sale and consumption of drinks".³⁹ That is, the whole on-licensed trade as defined above, some 147,000 outlets.

36. Since the time of the Beer Orders the OFT have applied a stricter market definition in tandem with that used by the European Commission. When analysing the market, they define it "both in terms of full on-licences and in terms of all on-licences".⁴⁰ In evidence, Mr Bishop of the FSB⁴¹ told us he believed "the pub sector represents a distinct market and a separate market in itself".⁴² The OFT have disagreed: "given the degree of competition in on-trade retailing, we have not needed to carry out any in-depth analysis of market definition in this area but it is clear that there are at least significant doubts about whether pubs are in a discrete market".⁴³

37. There is clearly an overlap between public houses and other outlets whose main purpose is to sell alcoholic (and non-alcoholic) drinks for consumption on the premises. However, seen from the viewpoint of the consumer, there is a difference between going out for a drink at a public house and going out for a meal at premises where alcohol may be consumed. We would therefore suggest, on a common sense basis, that if public houses are not a discrete market, all on-licensed premises are not a coherent market either. It is clear there is no simple division: a number of self-styled public houses are now in reality restaurants with adjacent bars. However, an adequate proxy for a true definition of the market may be full on-licences plus clubs on-licences. This situation will be further complicated when the *Licensing Act 2003* comes into force.

38. We disagree with the definition of the public house market which the OFT has adopted in the past. We recognise that the licensing regulations are due to change. However, we do not believe that these changes will alter the shape of the market itself. Nor are we certain about the speed with which the new licensing regulations will be implemented by the licensing authorities. It seems to us that there is time for the OFT to reconsider its previous definition so as to more accurately define the market in question and to establish mechanisms for monitoring it.

39. Without clear direction from the competition authorities, we decided we would look at competition in the market for beer using the three definitions of the relevant market, as proposed by the EU, the OFT and the FSB. The OFT told us that under these definitions of the market: "between them, the top ten pub-owning companies (including Punch,

³⁹ European Court of Justice, Case C-234/89, *Delimitis v Henninger Bräu AG*, 28 February 1991 (European Court Reports 1991 I-0935 para 16)

⁴⁰ MMC, *The Supply of Beer*, Cm 651, 1989, para 2.128

⁴¹ Mr Bishop is Deputy Head of Parliamentary Affairs at the FSB

⁴² Q 2

⁴³ Appendix 22, para 6

Enterprise and three brewers) own about 22,000 tied tenanted pubs. This accounts for about 37% of the UK's pubs but only 25% of all full on-licences and 15% of all on-licences".⁴⁴

40. The blurring of the retail market boundaries made it very difficult for an accurate analysis of the number of public houses in the UK to be made. We were provided with several estimates, the majority of which put the figure in the region of 60,000.⁴⁵ Using our extended definition of pubcos and this estimate of the number of public houses, the top ten pubcos own just under 50 percent of UK public houses, 33 percent of all full on-licences and 20 percent of all on-licences.

41. Ms Kent⁴⁶ of the OFT told us the general benchmark they used to determine if a company or group holds a dominant position is 40 percent of market share.⁴⁷ However, the holding of a dominant position itself is not unlawful. Only if there was evidence of abuse, such as collusion against tenants or price fixing amongst the pubcos, would dominance become anti-competitive.⁴⁸ When asked if they had received evidence of the abuse of a dominant position in the market for beer, Mr Vickers, the Chairman of the OFT, told us: "we have not had evidence of that kind and we are not near the thresholds—I will avoid the word "trigger"—where the provisions on abuse of dominance come into play".⁴⁹

Wholesale supply

42. Because of national brewers' public house ownership and loan ties with independent free house operators, the MMC Report suggested that national brewers directly controlled the wholesale supply to almost 70 percent of public houses in the UK (other brewers controlled supply to 20 percent while independent wholesalers supplied the remaining 12 percent). They concluded this inevitably fed through into higher retail prices for the consumer.⁵⁰

43. The international brewers continue to supply free house operators and have supply agreements with many of the pubcos but no longer act as pure wholesalers to pubcos' tenants. This position has been taken over by the pubcos themselves. Free house operators are left with the compromise of receiving a limited range of products from one of the international brewers, being supplied by more than one brewer, or getting a range of beer brands from an independent wholesaler at inferior prices.⁵¹

44. Pubcos either have their own wholesaling and distribution operations or are supplied directly by brewers. While some of the brewers' brand supply agreements oblige pubcos to meet certain distribution or volume commitments, these are not imposed onto pubcos'

⁴⁴ *Ibid.* para 7

⁴⁵ For example, see Appendix 5, para 3.4 where the total number of public houses is given as 58,150, while the Industry Report, *Publican Newspaper*, 12 January 2004, puts the figure at 59,663

⁴⁶ Ms Kent is Director of the Competition Enforcement Division at the OFT

⁴⁷ Q 609

⁴⁸ Q 607 (Mr Vickers)

⁴⁹ Q 658

⁵⁰ MMC, *The Supply of Beer*, Cm 651, 1989, para 1.19

⁵¹ Appendix 23, para 204

tenants. Pubcos base the wholesale price of beer sold to their tenants on the brewers' own standard wholesale selling price for each product. These prices are used throughout the industry, including brewers' own sales to independent free house operators.⁵²

45. The pubcos argued that through the multiple supply contracts they had with brewers, they offered tenants a greater choice of beers than was available to them before the Beer Orders. For example, Punch told us when they first acquired public houses from the Bass Lease Company, 87 percent of the beer sold in those public houses was brewed by one supplier—Bass. Today, Punch purchases beer brands from 46 different suppliers and the largest single brewery supplier to their estate (Coors) produced just 34 percent of the beer sold in their estate.⁵³

46. Although pubcos control the wholesale supply to their own estates, no one pubco holds a dominant position in the wholesale market for beer. The largest pubco, Enterprise Inns, controls wholesale supply to just under 15 percent of public houses, 10 percent of full on-licences and six percent of all on-licences. Other wholesalers, mainly the international brewers, supply free house operators who account for just under 30 percent of the market.

Small brewers

47. One area of concern highlighted by our witnesses was the availability to tenants and consumers of locally brewed beers.⁵⁴ Tenants, small brewers and consumer organisations told us the beer-tie and pubcos' centralised distribution systems appeared to be stopping some small brewers from supplying public houses in their area.⁵⁵

Barriers to entry

48. The Campaign for Real Ale (CAMRA) told us there were barriers to entry for small brewers trying to gain access to the market for beer. They suggested the big four international brewers maintained their dominance of the brewing market through discounting and distribution.⁵⁶ The Society of Independent Brewers (SIBA) believed this dominance was encouraged by the supply agreements brewers had with the larger pubcos and by pubcos' operating practices.⁵⁷

49. To get a clearer idea of how small brewers were treated by the pubcos, we asked SIBA what the criteria were for small brewers to get their product onto pubcos' wholesale price lists. Mr Stafford, the Commercial Director of SIBA, told us there were four main criteria which had to be fulfilled: the small brewer had to convince the pubco there was a demand for their product; the brewer had to show the orders placed by pubcos could be honoured; the price the pubco would pay for the product (usually determined by the pubco and not

⁵² Appendix 23, paras 201-204

⁵³ *Ibid.*, para 187

⁵⁴ The term 'small brewer' here distinguishes the 450 local and micro brewers from the regional, national and international brewers and comprises brewers producing up to 30,000 hectolitres per annum. (Source: Appendix 26, para 3.1.2)

⁵⁵ For example Appendix 12, para 7.5; Appendix 26, para 3.2.2.1; and Appendix 5, para 3.2

⁵⁶ Appendix 5, para 3.2

⁵⁷ Appendix 26, para 3.2.2.1

by the brewer); and the logistics—could the small brewer comply with the distribution demands of the pubco.⁵⁸

Demand and supply

50. Independent research commissioned by CAMRA suggested there is consumer demand for locally produced beers amongst the adult public house visiting population. It found 55 percent of respondents agreed with the statement “at least one beer sold in every pub should be locally brewed”.⁵⁹ SIBA told us in recent membership surveys they found more than 70 percent of small brewers were not able to count tenants of the large pubcos (1,000 public houses and above) among their customers. However, 90 percent of small brewers would be prepared to deliver directly to pubco-controlled public houses if given the chance.⁶⁰

Listing fees

51. SIBA told us pubcos demanded fees for listing them on pubcos’ wholesale price lists. These were not ‘listing’ fees in the normal meaning of the term but marketing fees to advertise the small brewers’ brands which would be put into the marketplace. These could be a serious financial commitment for the small brewer which was paying these fees without any guarantee of the volume of its product it would sell. The expense could be prohibitive, with the result that small brewers could not compete with the national, or even regional, brewers. Small brewers would rather deal directly with local tenants “so when it comes down to marketing they have got the ability and the resources to pop down to their local pubs and go and talk to the licensees and do their marketing that way and also stand in front of the consumer and talk to them”.⁶¹

Prices

52. It was suggested to us that small brewers found it difficult to gain wholesale price ‘listings’ for their products from pubcos because small brewers’ price differential,⁶² or discount, was considered too low by pubcos.⁶³ One small brewer told us when they tendered their product to a particular pubco, the pubco “had no interest in the price we would actually sell our beer to them for, or even what the price to the tenant would be. What they were interested in and were very interested in was DISCOUNT”.⁶⁴ Their tender was rejected due to the low discounts they were quoting. The small brewer re-tendered the following year quoting a higher wholesale price: “our solution was simple for the following

⁵⁸ Q 563

⁵⁹ Appendix 5, para 5.5

⁶⁰ Appendix 26, para 3.1.2

⁶¹ Qq 564-565 (Mr Stafford)

⁶² Between the brewers selling price pubcos are willing to pay and the wholesale selling price they expect to charge their tenants.

⁶³ For example Appendix 12, para 7.5

⁶⁴ Appendix 6

year—up went our list prices and up went our discount, the price we quoted was exactly the same but the pubcos’ slice goes up”.⁶⁵

53. Marketing fees act as a deterrent to the extension of consumer choice and will usually be reflected in higher prices to the consumer. If pubcos are serious about extending consumer choice to include the products of small brewers they should reconsider their policy on marketing fees.

54. Small brewers are unable to offer the same level of discounts as national brewers as they do not have the size of operation required to benefit from the same economies of scale. Pubcos’ requests for higher wholesale prices and bigger discounts mean the small brewer which cannot offer these is “effectively priced out of competing for business, and denied market access” to pubcos’ estates.⁶⁶ This in turn denies pubcos’ tenants beers from small brewers even if their customers demand it.

Guest beer rights

55. Tenants, consumers, small brewers and their representatives suggested the perceived problems for small brewers could be mitigated by reintroducing the ‘guest beer provision’ of the Beer Orders.⁶⁷ The Beer Orders allowed for premises, which remained tied to the six national brewers to sell a brand of draught cask-conditioned beer and a brand of bottle-conditioned beer from another supplier. The Director General of Fair Trading (DGFT) found in 2000 that only 1,700 of the national brewers’ remaining public houses had guest beer rights. Whitbread’s sale of its tenanted public house estate in 2001 meant virtually no national brewers’ tenants still had guest beer rights. In light of this, the Government took the decision that the guest beer provision should be revoked with the rest of the Beer Orders in 2003.⁶⁸

56. We asked our witnesses what they thought about reintroducing a guest beer provision. Mr Thorley, Chief Executive of Punch, told us Punch still had around 500 public houses which retained a guest beer right in their agreements as a legacy of their former ownership by a brewer. However, in a survey of these tenants they found “only 17 percent take advantage of that guest beer right [...] and 68 percent buy brands which we sell already from the brewer even though it is already on our price list”.⁶⁹

57. This showed one of the most curious effects of the guest beer provision: although it was included in the Beer Orders to aid small brewers it did not restrict national brewers, who were the tied suppliers to a public house, from selling beer independently and separately to that public house. This was due to the Beer Orders specifying a tied tenant could purchase from “whomsoever he may choose at least one brand of draught cask-conditioned beer

⁶⁵ *Ibid.*

⁶⁶ Appendix 5, para 3.2

⁶⁷ For example see Appendix 12, para 9.4; Appendix 23, para 473; and Appendix 5, para 10.1

⁶⁸ Appendix 7, page 2

⁶⁹ Q 558

selected by him”.⁷⁰ This did not specifically preclude tenants from purchasing their guest beer from their brewer-landlord or another national brewer.

58. Mr Bott, Chairman of the Council for SIBA, told us that this ‘loophole’ meant small brewers were no better off because of the Beer Orders: tenants simply substituted their tied national brewers’ brands for another national brand “an awful lot of those licensees realised that instead of buying their John Smith’s from the owning brewery they could buy Tetley’s at the same sort of price that the brewery was producing John Smith’s. We were left out of that loop. We did not gain the opportunities to sell beer that we thought we would”.⁷¹

59. We asked the DTI about the possibility of the Government reintroducing the guest beer provision. They told us that as the adverse competition effects identified in the MMC report no longer existed, it would not be legally possible simply to re-instate the original guest beer provision. Nor would it be possible to extend it to pubcos as the Beer Orders were specifically directed at the six named national brewers. Further, introducing new legislation requiring the pubcos to offer tenants the choice of a guest beer could run counter to general EU competition policy by “effectively creating a market distortion. Regulatory intervention does not appear necessary, given that the market power of the large brewers is now more balanced with the purchasing power exerted by pubcos”.⁷²

60. The DTI continued, “there is nothing to stop potential tenants, whether of pubcos or brewers’ premises, seeking in their detailed contract negotiations to secure rights to offer guest beers or rights to directly source some or all of their beer supplies, although this is likely to influence other terms of the deal. Likewise it is open for a pubco to adopt a policy of allowing their tenants to offer guest beers, possibly as a means of attracting suitable tenants; however these are essentially matters for commercial negotiation”.⁷³

61. We concur in the DTI’s conclusion: a statutory requirement on pubcos to allow all tied tenants the option of offering a guest beer of a particular type, for example cask ales and regional or national specialities, would run contrary to EU competition law and could lead to the UK Government being challenged in the European Courts. However, the ability of public houses to offer a broader range of products, for example to satisfy demand for local products, is important in the interests of extending consumer choice. In the absence of the legislative option we recommend that pubcos allow their tenants more flexibility in their choice of the products they sell. The early adoption of such practices should afford more opportunity for small brewers to participate in the market.

Distribution problems

62. The large pubcos told us small brewers had been able to access their distribution infrastructure, which operated nationally whereas their own infrastructures were only regional or local in scope.⁷⁴ However, SIBA argued that because pubcos outsourced

⁷⁰ *The Supply of Beer (Tied Estate) Order 1989*, SI 1989/2390, article 7, subsection (2)(a)(i)

⁷¹ Q 601

⁷² Appendix 7, page 2

⁷³ Appendix 7, page 4

⁷⁴ Appendix 23, para 193

distribution to the international brewers' distribution arms, small brewers were in practice required to ship their goods to the national brewers' regional warehouses, sometimes up to 200 miles from their brewery. Small brewers often found this both impractical and prohibitively expensive.⁷⁵ Beer was then transported back through the national brewers' distribution networks to local public houses, which could be "only five miles down the road from the originating brewery".⁷⁶

63. Punch told us that for the small brewer who was unwilling or unable to get their product into Punch's distribution depots, they had an alternative arrangement with Beer Seller, a cask beer specialist, to assist in delivering small brewers' brands.⁷⁷ Enterprise, through their Unique estate, had adopted SIBA's 'Direct Delivery Scheme' (DDS), where SIBA members delivered local beers direct to local public houses owned by Enterprise.⁷⁸ Both pubcos also ran specialist cask ale programmes, with Enterprise purchasing up to 264 cask ale brands from 150 brewers.⁷⁹

64. With the DDS, the Chairman of the Council of SIBA told us that they act as a 'middle person' between the small brewer and the pubcos, accepting orders on behalf of the pubcos electronically and pushing them out to the small brewers in question. The brewers delivered these particular orders direct to the public houses, which they recorded. SIBA paid the brewers and was reimbursed by the pubcos. The scheme had been well received by pubcos' tenants: "it has proven to be a fantastic success and over 95 percent of the licensees interviewed by our telephone surveys are extremely delighted with the new Direct Delivery Scheme".⁸⁰

65. The Society of Independent Breweries' offers tenants the opportunity to have a permanent choice of SIBA members' beers delivered directly by the small brewer, rather than relying on pubcos guest ale programmes. This gives small brewers the potential of trading locally while retaining the economies of central sourcing and administration of the pubcos. SIBA told us the scheme had so far been embraced by three pubcos but had yet to find broader support, despite their ability to demonstrate sales levels over and above established guest ale programmes.⁸¹

66. At a national level there are opportunities for small brewers to supply the on-licensed trade, with around 17,000 free public houses available for them to supply. Pubcos' centralised distribution facilities enable small brewers who are 'willing and able' to deliver to regional depots to have access to a far wider geographical market than ever before. However, we are concerned that alternative beer distribution arrangements for those small brewers which are not 'willing' or 'able' are dwindling, with the recent acquisition of Beer Seller by one of the big three centralised logistics companies, Scottish Courage. For those small brewers for whom barriers to market entry still exist,

⁷⁵ Appendix 26, para 3.2.1.7

⁷⁶ Q 568 (Mr Bott)

⁷⁷ Appendix 23, para 188

⁷⁸ Appendix 8, para 1.3 (ii)

⁷⁹ *Ibid.*, para 1.3 (i)

⁸⁰ Q 570 (Mr Stafford)

⁸¹ Appendix 26, para 3.2.1.10

Society of Independent Brewers' 'Direct Delivery Scheme' suggests one possible way forward, especially if operated on a regional basis.

Distribution

67. Originally public houses were sold to pubcos under a structure whereby the national brewers retained credit control, ordering and distribution. Pubcos told us they had become increasingly concerned with the ability of these brewers to unduly influence the choice of their tenants, through the order and delivery process, towards brewers' own brands. Larger pubcos had created their own infrastructure to handle ordering and credit management processes but the distribution of beer remained in the control of three international brewers.⁸²

68. Because the majority of beer delivered to public houses is draught, specialist distribution has to be used. This distribution is almost exclusively owned by the national brewers: Carlsberg UK, Scottish & Newcastle (branded as Scottish Courage) and TradeTeam, a partnership between Exel and Coors. Punch told us that to sever the link between brand supply and distribution they had contracted out their distribution business. In 2002, following tendering procedures, Carlsberg UK was appointed as sole service provider for retail distribution to Punch tenants. Under their contracts, Carlsberg stocked and distributed products required by Punch's tenants, whether or not they were brands from rival brewers. This was a service Carlsberg did not offer its other customers.⁸³

69. We are concerned that the national brewers retain a stranglehold on the distribution for beer. This is due not so much to the *supply* contracts the national brewers have with the pubcos but the *distribution* contracts pubcos have with national brewers' distribution arms. A barrier to entry such as this could be avoided if the link between brand supply and distribution were severed.

70. The distribution market for beer has been investigated by the OFT in the context of the takeover of the assets of Interbrew UK's distribution business by TradeTeam in 2002, which was not referred to the Competition Commission. However, since then alternative wholesaling and distribution arrangements have further dwindled with the recent acquisition of the largest independent beer wholesaler, the Beer Seller, by Scottish Courage.⁸⁴

71. In the distribution market for beer there is the strong possibility of anti-competitive consequences. We would hope that the OFT's latest consideration of market concentration in this area will not be their last. The distribution market should be kept under close and regular scrutiny.

⁸² Appendix 23, para 225

⁸³ *Ibid.* paras 226-227

⁸⁴ The Beer Seller, previously positioned as a cask beer specialist, has been integrated within Scottish Courage's existing wholesaling operation, Waverley, to create Waverley TBS. Source: Appendix 26, para 3.2.1.9

6 The contractual relationship between tenant and pubco

Tenants

72. Prospective licensees have three models to choose from: to become the licensee of a managed public house, to purchase a freehold public house (free house operator) or to become the tenant of a pubco's public house.

73. Choosing to become the retail operator of one of the 12,000 managed public houses gives an individual limited operational freedom as the landlord sets the retail price for beer sold on the premises. The manager has no say in the brands of drink stocked and limited input into the additional amenities offered to customers. Operators who purchase the freehold of one of the 17,000 freehold public houses have complete operational freedom. They decide how to run their business without the support or intervention of a landlord. This includes the choice of amenities on offer, the mix of brands they stock, from whom they source their products, and the retail price they charge their customers.

74. Becoming the operator of one of the pubcos' and regional brewers' 30,000 tenanted public houses gives an individual freedom to operate their business as they see fit, within the terms of their agreement. In most cases they have a choice of the amenities they provide and set the retail price charged to customers. They also select the brands they stock but, due to the exclusive purchasing obligations of their agreement, these have to be sourced from their pubco's wholesale price list, which contains a limited number of brands. There are a wide variety of tenanted public houses available for prospective licensees to choose from. These range from 'high street bars' to 'country pubs' and from food led 'gastro pubs' to more traditional drinking establishments.⁸⁵

Tenant pipeline

75. The demand for public house tenancies seems strong. There are large numbers of applicants for each of the large pubcos' available public houses. A Deutsche Bank report found Enterprise, Punch and Greene King had 900, 1,400 and 700 applicants respectively for the available 17 percent, 31 percent and 61 percent of their respective estates. The ratio of demand for tenanted public houses to those available for lease was three to one in the case of Enterprise, two to one in the case of Punch and almost two to one in the case of Greene King.⁸⁶

Low costs of entry

76. The ALMR told us surveys had found the main reason tenants chose to lease pubcos' public houses was because they were unable to purchase the freehold of the public house, because either it was not available or it was too expensive to do so.⁸⁷ As the purchaser of a

⁸⁵ Appendix 23, Annex A

⁸⁶ Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 31

⁸⁷ Appendix 1, para 16

free house, the operator has to fund and service the full capital costs of their public house. They may finance their purchase through a bank loan but this is usually limited to a maximum of 70 percent of the property's value.⁸⁸ Pubcos told us that becoming one of their tenants provided a relatively low cost entry into running an on-licensed business, as the capital asset, the public house, was provided by them.⁸⁹

77. There are two ways to become the tenant of a public house tied to one of the pubcos. Incoming tenants can either take on new leases direct from a pubco or they can take over the remaining lease (short term tenancies are non-assignable) of an incumbent tenant on assignment. The proportion of pubcos' tenants entering public houses through each method varies from pubco to pubco. For one of the larger pubcos, around 47 percent of new tenants enter through new agreements while 53 percent choose the assignment method.⁹⁰

78. Ingoing tenants entering a new lease with a pubco only have to purchase the trade fixtures and fittings (tables, chairs and 'bric-a-brac'), provide a deposit for rent and stock ordering, and capital for stock and glassware. Ingoing tenants who enter through assignment also have to pay the outgoing tenant an assignment premium ('goodwill'). For free house operators this premium is included in the freehold value of the public house.

79. Our witnesses provided us with estimates which showed pubcos' tenants' ingoing costs were 10 to 14 percent of those of a free house operator.⁹¹ Pubcos told us the other costs of entry were similar but the economic cost of the property during the life of a lease would, for many tenants, also be cheaper as free house operators financed all repairs and maintenance themselves.⁹² For many tenants, this was the responsibility of their landlord. In addition, many tied tenants had access to cheap loans. By contrast, free house operators had to source working capital for themselves, often at a higher rate of interest than was available to pubcos' tenants.⁹³

Pubcos' agreements with their tenants

80. The relationship between pubco and tenant is formalised through an agreement known as the lease. Each pubco offers a choice of leases, varying by type in length and conditions. The main conditions of these agreements are the repair and maintenance obligations, the ability to 'sell on' the lease (assignment) and the degree to which tenants are obliged to purchase products from their pubco—the so called 'beer tie'.

81. The extent of the tie conditions in tenants' agreements determines the way in which their 'rent' is collected. Pubcos derive their income (total rental value) from public houses through three very different but related revenue streams. The wholesale profit (sometimes referred to as the 'wet rent') is the differential between the prices they pay their suppliers for tied products and the wholesale price for which they sell them on to tenants. Income

⁸⁸ Appendix 3, para 5.3

⁸⁹ Appendix 23, para 97

⁹⁰ Appendix 2, para 10 and Appendix 10, page 2

⁹¹ Appendix 23, para 94

⁹² *Ibid.* para 92

⁹³ Appendix 3, para 5.9

from amusement with prizes machines (AWPs) in some cases goes solely to the pubco or the tenant but generally is shared equally. The dry (commercial or property) rent charged is decided by the pubco at the beginning of a lease and is subject to review at regular intervals. Together, these three streams of income plus any additional benefits offered by a pubco should equal the 'rent' which would be paid by a free from tie tenant.⁹⁴

82. The income mix for each pubco differs. Enterprise estimated for a public house trading 240 barrels per annum and earning them £3,000 in AWP income, their mix was 49 percent dry rent, 43 percent wet rent and eight percent AWP income.⁹⁵ InnSpired's income mix was 55 percent wet rent, 40 percent dry rent and five percent AWP income.⁹⁶ The mix also differed from agreement to agreement. For the Enterprise example above, in cases where AWP income went exclusively to the tenant,⁹⁷ the mix changed to 57 percent dry rent and 43 percent wet rent.

Types of leases

83. There are two distinct models of tenant agreements, both refined in the 1990s: tenancies, developed historically by the national brewers and still favoured by many of the regional brewers; and the long lease developed initially by Innpreneur and adapted by today's pubcos.⁹⁸ Tenancies refer to short term internal repairing, non-assignable agreements, usually three years in length with the opportunity for the tenant to terminate the agreement at any time. This type of agreement is attractive to tenants who are risk averse and require greater levels of support from their pubco. Leases are longer term, typically 10 to 25 years, and are assignable with full repairing obligations. These agreements are more attractive to tenants (known as lessees) who see the proposition as an opportunity to develop a business and capitalise on any goodwill created.⁹⁹

84. To determine the prevalence of these arrangements, we asked the ALMR to survey its members from which we estimated the extent of the tenant/lessee split. Between them, respondents owned 23,000 public houses, or just over three-quarters of pubcos' tenanted estates. Of these, 45 percent operated on short term tenancy agreements, while the remaining 55 percent operated as lessees. Of the public houses covered by the survey, just under a fifth were owned by regional brewers. Their tenanted estates' agreements were mostly of the traditional short-term tenancy type (83%) as opposed to lessee agreements (17%). In comparison, non-brewery pubcos' agreements were mostly of the longer term lessee type (64%).¹⁰⁰

85. The complaints we received from tenants did not generally differ according to whether they had a tenancy or lessee agreement. We considered that the material differences between the two types of tenant did not warrant separate investigation of their

⁹⁴ Appendix 12, para 3.1

⁹⁵ Appendix 8, Annex 4

⁹⁶ Appendix 16, para 1.4

⁹⁷ Currently 46 percent of Enterprise's estate. Source: Appendix 10, para 27

⁹⁸ Appendix 1, para 13

⁹⁹ Appendix 23, para 84

¹⁰⁰ Appendix 2

relationships with their pubcos. Throughout our Report, tenants and lessees are referred to as ‘tenants’ except where we consider differences are substantial enough to justify distinguishing between them.

Repair obligations

86. Free house operators bear all the internal and external repair and maintenance costs for their public house. Tenants, with long lease agreements (lessees) generally have full repairing leases. They, too, are obliged to maintain and repair the structure and inside of the building, following an initial dilapidation report and agreement from their pubco to put right any existing defects. For most tenants with tenancy agreements, the pubcos retain the responsibility for the structure but responsibility for the internal repair and maintenance remains with the tenant.¹⁰¹

Buildings insurance

87. Tenants have to pay a monthly buildings insurance premium through their pubcos to ‘protect’ the public house. Full buildings insurance cover is supplied through the pubco in their name and then charged to their tenants who are listed as an interested party. The pubcos argue that the cost of this insurance is usually below the market rate as pubcos use their purchasing power to negotiate lower premiums for their whole estates.¹⁰²

88. Where problems are identified by tenants they are required to inform their pubco’s customer service department, or their nominated insurance provider, immediately, and these contact a contractor of their choice to carry out the repairs. The repair process is usually overseen by a surveyor who, in the case of the larger pubcos, is one of their employees. A schedule of works is agreed between all parties and will include an insurance company loss adjuster should a claim be made by the pubco, as policies provide cover for tenants should they see a reduction in turnover following a damage loss or while the public house is closed for repair.¹⁰³ Some pubcos’ agreements also contain clauses offering rent concessions during this period.¹⁰⁴

89. The external repair of a public house is often crucial to its trading success as passing trade may be discouraged by premises which do not appear to be well maintained. Tenants’ representatives told us: “getting the landlord to maintain the property can prove extremely difficult”.¹⁰⁵ Disputes frequently arise due to the failure to carry out the necessary works within the agreed timescale.¹⁰⁶ Maitland & Walker (M&W) suggested: “litigating these issues is an expensive and time-consuming business which is not in the interests of either the landlord or the tenant”.¹⁰⁷ A number of tenants, who asked for their names to be kept in confidence because they feared an adverse reaction by their pubco, complained about

¹⁰¹ Appendix 3, para 5.13

¹⁰² Appendix 23, Annex G

¹⁰³ *Ibid.*

¹⁰⁴ See Appendix 19, Section 6

¹⁰⁵ Appendix 17, para 4.16

¹⁰⁶ For example see Appendix 19 and Appendix 15, para 8

¹⁰⁷ Appendix 23, para 465

the difficulty in getting their pubco to carry out necessary repairs and the resultant damage to their business. One tenant, who was willing to be named, believed the unexpected delays in carrying out repairs and the attitude of their pubco was instrumental in her having to leave her public house business.¹⁰⁸

90. From the evidence we have received, it is clear that many tenants experience problems in enforcing their pubco's duty to maintain and repair their public house. This is unacceptable. Pubcos would improve their reputation as landlords if they ensured that tenants' agreements contained an inexpensive and efficient system of arbitration or alternative dispute resolution with fully independent arbitrators or experts to resolve such disputes without imposing legal costs on either side.

Assignment

91. Tenants complained it was their pubco that had benefited from tenants' investments in their business, as improvements they made increased the value of the freehold.¹⁰⁹ However, pubcos argued that lessees' agreements offered the opportunity for tenants to sell on (shorter tenancy agreement usually cannot be sold on) their lease to a third party after a qualifying period (usually two years). They could then realise the capital value of their goodwill and any improvements to the public house they had carried out. This sale process is known as assignment. Although tenants did not gain from the capital appreciation on the freehold, they often had an asset which was assignable and provided them with a return on their initial capital investment. Enterprise told us the average assignment premium paid to outgoing tenants was in the region of £65,000, including fixtures and fittings.¹¹⁰

92. Many of the large pubcos have assignment teams to support tenants with assistance and advice through the process of selling their business. They also provide access to their websites, where tenants can advertise their business and access pubcos' databases of applicants waiting to enter the industry.¹¹¹

93. A further issue is risk. In times of economic stability it is easy to forget that the value of an asset can fall as well as rise. Should the value of the public house fall, the whole of the value loss is experienced by the owner, be they pubco or free house operator, whereas the tenant is largely protected. The owner is also susceptible to the impact interest rate increases would have on any outstanding debt on their property.¹¹² In this respect, pubcos' tenants are no different from the tenants of houses, shops or other business premises: they have to balance the reduced cost to themselves of renting rather than purchasing premises against the fact they will not reap any appreciation in the capital value of the premises.

Exclusive purchasing obligations (the beer tie)

94. Historically, each brewer incorporated an exclusive purchasing obligation in their public house leases which required tenants to sell their brewer's products alone, the so-

¹⁰⁸ Appendix 19, Section 6

¹⁰⁹ For example see Appendix 21

¹¹⁰ Appendix 8, para 2.7

¹¹¹ Appendix 23, Annex G

¹¹² *Ibid.* para 96

called 'beer tie'. This restricted consumer choice and considerably limited operational freedom for their tenants. Pubcos now lease their properties to tenants through one of a number of different types of lease, which vary in conditions. The main condition is that tenants, who pre-Beer Orders were tied to purchasing beer products from their premises' brewer-owner, now have to purchase their beer products from their pubco. These are supplied at a price decided by the pubco and not the open market. Unlike the brewers post Beer Orders, many pubcos are also able to tie non-beer products such as cider and spirits.¹¹³

95. To ensure that their tenants do not purchase beer outside their tie, pubcos employ flow monitoring systems and regular 'surprise' searches by external agencies. Tenants have a legal obligation to allow such searches as pubcos, as landlords, enjoy the 'company's right of entry' into their premises. Because of the tie, competition for pubcos' tenants' business between the company's nominated supplier and other suppliers is precluded.¹¹⁴

96. Pubcos suggested to us that they continued to use the beer tie as it enabled them to negotiate supply contracts with a wide selection of beer and other drink suppliers. This provided their tenants, and consumers, with a greater choice than was available in the past. Only in this way would pubcos be able to offer their tenants "certainty of product range, price and distribution; to afford services and investment to benefit the retailer; and to agree rents based on an equitable division of the available retail profit".¹¹⁵

Lack of information for prospective tenants

97. **We received evidence which suggested prospective tenants were not being provided with the quantity or quality of information needed to make a rational decision on the merits of a lease proposal.**¹¹⁶ Morgan Stanley carried out a survey asking tenants to rate their pubcos' performance on various measures relating to the advice given or offered prior to signing their lease. They found a quarter of tenants rated their pubco as less than satisfactory for how well they explained their lease, with only seven percent rating them as excellent. A third of tenants rated their pubco as less than satisfactory for disclosing all relevant information. A similar proportion rated their public houses' profitability compared to initial expectations as less than they expected. 35 percent of tenants said they were not given enough time to check they were happy with their contract before signing their lease.¹¹⁷

The application process

98. The pubcos suggested to us that they provided the necessary information required by prospective tenants during their recruitment processes.¹¹⁸ Once approached by interested applicants, those who had access to the internet were initially directed to pubcos' websites.

¹¹³ Appendix 23, para 10

¹¹⁴ European Commission Decision 2000/484/EC, Case IV/36.492/F3, *Inntrepreneur* (OJEC (L) 2000 195/49 para 49)

¹¹⁵ Appendix 23, para 120

¹¹⁶ For example see Appendix 15, Appendix 19 and Q 62 (Ms Newport)

¹¹⁷ Appendix 20, Annex 2

¹¹⁸ Appendix 8, para 3.1 and Q 339

Prospective tenants who did not have internet access were provided with paper based information. This provided an analysis of the ‘pros and cons’ of running a public house, the available alternatives and the potential pitfalls. The information provided also took a prospective tenant through the process of applying for a public house, the costs, the legal work, and what actually happened over the first six months of being a pubco’s tenant. If, having read this, applicants wanted to proceed they submitted a formal written application to the pubco.¹¹⁹

99. Pubcos then go through a formal application process with a prospective tenant, involving: an initial screening telephone interview; a general interview with a business development manager (BDM); a credit check of the tenant; a second interview, focussed on a specific public house, involving a business plan analysing the performance of the property based upon the rent proposed¹²⁰ and an audit of the applicant’s key skills; then follow up interviews continue with business plans for a number of public houses and a variety of leases until a match is found.¹²¹ Punch described this process for both sides as “extremely rigorous and from those who progress from initial interest to actual application, we get an average 26% dropout rate, due to our rejecting them or their withdrawal once they fully understand the implications of running a pub”.¹²²

100. We asked our pubco witnesses what level of information they provided for prospective tenants once a particular public house and complementary lease agreement had been selected. Mr Tuppen, the Chief Executive of Enterprise, believed “the information available to licensees is complete. They [prospective tenants] know or have the ability to find out everything they could possibly need to know in order to run their business”.¹²³ Further, they provided historic barrelage information (volume sales of beer), full wholesale price lists, and the lease itself, which detailed the rent payable and the rent review process. The Chief Executive of Punch confirmed they, too, provided this information.¹²⁴

Assignment

101. Enterprise suggested some of their tenants might not have received all the information they needed, especially in cases where their tenants’ leases had been assigned. Tenants wishing to sell their public house business, through the assignment of their lease to a third party, are under no obligation to provide prospective tenants with information. The Chief Executive of Enterprise suspected “there will be a strong correlation between those who have come to you with complaints, those who have failed to prepare a detailed business plan and, indeed, those who took the lease on an assignment”.¹²⁵

102. Several witnesses suggested that in the purchase of any other business it is standard practice for the historic profit and loss accounts of a business to be made available to the

¹¹⁹ Appendix 23, para 132

¹²⁰ Assistance for prospective tenants in compiling their own business plans is usually provided on pubcos’ websites or in hard copy

¹²¹ Appendix 23, para 254

¹²² *Ibid.* para 135

¹²³ Q 339

¹²⁴ Q 538 (Mr Thorley)

¹²⁵ Q 327 (Mr Tuppen)

purchaser.¹²⁶ Unfortunately, the profit and loss account of each tenant is not known by pubcos as there has never been a requirement in their agreements to share such information. Tenants generally keep these details confidential from their pubco.¹²⁷

103. Large pubcos offer tenants the right to information should they choose to look for it. However, many prospective tenants are unaware this information exists. This appears to be particularly true of those who become tenants through taking leases from incumbent tenants on assignment.

104. Judging from Punch's and Enterprise's descriptions, their approach to the application process and the type of information supplied appears to be extremely thorough. It may well be that not all pubcos follow best practice. However, prospective tenants must take some responsibility themselves. Prospective tenants should make themselves aware of the information available to them from the pubco before committing to a lease. If there is information prospective tenants believe should be available but is not, they should ask the pubco for such information. If the information is not forthcoming, then prospective tenants should look to other companies.

105. We are aware that pubcos, as landlords, do not have the right to unreasonably withhold consent to assignment by tenants¹²⁸ and can only offer advice to these prospective tenants. Pubcos should insist that tenants assigning leases provide prospective tenants with the same level of information that their pubco would provide.

106. Prospective tenants entering the trade through lease assignment should not sign agreements until they are fully aware of an incumbent's annual profit and loss accounts for the business they are purchasing. They should also contact the pubco for information they believe is not forthcoming from their assignor.

Legal advice

107. All parties, including the pubcos, expressed concern that prospective tenants were failing to take the correct legal advice before committing themselves to lease agreements.¹²⁹ Morgan Stanley found 40 percent of prospective tenants took no legal advice before signing their contracts. Only 42 percent said they were encouraged by the pubco to do so and 63 percent were not asked by their pubco whether they had.¹³⁰ M&W told us that in their experience tenants who became involved in business failure or disputes with their landlord had not only failed to obtain proper legal advice when taking their lease but had also failed to obtain adequate accountancy advice. These tenants had also not obtained valuation advice or had not commissioned a survey report on the condition of the buildings, even when they took a full repairing lease.¹³¹

¹²⁶ For example see Appendix 17, para 5.10; and Appendix 23, para 451

¹²⁷ Appendix 23, para 104

¹²⁸ Under Section 19 of the *Landlord and Tenant Act 1927* as amended by Section 1 of the *Landlord and Tenant Act 1988*

¹²⁹ For example see Q 282 – 286 (BBPA) and Q 108 (A.B. Jacobs)

¹³⁰ Appendix 20, Annex 2, table 13

¹³¹ Appendix 23, para 449

108. We asked the pubcos what assurances they demanded from tenants that they had taken legal and other professional advice. The Chief Executive of Punch told us they “strongly request that they [prospective tenants] take legal advice”.¹³² The Chief Executive of Enterprise told us their prospective tenants were “subjected to a positive barrage of reminders to take independent advice. On no less than four occasions are they reminded of this in writing”.¹³³ These were: at the time of their application when they received Enterprise’s code of practice; the advice Enterprise gave prospective tenants to aid them in completing their business plans; at the time of offering a specific public house; and at the time of their agreement proposal.

109. Pubcos asserted that no matter how hard they attempted to get prospective tenants to take independent advice they did not always do so.¹³⁴ Mr Payne, the Chief Executive of the Federation of Licensed Victuallers (FLVA), confirmed this by telling us that tenants were advised by pubcos “to get advice, to get a solicitor, an accountant but a lot of them will run in and sign because they want the pub”.¹³⁵ The FLVA found when they asked pubcos for information they were always sent the information they required. To combat prospective tenants’ lack of prudence, the Chief Executive of Enterprise proposed to make the taking of independent advice by prospective tenants mandatory. In these cases, they intended to pay for, or at least contribute towards, the costs of advice.¹³⁶

110. Prospective tenants should seek independent professional advice before committing themselves to a lease agreement. This should not be limited to legal advice but should include advice from a suitable accountant with expertise in the licensed trade and a qualified surveyor with experience in valuation in this sector.

111. We believe that many of the disputes which arise between pubcos and their tenants would be eliminated if pubcos insisted as a condition of acceptance that tenants obtained all necessary professional advice. This should be one element of an industry-wide code of practice. We also strongly commend the example set by Enterprise in proposing to contribute to the cost of this. In the long run, ensuring that tenants know exactly what they are committing themselves to when they take on a lease will be to the benefit of the reputable pubco itself, as well as to its tenants.

¹³² Q 538 (Mr Thorley)

¹³³ Q 326 (Mr Tuppen)

¹³⁴ *Ibid.*

¹³⁵ Q 167

¹³⁶ Q 326

7 The cost of the tie to tenants

The wholesale price differential

112. Many tenants complained that the wholesale price they paid for tied products was excessive, which made them uncompetitive in their local marketplace.¹³⁷ However, pubcos told us their wholesale selling price was broadly similar to the standard national wholesale prices, before discount, published by the brewers and charged to free house operators.¹³⁸

113. National brewers' standard wholesale price lists provide information on the price at which beer is normally sold at the wholesale level. They do not indicate the actual price at which it is bought and sold on, due to brewers' practice of discounting.¹³⁹ Because pubcos consider as commercially confidential the detail of their contracts with brewers, such as the actual price they pay for products, there is a lack of transparency surrounding the nature of product discounts obtained by pubcos and the degree to which they are passed onto their tenants. Tenants find it difficult to ascertain with any accuracy the 'real' wholesale price pubcos paid for their beer, much less to compare wholesale prices between different agreements and thereby work out the 'value equation' which balances the rent, wholesale prices (wet rent) and any further 'countervailing benefits'.¹⁴⁰

Free house discounts

114. For a free house operator, the wholesale price paid is the price according to brewers' standard wholesale published price lists, less any discounts. Mr A. B. Jacobs suggested as a guide that these discounts ranged from £40 to £140 a barrel for a single public house,¹⁴¹ while Maitland & Walker (M&W) estimated the discount to be in the region of £80 to £90 a barrel.¹⁴² Higher discounts were available according to volume purchased, the distance from an 'average' distribution area or membership of a purchasing group.

115. Pubcos' tenants generally paid the brewers' standard wholesale price with no discount. The FSB told us that tenants forwent some £70 per barrel of beer by having to purchase beer from their pubco as opposed to buying on the free market and they had known of instances where this disadvantage had risen to £100 per barrel.¹⁴³ The FSB reported it had received a large amount of correspondence from its members stating that this wholesale price differential was in the region of 35p to 45p per pint.¹⁴⁴ Alan Dunton, Managing Director of EasyBars Ltd, gave the FSB an example of the differential on a pint of Carlsberg supplied through his pubco (Punch) and to an adjacent free from tie competitor, supplied directly by a brewer/wholesaler (Carlsberg-Tetley, now Carlsberg UK). The Carlsberg lager

¹³⁷ For example see Appendix 25, page 4; Appendix 27, page 3; and Appendix 15, para 9

¹³⁸ Appendix 8, para 2.2 (iii)

¹³⁹ Appendix 1, para 26

¹⁴⁰ *Ibid.*, para 27

¹⁴¹ Appendix 17, para 2.2

¹⁴² Appendix 23, para 420

¹⁴³ Appendix 12, para 5.1

¹⁴⁴ Appendix 13

supplied by Punch to his public house cost him 81p a pint, while his competitor was charged 42p, a differential of just over 39p a pint or £110 a barrel.¹⁴⁵

116. Mr Dunton gave similar evidence to us based on the price he paid for Tetley beer in three public houses he operated. In two public houses he operated, tied to Punch under an Allied Domecq and Punch Growth Lease, he paid £279 and £233 a barrel (including a £45 a barrel discount) respectively. In the free from tie public house he had been quoted £164 a barrel, a ‘full’ discount of £115.¹⁴⁶ Other tenants provided further evidence, based on brewers’ and pubcos’ wholesale price lists that showed the prices they paid to their pubcos were, on average, 30 percent higher than the free market price.¹⁴⁷ To put this loss of ‘discount’ into perspective, a tied tenant with an average throughput of 210 barrels per annum, with no discount, would be paying in excess of £10,000 per annum more than a free of tie tenant.¹⁴⁸

117. Pubcos said the wholesale price they charged was “comparable with the free market price, if not a little lower than that available in the free trade if considered on an equivalent basis”.¹⁴⁹ They argued that for a direct comparison to be made it was important to take into account that should a free house operator wish to stock all the top selling brands he/she would need to source products from at least eight different brewer/wholesalers. National brewers were generally not prepared to offer competitive terms on a competitor’s products. A free house operator would be left with the choice of buying products through an independent wholesaler at a lower retail margin or purchasing a less attractive range of products from a single brewer. Pubcos argued that they offered their tenants all the top brands in a ‘one-stop shop’ at certain pricing.¹⁵⁰

Pubcos’ scale discounts

118. Centralised beer purchasing with high minimum order values allows pubcos to negotiate higher discounts from brewers than are available to free house operators. This discount is not necessarily passed onto their tenants; instead it increases their wholesale margin at the expense of the brewers.¹⁵¹ Tenants and their representatives complained the wholesale margin which pubcos made on beer did not reflect their input into the public house business. Many tenants called for a higher proportion of these discounts to be shared with them.¹⁵²

119. The actual amount of discount pubcos achieve from individual brewers, and therefore the margins they make, is not publicly available as pubcos consider such arrangements

¹⁴⁵ Appendix 13, para 1

¹⁴⁶ Q 5

¹⁴⁷ For example see Appendix 25 and Appendix 27

¹⁴⁸ Appendix 17, para 2.3.1

¹⁴⁹ Appendix 23, para 32

¹⁵⁰ *Ibid.*, para 36

¹⁵¹ Appendix 12, para 2.10

¹⁵² For example see Appendix 25, para 6 and Appendix 12, para 2.1

commercially confidential. However, the Chief Executive of Enterprise told us that “a pub company of our scale can get a [average] discount of about £140 a barrel”.¹⁵³

120. Investec Securities suggested for a barrel of beer selling at £2.20 a pint, pubcos paid brewers in the region of £130 a barrel (table 4). This barrel of beer would be available to a free house operator at between £190 to £230 a barrel, depending on the volume purchased. The same barrel of beer was sold onto pubcos’ tenants at £300 a barrel. On this basis the pubcos’ margin was in the region of £170 a barrel, and the discount forgone by tenants was in the region of £70 to £110 a barrel.¹⁵⁴

Table 4: Estimated beer margins

	Per barrel £	Per pint £	Margin
Tenanted pubco's purchase price for standard lager	130	0.45	
Tenant's purchase price for standard lager	300	1.04	
Pubco's gross margin	170	0.59	131%
Tenant's gross margin assuming £2.20 per pint (inc. VAT) retail selling price	239	0.83	44%

Source: Investec Securities, *Tenanted Pubs*, 14 May 2004, page 3

Tenants’ discounts

121. Some pubcos have reacted to the criticisms that they do not offer discounts by introducing leases allowing tenants to earn discounts on certain products, for example up to £50 a barrel with Punch’s ‘Growth Lease’ and S&N Pub Enterprises’ ‘25 year Investment Lease’. Enterprise also told us they were introducing a new agreement, the ‘Retail Partnership Agreement’, in which tenants would be able to choose from two discount packages, with discounts of up to £100 a barrel.¹⁵⁵

122. We were interested in finding out how widespread the use of discounts was by pubcos. Punch told us that one third of public houses in their estate purchased their beer with discounts of approximately 15 percent or an average of £45 per barrel, with a small number receiving discounts of an average of £80 per barrel.¹⁵⁶ Punch guaranteed these discounts for the life of the tenant’s lease—a commitment they said was “not available to free of tie publicans who rely on the free market price at a particular time”.¹⁵⁷

123. Deutsche Bank estimated that 35 percent of Enterprise’s tenants received discounts of around £32 per barrel, while 90 percent of W&DB’s tenants received some form of discount. Their ‘Union Pub Lease’ offered discounts on non-W&DB brewed products of around £70 per barrel.¹⁵⁸ However, A.B. Jacobs told us that across the industry such

¹⁵³ Q 345 (Mr Tuppen)

¹⁵⁴ Investec Securities, *Tenanted Pubs*, 14 May 2004, page 3

¹⁵⁵ Appendix 8, para 3.5 (iv)

¹⁵⁶ Appendix 23, para 24

¹⁵⁷ *Ibid.* para 123

¹⁵⁸ Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, pages 32-33

discounts were not widespread: “on the basis of recent surveys the discounts are generally on selected products and about 40% to 50% of those which could be achieved in the open market”.¹⁵⁹

124. The wholesale selling prices quoted to tenants for tied beer purchases is roughly the same as the brewers’ standard wholesaling selling price at which free house operators purchase their beer. However, the actual wholesale price paid by pubcos’ tenants is in reality higher than is available to free house operators because of the higher discounts that are available to these operators. Whilst pubcos do operate some discount schemes, and these have increased in recent years, they do not match the opportunities available to free house operators.

125. As with any commercial contract, we believe the actual details of pubcos’ contracts with individual brewers should remain confidential. However, we believe that pubcos should advise their tenants of the average discount they receive, how this compares to the free market discounts available, and how much of this discount pubcos are passing onto their tenants.

AWP income

126. Pubcos derive further income from their tenants through taking a share of income for machines sited in their public houses: for example, pool tables, vending machines and in particular amusements with prizes (AWP) machines, such as ‘slot’ machines. Tenants are not ‘tied’ to pubcos for AWP machines in the same way as they are for beer. A machine tie is imposed as pubcos’ agreements require tenants to obtain written consent from them for the introduction of machines. Consent is usually provided on condition income is shared with the pubco (usually 50/50 net of rent and VAT) and is limited to machines provided by certain operators only, nominated by the pubco.¹⁶⁰

127. Dr Rawlings, Director of the Pub & Leisure division of the BBPA, told us that pubcos’ share of AWP income represented the “added value which the pubco puts in”.¹⁶¹ The income, quality and number of AWP machines had risen “primarily because the pubcos had taken an interest; prior to that a lot of pubs did not realise the potential of gaming machines”. Further, “where the pubcos have gone in and taken on companies they will go round and do deals with suppliers, much as they can with anybody else; they will turn the fruit machines around”.¹⁶² Non-tied tenants were “renting second-tier machines from the suppliers because they are somewhat cheaper, but they are not earning the money” machine tied tenants can.¹⁶³

¹⁵⁹ Appendix 17, para 2.3

¹⁶⁰ Appendix 14, para 15

¹⁶¹ Q 304

¹⁶² *Ibid.*

¹⁶³ Q 305

Improved income

128. Pubcos suggested that AWP machines in their tenanted public houses outperformed machines in free houses by almost 100 percent.¹⁶⁴ We asked Enterprise to clarify these comments. They provided information (table 5) from a range of machine operators demonstrating that AWP machines in tenanted public houses outperformed machines in free of machine tie public houses, after rent had been deducted.

Table 5: Average AWP machine income

Source of information	Average weekly cash balance (Post rent)		Difference
	Leased / Tenanted	Free of machine tie	
Local operator	£226	£135	67%
Regional operator	£206	£94	119%
National operator	£202	£157	29%
National operator	£187	£91	105%

Source: Appendix 10 para 18

129. **The machine tie improves tenants' takings from amusement with prizes machines (AWP). However, as free of machine tie tenants retain 100 percent of these takings as income, while tied tenants by pubcos' own admission¹⁶⁵ receive an average 50 percent of these takings, it appears from the information the pubcos themselves submitted that in many cases free of tie tenants make more money from their second tier machines than tied tenants do from their more up-to-date models. In our opinion, pubcos do not add sufficient extra value from their deals to justify their claims to 50 percent of the takings from AWP machines. We remain unconvinced that the benefits of the AWP machine tie outweigh the income tenants forgo and we recommend that the AWP machine tie be removed.**

Royalties and rents

130. AWP machine operators have written to us complaining that the larger pubcos charged them royalties to be listed as nominated suppliers to their public house estates.¹⁶⁶ In the case of Enterprise and Punch, the operators had to pay £22.50 and £11 per week respectively for each machine installed.¹⁶⁷ We asked our pubco witnesses if they took royalties from AWP operators to be nominated. The Chief Executive of Punch confirmed Punch did but told us: "we use it to subsidise the rent".¹⁶⁸ The Chief Executive of Enterprise also suggested the AWP rent levels Enterprise's tenants were charged were lower than for a free house operator.¹⁶⁹

¹⁶⁴ Q 339 (Mr Tuppen)

¹⁶⁵ Appendix 8, Annex 14a

¹⁶⁶ see Appendix 18, Executive Summary

¹⁶⁷ *Ibid.* Section 4

¹⁶⁸ Q 553 (Mr Thorley)

¹⁶⁹ Q 339 (Mr Tuppen)

131. We received evidence, on a confidential basis, which showed the larger pubcos' machine tied tenants paid higher rents than free of machine tie tenants. This was because the royalty payment made to pubcos by AWP operators was included in the rent tenants paid without their knowledge. For example, where a free from machine tie tenant would pay £50 a week rent per AWP machine, a tied tenant would pay £70 a week, including a rent premium of £20, which was subsequently paid to the pubco by the AWP operator as royalties.

132. Pubcos' tenants, who are tied for AWP machines, pay higher rents for AWP machines than tenants who are not tied. This is due to pubcos' practice of extracting royalty payments from AWP operators to become a pubco's nominated supplier. We feel many tenants may not be aware of these arrangements. If the AWP machine tie is not to be removed quickly, there is no reason why pubcos could not immediately introduce more transparency about their contractual relationships with their nominated AWP operators.

8 The benefit of the tie to tenants

133. Pubcos do not deny that their tied tenants pay higher wholesale beer prices than other public house operators. The offset, or ‘countervailing benefit’, to the tenant is in the form of a lower than commercial, or free of tie, dry rent (rent) and special commercial or financial advantages (SCORFA).¹⁷⁰ Under EU competition law, contracts containing an exclusive purchasing obligation, such as the beer tie, have only ever been permitted if they provide such ‘countervailing benefits’. The theory is that the net cost of the beer tie to the tenants makes them no worse off than if they were free of tie.¹⁷¹

Dry rent – the profit assessment method

134. For new leases, pubcos calculate the rent on the basis of a projection of the fair maintainable level of trade (FMT) a competent hypothetical untied tenant would be expected to achieve. This includes total ‘wet’ sales and an estimate of additional income from food sales, room rentals and AWP machines. Similar projections are made relating to the likely costs of the public house in the hands of the same hypothetical tenant, excluding the tenant’s salary, which are subtracted from the FMT. The rent valuation is assessed on the basis of a percentage of the remaining profit, known as the ‘divisible balance’. Pubcos suggested to us that their share of these ‘profits’, the rent, reflected the market demand and specific agreement terms for a particular public house but were typically around 50 percent.¹⁷²

135. If a pubco believes the share is inequitable for either side, they adjust the required rent to the requisite level. Expected AWP income is then deducted to arrive at the rent offer they present to an ingoing tenant. It was accepted by all parties that this was an imprecise science but was the standard industry method for the valuation of on-licensed premises, as supported by the Royal Institution of Chartered Surveyors (RICS).¹⁷³

136. Once the required rent has been decided by a pubco, the rent an ingoing tenant actually pays follows further negotiation with the pubco through agreement of an appropriate assessment of FMT. Once the rent has been agreed it is indexed, increasing annually by the increase in the retail price index (inflation). Rents are also subject to review at prescribed intervals, usually three to five years, when the calculation is repeated.¹⁷⁴

Fair maintainable rent (FMT)

137. The determination of rent levels has been a major source of concern among tenants, particularly the evaluation of a fair maintainable trade (FMT) by pubcos’ valuers. A lack of

¹⁷⁰ Appendix 8, para 2.12 (iii)

¹⁷¹ For example see European Commission Decision 1999/474/EC, Case IV/35.992/F3, *Scottish & Newcastle*, 16 June 1999 (OJEC (L) 1999 186/28)

¹⁷² Appendix 23, para 142

¹⁷³ RICS, *The Capital and Rental Valuation of Restaurants, Bars, Public Houses and Nightclubs in England, Wales and Scotland*, Valuation Paper 2, 2003

¹⁷⁴ For example see Appendix 23, para 40 and Appendix 12, paras 5.4 -5.5

transparency and accuracy in calculating FMT has given rise to complaints that rent levels bear no relation to the actual level of business being done in tenants' public houses.¹⁷⁵

Transparency

138. There is a lack of transparency about the way pubcos' valuers decide what a fair FMT for a particular public house is. The valuation of FMT is made on the basis of the public house, trade fixtures and fittings and the future trading potential that would be achieved by a competent operator.¹⁷⁶ Valuers are required to ignore the actual trade of an incumbent tenant, whether they are under-performing or are achieving above average trade. In effect, valuers are required to value the property and not its occupier.¹⁷⁷

139. Pubcos' valuers 'adjust' FMT for differences in the public house business being assessed; this might include differences in the agreement terms, which include the discounts available and repairing obligations, as well as the date the rent was assessed. They also have regard to the views of the tenant, knowledge of the past performance of the public house concerned and the quality of past tenants.¹⁷⁸

140. The larger pubcos told us that "every effort is made at the outset to agree the rent on a transparent and consistent basis"¹⁷⁹ and that they always provided tenants with a copy of their analysis of the rent calculation. However, tenants are provided with basic information only on the expected level of sales, estimated costs and level of rent required for the public house. The tenant is not in a position to see how their pubco decided their rent as pubcos consider the supporting detail of profit assessment and rent computation on how they were constructed confidential.¹⁸⁰ For example, the FSB provided evidence of a pubco tenant in South East England who was advised by an accountant to ask for a written explanation of how his rent was calculated. He was refused both a written explanation and even a breakdown of the possible factors which could influence rent levels.¹⁸¹ Pubcos maintained that for tenants to make a decision on whether to sign an agreement they only needed to know the quantity of product they were likely to sell, the cost of the beer they would purchase and the rent they would have to pay.¹⁸²

Accuracy

141. The FMT of any particular public house is a matter of opinion and where the FMT of a public house has been set too high, or the associated costs too low, it can lead to serious problems of over estimating the rent. A.B. Jacobs told us that in recent cases he knew of, the costs that had been underestimated by valuers included the buildings insurance the

¹⁷⁵ Appendix 12, paras 6.1–6.10

¹⁷⁶ RICS, *The Capital and Rental Valuation of Restaurants, Bars, Public Houses and Nightclubs in England, Wales and Scotland*, Valuation Paper 2, 2003, page 2

¹⁷⁷ Appendix 3, para 6.1

¹⁷⁸ Appendix 23, para 145

¹⁷⁹ *Ibid.*, para 39

¹⁸⁰ Appendix 17, para 3.7

¹⁸¹ Appendix 12, para 6.4

¹⁸² Q 339 (Mr Tuppen)

pubco should charge, the gas usage for beer raising, and the water rates based on usage. The magnitude of error he found in these cases was between 50 and 200 percent.¹⁸³

142. The effect of such underestimation of costs on the divisible balance, and therefore the rent, could be expensive for tenants as any miscalculation here means “for every £1,000 of legitimate cost left out of the profit assessment by valuers, the landlord gains £500 in rent and the tenant bears the burden of that £1,000 out of their income”.¹⁸⁴ Mr Jacobs believed such errors were made because valuers “generally have no operational, managerial or marketing experience relative to a pub, let alone knowledge of accounting practice and in particular the disciplines for profit assessment”.¹⁸⁵

143. One witness suggested to us that the performance of the hypothetical tenant of a public house, in its then current condition, should use the historic profit and loss accounts of the business to form the basis of the profit assessment.¹⁸⁶ Unfortunately, the precise profitability of each retailer is not known by pubcos as there has never been a requirement in their agreements to share such information and tenants generally keep these details confidential.¹⁸⁷

144. The industry could and should establish clear guidelines for the valuation process. Where they do not already exist, new national guidance for rent calculation should be compiled, and disclosure rules clarified. The profit assessment method of calculating rent should be carried out in accordance with national accounting standards and with knowledge, prudence and due diligence.

145. Pubcos should provide their tenants with a comprehensive breakdown of how their rent was calculated. This should reveal the whole detail of the profit assessment and how the specific requirements of the lease conditions had been interpreted by valuers. The profit assessment should form an addendum to leases, with any subsequent review, to ensure transparency.

Rent reviews

146. Tenants were also concerned about the use of upward only rent review (UORR) clauses in their agreements which meant rents had to increase, even when trade could be falling.¹⁸⁸

Upward only rent review (UORR)

147. At the outset of our inquiry we did not intend to specifically examine UORR clauses as we were aware that the ODPM was undertaking public consultation on commercial property leases generally, which included options for deterring or outlawing the use of

¹⁸³ Appendix 17, para 4.8

¹⁸⁴ *Ibid.*, para 4.10

¹⁸⁵ *Ibid.*, para 4.9

¹⁸⁶ *Ibid.*, para 5.10

¹⁸⁷ Appendix 23, para 104

¹⁸⁸ For example see Appendix 25, para 9 and Appendix 12, paras 6.1-6.10

UORR clauses in all such leases.¹⁸⁹ However, we could not ignore the concerns about such clauses expressed to us by tenants and their representatives.¹⁹⁰

148. The majority of pubcos' agreements provide for the rent to increase each year in line with the rate of inflation. Pubcos told us these clauses were included so that when a full review of the rent took place the increase did not create a sudden unexpected burden on their tenant.¹⁹¹ However, many tenants said when their rent reviews took place proposed increases were still unexpectedly high. Many believed that their rents should be reduced because of falling trade, but as their agreements contained UORR clauses this was not possible.¹⁹²

149. We asked the ALMR to undertake a survey of its members to gauge the use of UORR clauses in pubcos' leases and whether there were any differences between true pubcos and brewers.¹⁹³ The survey found the use of UORR clauses by pubcos was more common in long leases than traditional short term tenancies. Three quarters of pubcos (19 companies) did not include an UORR clause in some or all of their agreements. In terms of public house numbers, this figure increased slightly to 76 percent, with just over 17,000 public houses not being governed by such a clause. Of the 19 companies, 84 percent had never included an UORR clause in their contracts. Three companies, representing over 9,000 public houses, stated that they had recently abolished UORR clauses for some or all of their agreements. Several respondents (28%) noted that while their agreements included UORR clauses, these were not applied automatically and discretion was always exercised, with rents being frozen or reduced in exceptional circumstances. Others said that in practice the clauses were often ignored or unenforced.¹⁹⁴

150. We were also told by our pubco witnesses that their new 'preferred' leases did not contain UORR clauses and in the case of old leases they did not exercise these clauses. Of the larger pubcos, Mr Harrison, Operations Manager for Enterprise, told us that Enterprise had removed UORR clauses from all their current agreements with tenants, except those of a company they had recently acquired. They were currently in negotiations to remove such UORR clauses from these agreements.¹⁹⁵ Of the Punch estate, 31 percent of tenants had agreements which included UORR clauses.¹⁹⁶ These were mainly 'legacy' leases they had inherited when they took over other companies' estates and in these cases they did not exercise them. The Chief Executive of Punch told us that none of their current leases contained UORR clauses and they told us they would look at removing these clauses from all legacy agreements.¹⁹⁷ W&DB also confirmed they had no UORR clauses in any of their agreements.¹⁹⁸

¹⁸⁹ ODPM, *Government consults on commercial lease reform*, News Release 2004/0106, 23 April 2004

¹⁹⁰ For example see Q 39

¹⁹¹ Appendix 23, para 165

¹⁹² For example see Appendix 25, para 9 and Appendix 5, para 7.1

¹⁹³ Appendix 2

¹⁹⁴ *Ibid.*

¹⁹⁵ Q 366

¹⁹⁶ Appendix 24, para 2

¹⁹⁷ Q 527 (Mr Thorley)

¹⁹⁸ Appendix 28, Section 4

151. We commend pubcos which have already removed upward only rent review (UORR) clauses from their agreements. We consider this best practice within the industry and we call upon those pubcos which have not already done so to remove such clauses as soon as is practicable.

Grievance procedures

152. If tenants believe the rent offer is unfair they have different options depending on whether they are prospective tenants or incumbent tenants undergoing lease renewal or rent review.

153. Prospective tenants have the option to decline signing a proposed lease without penalty. However, incumbent tenants rarely have this option as the public house is their business and often their only accommodation. If they are trying to negotiate a lease renewal and choose to walk away they receive payment from their pubco for only the fixtures and fittings. Under the terms of their original agreement the leased premises, the public house, reverts to its pubco owner. Such tenants have the choice of court action but this is expensive. Incumbent tenants undergoing rent reviews often have the further possibility of independent review by rent panel, third party arbitration or mediation.¹⁹⁹

154. M&W told us that the level of pubco/tenant litigation was currently low due mainly to the introduction of tenant discounts and ‘fair dealing’ measures taken by the more responsible pubcos to ensure prospective tenants were better informed before taking on a lease.²⁰⁰ However, they were aware of instances where tenants had entered into leases on unsustainably high rents or had accepted or had had imposed upon them inappropriate rent increases on review.²⁰¹ They provided evidence from one valuer which showed in fifteen cases where a court decision was required the settled rent was substantially below the pubcos’ opening offer. M&W suggested that while this was a small sample of settlements, they appeared to “confirm our experience that current pubco leases are often over rented”.²⁰²

155. Pubcos provided us with information about the nature and extent of arbitration in their estates. All Enterprise’s agreements provided for either party to refer a rent assessment to a third party arbitrator, who is charged with determining the ‘correct’ rent and whose decision is binding on both parties.²⁰³ In the year to September 2003 they had completed 718 rent reviews, of which two were referred to arbitration for settlement. Up to March 2004, a further 410 rent reviews were completed; none of them were referred to arbitration.²⁰⁴ Since August 2001, Punch had agreed 648 rent reviews with their tenants, with nine arbitrations and two court determinations,²⁰⁵ while InnSpired told us that

¹⁹⁹ Q 357

²⁰⁰ Appendix 23, para 408

²⁰¹ *Ibid.* para 461

²⁰² *Ibid.* para 437

²⁰³ Appendix 8, para 3.8 (ii)

²⁰⁴ *Ibid.*, para 2.16 (ix)

²⁰⁵ Appendix 23, para 167

although they had a provision for tenants to appeal on rent reviews they had never gone to arbitration.²⁰⁶

156. Court or third party arbitration is expensive and unaffordable for many tenants. Many pubcos have introduced alternative methods of dispute resolution, such as rent review panels and mediation, where tenants can challenge the decision of the valuers.²⁰⁷ At W&DB, rents were proposed by tenants' business development managers (BDM) but they were all reviewed by an independent rent panel, irrespective of whether they were in dispute or not. W&DB told us that in the time the panel had been in existence; only one rent had gone to arbitration.²⁰⁸ Punch told us they had introduced a charter under which they were committed to the opportunity of an independent mediation service at no cost to the tenant. They suggested they had found: "provided our retailers are prepared to be open and honest about their business, we have always been able to reach agreement through the mediation service".²⁰⁹ Since the launch of its charter in September 2003, three cases had been mediated with a further four cases pending.²¹⁰

157. We believe it would be preferable for the industry to develop a nationwide register of rent reviews, accessible by professional valuers representing both sides of the industry. Although we believe the proportion of rent reviews not resolved amicably is small, such a register would increase transparency and reduce contested reviews.

158. The pubcos have argued that if tenants do not agree with their rent assessment, they should not have entered into the lease or accepted the rent review.²¹¹ We do not share this view. In the relationship between pubco and tenant, the tenant is in the weaker bargaining position. Pubcos should recognise that they have a responsibility to ensure they do not exploit their position of economic strength. All tenants should be treated fairly and rents should be reasonable and sustainable.

Rent concessions

159. The larger pubcos suggested to us that they offered support to tenants should the level of trade be "materially short of a fair maintainable level".²¹² Punch told us in such cases action was taken to "energise the business".²¹³ This included promotional activity, the introduction of new amenities such as food, alteration to trading hours and tenant training. On these occasions they also offered rent concessions for a period of time while the action took effect. Punch's agreements allowed rents to be reduced through temporary rent concessions or a formal rent review but only if they believed the rent was untenable

²⁰⁶ Appendix 16, para 3.5

²⁰⁷ *Ibid.*, para 467

²⁰⁸ Appendix 28, Section 4

²⁰⁹ Appendix 23, para 162

²¹⁰ *Ibid.*, para 167

²¹¹ *Ibid.*, para 438

²¹² Appendix 23, para 279

²¹³ *Ibid.*

through no fault of the tenant. They had 167 active concessions and 140 ‘stepped’ rents in place to allow tenants to return their business back to an agreed level.²¹⁴

160. Enterprise suggested to us that they would informally review rents if the trading performance of the public house was such that the established rent was unsustainable due to circumstances outside the tenant or lessee’s control. In these cases, rent concessions would be awarded on a temporary basis until such time as the trading performance could sustain the established rent. They had 19 rent concessions in place, averaging £9,000 per public house.²¹⁵

161. In M&W’s experience the offering of rent concessions by pubcos in response to a tenant in trading difficulties was rare, although pubcos’ attitudes had improved in comparison with the stance adopted in the early 1990s. They believed pubcos could do more to assist tenants in such circumstances.²¹⁶

162. Some pubcos are willing to offer rent concessions in cases where tenants are experiencing financial difficulty through no fault of their own, for example because of demographic changes or because the public house is closed for repairs. We recognise this as good practice and commend it to the industry as a whole.

Special commercial or financial advantages (SCORFA)

163. Pubcos suggested to us that the higher wholesale prices they charged their tenants enabled pubcos to offer tenants support functions, which were unavailable to free house operators. These included: business development assistance, such as training and legal support through a business development manager (BDM); investment; centralised technical and complaint services; and financial benefits through pubcos’ increased purchasing power.²¹⁷

Training

164. Many tenants enter public houses with little or no direct business experience of the sector or of running a business generally. Pubcos told us that they made a variety of training courses available to assist new and incumbent tenants to run their business.²¹⁸ Enterprise’s new ‘Retail Partnership Agreement’ will require tenants who do not already hold an appropriate qualification to attend Enterprise’s training course. This covers the British Institute of Innkeeping (BII) Induction Certificate, the National Licensee’s certificate, and the Food Hygiene Certificate. The course also provides information to enable tenants to gain further qualifications in licensed premises management.²¹⁹ Punch told us that they offered a comprehensive training package, all accredited by the BII, to both existing tenants and prospective applicants whether they took a public house with

²¹⁴ *Ibid.*, paras 157-159

²¹⁵ Appendix 8, para 3.9 (iii)

²¹⁶ Appendix 23, para 433

²¹⁷ Appendix 3, para 4.6

²¹⁸ *Ibid.*, para 5.8

²¹⁹ Appendix 8, Annex 11

Punch or not. As part of their agreements an introductory training course was compulsory for all tenants.²²⁰

165. It is clearly to the benefit of both pubcos and their tenants that pubcos should encourage appropriate business training for prospective and incumbent tenants alike to improve their business knowledge and performance through courses such as those run by the British Institute of Innkeeping (BII). Some tenants who would benefit might be deterred by the cost. We suggest that as they would benefit from better trained and more competent tenants, pubcos should consider providing support to their tenants to attend these courses through the payment of course fees or grants to enable them to employ cover for the period when they are absent from the public house.

Legal and professional support

166. Legal and professional support provided by pubcos includes advising tenants on issues such as rating revaluation and appeals, licensing law reform and applications for licences, and employment regulations. For example, following the introduction of new licensing legislation, Punch have offered tenants a package service at cost price to assist them in the new licensing process. This will include: a survey of their properties; the pre-production of the core elements of tenants' business plans, as per the guidelines outlined by the Government; copies of applications for personal licences; and support in the application process.²²¹

Business development managers (BDM)

167. Pubcos told us that they offer their tenants support functions through a business development manager (BDM) or similar.²²² Some tenants complained to us that they did not receive the necessary support from their pubcos. They rarely saw their BDM²²³ and when they did, the BDM appeared to be uninterested in solving tenants' problems but was more interested in increasing the profits of the pubco.²²⁴ Tenants complained that their BDM changed frequently and the "majority have no operational or business experience, the few that do are often failed managers".²²⁵ A study by Morgan Stanley found that around one-third of tenants saw their BDM once a month but nearly half did so only once every six months, and 15 percent did so only once a year or less often.²²⁶

168. A.B. Jacobs in particular has been very critical of the attitude of some BDMs towards tenants, telling us one of the "business manager's prime tasks is to reduce or eliminate late payments for goods supplied, rent and insurance".²²⁷ He also suggested "it is not uncommon for business managers of pubcos to apply harassment to tenants who do not

²²⁰ For a list of training courses that the compulsory training covers see footnote to Q 538

²²¹ Appendix 23, para 319

²²² For example see *ibid.*, para 152

²²³ Appendix 12, para 5.6

²²⁴ Q 32

²²⁵ Appendix 17, para 4.16

²²⁶ Appendix 20, Annex 2, tables 14 & 15

²²⁷ Appendix 17, para 4.16

match up to trading and cash flow expectations”.²²⁸ On the other hand, Morgan Stanley found that tenants generally rated their personal relationship with their BDM between satisfactory and good, well above their relationship with their pubco.²²⁹

169. We were interested in finding out more about the background, business skills and remuneration of BDMs. The Managing Director of the Union Pub Company, Mr Oliver, told us that Wolverhampton & Dudley Breweries’ BDMs had been employed by the company for an average of 15 years. They came from a range of backgrounds, with many having previously worked in free and managed houses and a number having previously been tenants. They were given between 10 and 15 days formal and informal training a year. The majority were members of the BII and had achieved other qualifications. The informal training they were given covered “the whole gamut of issues that affect the licensed trade”²³⁰ such as property management, legal issues and marketing. Mr Patton, Customer Relations Director for Punch, also told us that Punch’s BDMs went through a training programme starting with a 10 day induction to the company and continuing onto their licence retailing course, which was compulsory for new tenants. Most of their BDMs had a brewing background with a few having been tenants.²³¹

170. Punch also told us that part of their BDMs salary was based on a bonus scheme and within the bonus scheme part reflected the profit of the area they ran.²³² An important element of the bonus scheme was related to their ‘Retailer Satisfaction Survey’, which asked tenants how they rated their BDM. Punch suggested this ensured: “our employees’ potential bonus is thereby directly linked to the service and support they provide”.²³³

171. It would appear that the performance of business development managers (BDMs) varies across the industry from excellent to dire. We found no consensus within the industry as to their role and function. Some seem to be more concerned with the policing of operations in the public houses under their supervision rather than the provision of genuine assistance to tenants. We recommend that the industry should review the support offered to tenants to ensure the application of best practice in the provision of support to individual businesses.

Investment

172. Many pubcos invest capital in their public house estates. In some cases this is done through joint investment with their tenants.²³⁴ Pubcos invest primarily in buildings and landlords in fixtures and fittings under their repair and maintenance obligations. Punch told us that they repaired or upgraded 10 to 12 percent of their estate each year, with an average spend of £60,000 per investment site and an additional tenant investment of £12,000 per site. They estimated the financial returns varied from project to project but in

²²⁸ *Ibid.*, para 3.11

²²⁹ Appendix 20, Annex 2, page 2

²³⁰ Q 440

²³¹ Q 528

²³² *Ibid.*

²³³ Appendix 23, para 240

²³⁴ Appendix 3, para 5.9

general they earned a payback on their investment after three to four years, the tenant faster.²³⁵

Centralised purchasing and technical services

173. Pubcos derive scale benefits, such as purchasing, which they suggested are passed onto tenants. Benefits for tenants included buying group discounts on electricity, contents and building insurance, capital equipment, and food products.²³⁶ Enterprise utilised their purchasing power to secure beneficial terms for their tenants on a range of non-tied non-drinks goods and services. These were made available without charge to any of their tenants. Sales of these goods and services were made by a range of suppliers to 2,500 Enterprise public houses in the 12 months to March 2004, generating an estimated saving of £1,600 per participating tenant.²³⁷

174. Pubcos offer their tenants centralised problem solving and complaint procedures which allow them to manage suppliers against specified service criteria to ensure that a higher level of sales support and technical service is provided to tenants than they might achieve on their own. Specific examples quoted by the pubcos have included arranging replacement products for tenants should there be a delivery or product quality failure, organising an emergency delivery for tenants who did not order enough stock, and arranging emergency repairs to drink-dispensing equipment.²³⁸

175. Punch's 'Frontline Customers Queries & Complaints Procedure' offers that if a service provided by Punch or its nominees fails to meet the published service standards, the issue can be raised with Punch through Frontline. Complaints or general problems are acknowledged within three working days of receipt and a reply sent or discussed by telephone within 10 working days. All complaints are logged, tracked and given an estimated time for resolution of the problem. If the complaint is not resolved within the agreed timescale it is passed to the appropriate senior manager. Any unresolved complaint is escalated within the business until it becomes the responsibility of the Chief Executive.²³⁹

176. M&W praised this approach to customer complaints and suggested all pubcos should adopted similar procedures and ensure they are fully implemented in practice. However, they stressed that: "it is important that pubcos do more than simply establish complaints handling procedures. In a significant number of cases in which we have been involved, tenants facing financial difficulty are treated unsympathetically by their pubco and do not receive constructive advice as to how best to deal with the trading difficulties that they have".²⁴⁰

177. Dealing with tenants' complaints quickly and efficiently is good business practice for all companies. Pubcos should ensure that a higher level of sales support and technical service is provided to tenants than they might achieve on their own. The

²³⁵ Appendix 23, para 282

²³⁶ Appendix 8, Annex 11

²³⁷ *Ibid.*, para 2.11

²³⁸ Appendix 23, para 229

²³⁹ *Ibid.*, para 459

²⁴⁰ *Ibid.*, paras 459- 461

terms of these procedures and details of the consequences should complaints and problems not be dealt with to the satisfaction of both parties should form part of tenants' agreements or a binding code of practice.

9 Balancing the costs and benefits of the tie

178. It has been claimed that the cost of the tie to tenants, the wet rent (wholesale price differential) plus AWP income paid by tenants to their pubcos, is exactly counterbalanced by the benefit of the tie to tenants, lower rent plus special commercial or financial advantages (SCORFA).²⁴¹ This ‘value equation’ suggests the countervailing benefits tenants receive should leave them in the same position as if they were not tied at all.²⁴²

179. We did not receive sufficient data for any one pubco or pubcos in aggregate to judge with any degree of accuracy whether the wholesale price differential on tied products plus AWP income were exactly counterbalanced by the countervailing benefits of a rent subsidy and other special commercial or financial advantages. With this in mind, our analysis is an approximate guide arrived at using established methods and the best estimates of the ‘true’ data available to us. These are backed by many assumptions, some of which we believe are unrealistic.

The cost of the tie to tenants

180. The wholesale price differential has been calculated by the European Commission as the average discount to a free house operator minus any discount granted to tied tenants.²⁴³ Data on the actual level of discount received by free house operators or pubcos’ tenants are not readily available. We received estimates of the discounts available to free house operators which ranged from £40 to £140 a barrel.²⁴⁴ Taking the middle of these estimates suggests free house operators’ discounts, the discounts pubcos’ tenants forgo because of the tie, are in the region of £70 per barrel.²⁴⁵

181. 30 percent of Punch’s estate received an average discount of £45 a barrel.²⁴⁶ A further 60% received an average discount of £8 to £9 per barrel.²⁴⁷ Across their whole estate this averages out to a discount in the region of £20 a barrel.²⁴⁸ With free house operators receiving discounts of £70 per barrel, this suggests the wholesale price differential is around £50 a barrel for a large pubco’s tenant.

182. These estimates may be too high, especially as free house operators cannot be certain of discounts from order to order, unlike pubco tenants whose discounts are guaranteed for the term of their agreements. The wholesale price differential also varies from pubco to

²⁴¹ For example see Q 202; Q228; and Appendix 17, para 3.8

²⁴² Appendix 17, para 3.8

²⁴³ See European Commission Decision, Case IV/35.992/F3 - *Scottish & Newcastle*, 16 June 1999 (OJEC (L) 1999 186/28 paras 50-57)

²⁴⁴ See for example Appendix 17, para 2.2; Appendix 23, para 420; and Appendix 12, para 5.1

²⁴⁵ Deutsche Bank have also estimated the discounts forgone by pubcos’ tenants as £70 per barrel. Source: Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, pages 32-33

²⁴⁶ Appendix 23, para 24

²⁴⁷ Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, pages 32-33

²⁴⁸ Assumes Punch estate of 4,430 public houses as at 31 October 2003. Source: Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 7

pubco and from agreement to agreement. For example, for tenants on Punch's preferred 'Growth Lease' the wholesale price differential would be closer to £35 a barrel.²⁴⁹

183. The value of pubcos' AWP income from each tenant is also not readily available. Deutsche Bank have estimated it is in the region of £4,000 per annum or £20 a barrel for an average public house.²⁵⁰ Together with the estimated wholesale price differential above, this suggests the total cost of the tie to tenants is in the region of £70 a barrel.

The benefit of the tie to tenants

184. The level of rent subsidy (the difference between the rent pubcos charge tied tenants and the rent for free house operators) has been calculated by the European Commission by subtracting the actual rental income from pubcos' tied estates from 15 percent of the turnover of the estate.²⁵¹ Information on the individual rents for each of the 30,000 tenanted public houses that pubcos own is not readily available. Data on the total rental income from the accounts of pubcos is available, from which estimates of the rent of an average tied public house can be made. The data suggests the rent for a large pubco's public house is in the region of £22,000 per annum.²⁵² Deutsche Bank have estimated that an average tied public house, with a throughput of 210 barrels and a rent of £24,000, has a turnover in the region of £200,000,²⁵³ of which 15 percent equates to £30,000. This suggests the value of the rent subsidy is in the region of £6,000 to £8,000 per annum or £30 to £40 a barrel for a large pubco's tenant.

185. Many of the SCORFA benefits offered by pubcos are intangible, such as business support, professional and legal advice, centralised complaint and ordering procedures. Some SCORFA benefits such as investment and purchasing scale benefits are tangible.²⁵⁴ Punch invests around £23 million pounds a year in development projects.²⁵⁵ This suggests an average spend across their estate of just over £5,200 per public house. Enterprise estimated the annual benefit to their tenants of purchasing non-tied, non-drinks goods from them at around £800 per public house across their estate.²⁵⁶ Pubcos' public houses often include free accommodation and other cost of living benefits for tenants, which the FSB²⁵⁷ and Deutsche Bank²⁵⁸ have estimated to be worth £5,000 and £10,000 per annum respectively.

²⁴⁹ Appendix 23, para 24

²⁵⁰ Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 5

²⁵¹ 15 percent of the turnover is the working assumption used by the European Commission to represent the 'rent' of a free house operator. For example see European Commission Decision 1999/474/EC, Case IV/35.992/F3, *Scottish & Newcastle*, 16 June 1999 (OJEC (L) 1999 186/28, paras 59-60)

²⁵² Estimated from: Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 7

²⁵³ *Ibid.*, Figure 5

²⁵⁴ The following estimates assume Punch's and Enterprise's public house estate of 4,430 and 5,180 respectively, as at 31 October 2003. Source: Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 7

²⁵⁵ Investec Securities, *Beer Prices in Community Pubs*, 7 September 2004, page 15

²⁵⁶ Appendix 8, para 2.11

²⁵⁷ Appendix 12, para 4.4

²⁵⁸ Deutsche Bank, *UK Pubs Sector Report – The bear pit*, 31 October 2003, Figure 5

186. We believe these benefits are over estimated. We were unable to confirm the investment or purchasing scale benefits by pubcos across the whole of their estates. We also believe the cost of living benefits achieved are overstated. Although in many cases tenants do get free accommodation, these estimates take little account of the benefits accruing to pubcos from having tenants living ‘on site’, such as buildings security.

187. Our analysis suggests the cost of the tie to tenants is in the region of £70 a barrel. This is ‘balanced’ by a rent subsidy and quantifiable SCORFA benefits in the region of £50-£75 a barrel plus an indeterminable amount of unquantifiable SCORFA benefits.

188. It should be remembered that this Inquiry stemmed from complaints about inequalities in the contractual relationship between pubcos and their tenants. On the basis of the evidence presented to us we feel that the immediately quantifiable cost of the tie is usually balanced by the benefits available to tenants. However, this does not mean that for every tenant the costs equal the benefits, leading to some tenants getting into financial difficulties. In such cases pubcos could do more to redress the imbalance. Indeed, it became clear as the Inquiry progressed, that some pubcos demonstrated greater sensitivity to tenants problems than others.

The consequences of ending the beer tie

189. Tenants and their representatives suggested to us that the problems tenants had complained to us about would be resolved if the beer tie were removed, enabling tenants to purchase their beer on the free market.²⁵⁹

190. We asked our witnesses what they believed the outcome of removing the tie would be for the industry. The FLVA expressed concern that if the tie was removed, pubcos could and would increase the rent tenants paid: “in all tenancy and lease agreements it is pointed out that the rent takes into consideration the tie and is therefore less than what [tenants] would be expected to pay if they were not under an obligation to purchase specified drinks from the landlord or their nominated supplier. It then goes on to say that if they are released from the tie the company reserves the right to review the rent taking into consideration the release from the tie”.²⁶⁰

191. Mr Salussolia, the Chairman of the ALMR told us that pubcos as mere property owners would not be interested in the business being carried out in the premises but only in maximising the rental income of the property: “there is a relationship with the pubco, because when you look at a site and you bid for a site with a pubco, they take into account what you are going to do with that site. You may not give the biggest rent bid, you may be chosen because you are going to give the biggest volume of return out of that business”.²⁶¹

192. The Chief Executive of Enterprise told us that removing the tie would split their business into wholesaling and property companies which would be “completely at-odds with what we believe and what we have sought to describe to you as the most important principle of the tenanted and leased business model that we operate, and that is the

²⁵⁹ For example see Appendix 25, para 10; Appendix 12, para 9; and Appendix 17, para 5.2

²⁶⁰ Appendix 11, page 1

²⁶¹ Q 206

principle of partnership”.²⁶² Enterprise saw the tie as essential to their partnership with tenants, ensuring that both were committed to sales growth and they shared risk. If pubcos were to operate under a rent only relationship, Enterprise believed, “it is difficult to see how those interests could be aligned with such assurance as we believe they are now”.²⁶³

193. Pubcos also argued that tenants would lose the special commercial or financial advantages pubcos provided because of the tie as pubcos would have no reason to offer these if they had no interest in building tenants’ businesses. Mr Findlay, Chief Executive of the W&DB told us that “the idea that a pubco could be split into a wholesaling operation and a property company would be bad news for the public house sector as a whole because what pub companies do is invest a lot of resource in managing what is actually legally a very complicated business. We provide a lot of advice to tenants that a property company just simply would not be able to do”.²⁶⁴ An example of the additional support given by W&DB was the £1 million they had invested in helping tenants through the process of the new licensing reforms. They suggested this was: “the sort of thing we do because we have a relationship with them based on knowledge of the business, knowledge of the trade, and the fact that we sell beer to them as well”.²⁶⁵

194. The Chief Executive of Punch told us that the only people who would benefit from the tie being removed and pubcos becoming pure wholesalers would be the international brewers: “the biggest wholesaler in the UK is owned by the biggest brewer. The second biggest wholesaler in the UK happens to be owned by the second biggest cider maker. The reality of the situation is that the brewers will cut out the wholesalers”.²⁶⁶ Independent wholesalers were unlikely to cope with a sudden increase in business from 30,000 pubco tenants.²⁶⁷ Through international brewers’ specialised distribution networks, by way of which they already deliver beer to the majority of public houses, they would become the dominant wholesalers: “that is what the competition authorities have investigated many times and sought to avoid. We [pubcos] act as a counterbalance to that. We are not as big a counterbalance as the supermarket chains who have 70 per cent of the off-trade but we are a counterbalance to that and at all stages we seek to use that counterbalance to subsidise the package”.²⁶⁸

195. Other areas of concern to our witnesses about ending the tie included the impact on small brewers, prospective tenants and smaller public houses’ tenants. The Campaign for Real Ale (CAMRA) suggested the tie was important for smaller brewers as it guaranteed them an outlet for their products: “these brewers currently own 5,800 tenanted public houses and are reliant on these tied outlets to showcase their products and provide access to market”.²⁶⁹ The tie guaranteed distribution for the output of these brewers, without which they could not otherwise compete with the larger brewers.

²⁶² Q 385 (Mr Tuppen)

²⁶³ *Ibid.*

²⁶⁴ Q 438

²⁶⁵ *Ibid.*

²⁶⁶ Q 506 (Mr Thorley)

²⁶⁷ Appendix 11, page 1

²⁶⁸ Q507 (Mr Thorley)

²⁶⁹ Appendix 5, para 2.2

196. CAMRA²⁷⁰ and Enterprise also believed the removal of the tie would mean prospective tenants would no longer have the option of a low cost entry into the industry in terms of capital outlay: “the tied system [...] offers a fantastic opportunity for people with relatively small resources. You do not need to spend half a million or a million to buy a pub; with £25,000/£30,000 you have the chance to take on and make money from a business”.²⁷¹

197. The FLVA were concerned that tenants who would lose out the most from the removal of the tie would be the tenants of smaller public houses. Once pubcos reassessed the rent of public houses, tenants would be able to purchase beer on the free market. However, they would not obtain the same discounts that pubcos did. Smaller public houses’ tenants would be ‘squeezed’ by higher rents and higher beer prices, which would lead them to go out of business.²⁷²

198. It is not clear that removing the beer tie would make tenants better off. In practice, pubcos, as property companies, would offset their loss of income from the wholesale price differential (wet rent) they charge by charging higher rents. The pubcos have the right to do this through clauses in their leases and would undoubtedly do so. Pubcos would maximise the rent for their properties as they would have no interest in expanding tenants’ businesses.

199. There is a danger that splitting the wholesaling and property functions of the pubcos would only benefit the international brewers who currently control the national distribution of beer. In the main, distribution companies owned by certain international brewers already deliver to the majority of tenanted public houses for the pubcos. Removing the tie would enable them to supply free from tie tenants with wholesale products directly. The national brewers would then have a virtual monopoly on the wholesaling of beer, as they did in the days before the Beer Orders.

Code of conduct

200. There have been calls for a legally binding industry code of conduct to ensure that pubcos fulfil the terms of their agreements with their tenants.²⁷³ The British Beer & Pub Association (BBPA) already recommends its members, who include Punch, Enterprise and the other large pubcos, to adopt codes of practice setting out guidelines on the granting and operation of leases as well as dispute settlement.²⁷⁴

201. The Chief Executive of Enterprise told us that Enterprise have had a code of practice since 1996.²⁷⁵ Punch’s code of practice, their ‘Retailer Charter’, includes sections on how their tenants could expect Punch to behave in their relationship at all stages, including applying for a public house, developing the business, agreeing rent reviews and renewing

²⁷⁰ *Ibid.*

²⁷¹ Q 388 (Mr Tuppen)

²⁷² Q 158 (Mr Payne)

²⁷³ For example see Appendix 12, para 9.11 and Appendix 5, para 8.8

²⁷⁴ Appendix 4

²⁷⁵ Q 329 (Mr Tuppen)

and transferring agreements. Adherence to their charter is measured by Punch through their customer services team.²⁷⁶

202. When questioned about whether such codes should be legally binding, the Chief Executive of Enterprise told us that: “if there were to be a legally binding industry wide code of conduct I would imagine with confidence that we would comply with all aspects of it. So it presents no risk to us. I simply caution that I fear you may be harming the market place by introducing such a thing because, as always, if you are trying to make something standard across the industry there is a risk that it finds its level at the lowest common denominator”.²⁷⁷

203. Since the British Beer & Pub Association (BBPA) code of practice was updated in 1997 the industry has changed and we suggest that this code of practice should be revised as a matter of urgency. This should involve consultation with the widest range of interested parties including tenants, their representatives and public house owners. The areas we believe a code should cover have been highlighted elsewhere in this Report but should include: rent reviews; the role of BDMs; complaint and dispute procedures; disclosure and the availability of information; and the taking of legal and professional advice by prospective tenants.

204. At this stage we do not think a legally binding code of practice necessary, but if the industry does not show signs of accepting and complying with an adequate voluntary code then the Government should not hesitate to impose a statutory code on it.

205. We hope that our successor Committee in the next Parliament will review the situation in the public house industry, in particular whether the code of practice is working.

²⁷⁶ Appendix 23, para 248

²⁷⁷ Q 415 (Mr Tuppen)

Conclusions and recommendations

The UK market for beer

1. Under any of the market definitions we have chosen, no one company, be it pubco, brewer or retail pub chain, holds a dominant position in the total market for beer. The largest brewer, Scottish Courage, has a market share of beer supply to the on-licensed trade of 26 percent but does not own a public house estate. The largest company in terms of public house ownership, Enterprise, owns just 15 percent of public houses, all tenanted, to whom it acts as wholesaler, and has no brewing or retail operations. There are sufficient different types of public houses: pubco managed, pubco tenanted, and free houses, for us to agree with the Office of Fair Trading (OFT) when they say “there seems to be a reasonable amount of competition between on-trade outlets”. There may, however, be higher concentrations of public house ownership in certain towns, areas, or regions. (Paragraph 19)
2. Although concentration in the brewing sector has increased since the Beer Orders, the sector appears to be competitive. (Paragraph 23)

The impact of pubcos on the sale and distribution of beer

3. There is clearly an overlap between public houses and other outlets whose main purpose is to sell alcoholic (and non-alcoholic) drinks for consumption on the premises. However, seen from the viewpoint of the consumer, there is a difference between going out for a drink at a public house and going out for a meal at premises where alcohol may be consumed. It is clear there is no simple division: a number of self-styled public houses are now in reality restaurants with adjacent bars. However, an adequate proxy for a true definition of the market may be full on-licences plus clubs on-licences. This situation will be further complicated when the *Licensing Act 2003* comes into force. (Paragraph 37)
4. We disagree with the definition of the public house market which the OFT has adopted in the past. We recognise that the licensing regulations are due to change. However, we do not believe that these changes will alter the shape of the market itself. Nor are we certain about the speed with which the new licensing regulations will be implemented by the licensing authorities. It seems to us that there is time for the OFT to reconsider its previous definition so as to more accurately define the market in question and to establish mechanisms for monitoring it. (Paragraph 38)
5. Although pubcos control the wholesale supply to their own estates, no one pubco holds a dominant position in the wholesale market for beer. The largest pubco, Enterprise Inns, controls wholesale supply to just under 15 percent of public houses, 10 percent of full on-licences and six percent of all on-licences. Other wholesalers, mainly the international brewers, supply free house operators who account for just under 30 percent of the market. (Paragraph 46)

6. In order to get their products onto pubcos' wholesale lists, brewers have to pay the pubcos listing fees. Marketing fees act as a deterrent to the extension of consumer choice and will usually be reflected in higher prices to the consumer. If pubcos are serious about extending consumer choice to include the products of small brewers they should reconsider their policy on marketing fees. (Paragraph 53)
7. A statutory requirement on pubcos to allow all tied tenants the option of offering a guest beer of a particular type, for example cask ales and regional or national specialities, would run contrary to EU competition law and could lead to the UK Government being challenged in the European Courts. However, the ability of public houses to offer a broader range of products, for example to satisfy demand for local products, is important in the interests of extending consumer choice. In the absence of the legislative option we recommend that pubcos allow their tenants more flexibility in their choice of the products they sell. The early adoption of such practices should afford more opportunity for small brewers to participate in the market. (Paragraph 61)
8. We are concerned about the small brewers which are not 'willing' or 'able' to deliver to the centralised distribution facilities of pubcos. Alternative arrangements for beer distribution are dwindling, with the recent acquisition of Beer Seller by one of the big three centralised logistics companies, Scottish Courage. For those small brewers for whom barriers to market entry still exist, 'The Society of Independent Brewers' 'Direct Delivery Scheme' suggests one possible way forward, especially if operated on a regional basis. (Paragraph 66)
9. We are concerned that the national brewers retain a stranglehold on the distribution for beer. This is due not so much to the supply contracts the national brewers have with the pubcos but the distribution contracts pubcos have with national brewers' distribution arms. A barrier to entry such as this could be avoided if the link between brand supply and distribution were severed. (Paragraph 69)
10. In the distribution market for beer there is the strong possibility of anti-competitive consequences. We would hope that the OFT's latest consideration of market concentration in this area will not be their last. The distribution market should be kept under close and regular scrutiny. (Paragraph 71)

The contractual relationship between tenant and pubco

11. From the evidence we have received, it is clear that many tenants experience problems in enforcing their pubco's duty to maintain and repair their public house. This is unacceptable. Pubcos would improve their reputation as landlords if they ensured that tenants' agreements contained an inexpensive and efficient system of arbitration or alternative dispute resolution with fully independent arbitrators or experts to resolve such disputes without imposing legal costs on either side. (Paragraph 90)
12. We received evidence which suggested prospective tenants were not being provided with the quantity or quality of information needed to make a rational decision on the merits of a lease proposal. Large pubcos offer tenants the right to information should

they choose to look for it. However, many prospective tenants are unaware this information exists. This appears to be particularly true of those who become tenants through taking leases from incumbent tenants on assignment. (Paragraph 103)

13. Judging from Punch's and Enterprise's descriptions, their approach to the application process and the type of information supplied appears to be extremely thorough. It may well be that not all pubcos follow best practice. However, prospective tenants must take some responsibility themselves. Prospective tenants should make themselves aware of the information available to them from the pubco before committing to a lease. If there is information prospective tenants believe should be available but is not, they should ask the pubco for such information. If the information is not forthcoming, then prospective tenants should look to other companies. (Paragraph 104)
14. We are aware that pubcos, as landlords, do not have the right to unreasonably withhold consent to assignment by and can only offer advice to these prospective tenants. Pubcos should insist that tenants assigning leases provide prospective tenants with the same level of information that their pubco would provide. Prospective tenants entering the trade through lease assignment should not sign agreements until they are fully aware of an incumbent's annual profit and loss accounts for the business they are purchasing. They should also contact the pubco for information they believe is not forthcoming from their assignor. (Paragraph 105 and 106)
15. Prospective tenants should seek independent professional advice before committing themselves to a lease agreement. This should not be limited to legal advice but should include advice from a suitable accountant with expertise in the licensed trade and a qualified surveyor with experience in valuation in this sector. (Paragraph 110)
16. We believe that many of the disputes which arise between pubcos and their tenants would be eliminated if pubcos insisted as a condition of acceptance that tenants obtained all necessary professional advice. This should be one element of an industry-wide code of practice. We also strongly commend the example set by Enterprise in proposing to contribute to the cost of this. In the long run, ensuring that tenants know exactly what they are committing themselves to when they take on a lease will be to the benefit of the reputable pubco itself, as well as to its tenants. (Paragraph 111)

The cost of tie to tenants

17. The wholesale selling prices quoted to tenants for tied beer purchases is roughly the same as the brewers' standard wholesaling selling price at which free house operators purchase their beer. However, the actual wholesale price paid by pubcos' tenants is in reality higher than is available to free house operators because of the higher discounts that are available to these operators. Whilst pubcos do operate some discount schemes, and these have increased in recent years, they do not match the opportunities available to free house operators. (Paragraph 124)

18. As with any commercial contract, we believe the actual details of pubcos' contracts with individual brewers should remain confidential. However, we believe that pubcos should advise their tenants of the average discount they receive, how this compares to the free market discounts available, and how much of this discount pubcos are passing onto their tenants. (Paragraph 125)
19. The machine tie improves tenants' takings from amusement with prizes machines (AWP). However, as free of machine tie tenants retain 100 percent of these takings as income, while tied tenants by pubcos' own admission receive an average 50 percent of these takings, it appears from the information the pubcos themselves submitted that in many cases free of tie tenants make more money from their second tier machines than tied tenants do from their more up-to-date models. In our opinion, pubcos do not add sufficient extra value from their deals to justify their claims to 50 percent of the takings from AWP machines. We remain unconvinced that the benefits of the AWP machine tie outweigh the income tenants forgo and we recommend that the AWP machine tie be removed. (Paragraph 129)
20. Pubcos' tenants, who are tied for AWP machines, pay higher rents for AWP machines than tenants who are not tied. This is due to pubcos' practice of extracting royalty payments from AWP operators to become a pubco's nominated supplier. We feel many tenants may not be aware of these arrangements. If the AWP machine tie is not to be removed quickly, there is no reason why pubcos could not immediately introduce more transparency about their contractual relationships with their nominated AWP operators. (Paragraph 132)

The benefit of the tie to tenants

21. The industry could and should establish clear guidelines for the rent valuation process. Where they do not already exist, new national guidance for rent calculation should be compiled, and disclosure rules clarified. The profit assessment method of calculating rent should be carried out in accordance with national accounting standards and with knowledge, prudence and due diligence. Pubcos should provide their tenants with a comprehensive breakdown of how their rent was calculated. This should reveal the whole detail of the profit assessment and how the specific requirements of the lease conditions had been interpreted by valuers. The profit assessment should form an addendum to leases, with any subsequent review, to ensure transparency. (Paragraph 144 and 145)
22. We commend pubcos which have already removed upward only rent review (UORR) clauses from their agreements. We consider this best practice within the industry and we call upon those pubcos which have not already done so to remove such clauses as soon as is practicable. (Paragraph 151)
23. The pubcos have argued that if tenants do not agree with their rent assessment, they should not have entered into the lease or accepted the rent review. We do not share this view. In the relationship between pubco and tenant, the tenant is in the weaker bargaining position. Pubcos should recognise that they have a responsibility to ensure they do not exploit their position of economic strength. All tenants should be treated fairly and rents should be reasonable and sustainable. (Paragraph 158)

24. Some pubcos are willing to offer rent concessions in cases where tenants are experiencing financial difficulty through no fault of their own, for example because of demographic changes or because of public house is closed for repairs. We recognise this as good practice and commend it to the industry as a whole. (Paragraph 162)
25. It is clearly to the benefit of both pubcos and their tenants that pubcos should encourage prospective and incumbent tenants alike to improve their business knowledge and performance through courses such as those run by the British Institute of Innkeeping (BII). Some tenants who would benefit might be deterred by the cost. We suggest that pubcos should consider providing support to their tenants to attend these courses through the payment of course fees or grants to enable them to employ cover for the period when they are absent from the public house. (Paragraph 165)
26. It would appear that the performance of business development managers (BDMs) varies across the industry from excellent to dire. We found no consensus within the industry as to their role and function. Some seem to be more concerned with the policing of operations in the public houses under their supervision rather than the provision of genuine assistance to tenants. We recommend that the industry should review the support offered to tenants to ensure the application of best practice in the provision of support to individual businesses. (Paragraph 171)
27. Dealing with tenants' complaints quickly and efficiently is good business practice for all companies. Pubcos should ensure that a higher level of sales support and technical service is provided to tenants than they might achieve on their own. The terms of these procedures and details of the consequences should complaints and problems not be dealt with to the satisfaction of both parties should form part of tenants' agreements or a binding code of practice. (Paragraph 177)

Balancing the costs and benefits of the tie

28. It should be remembered that this Inquiry stemmed from complaints about inequalities in the contractual relationship between pubcos and their tenants. On the basis of the evidence presented to us we feel that the immediately quantifiable cost of the tie is usually balance by the benefits available to tenants. However, this does not mean that for every tenant the costs equal the benefits, leading to some tenants getting into financial difficulties. In such cases pubcos could do more to redress the imbalance. Indeed, it became clear as the Inquiry progressed, that some pubcos demonstrated greater sensitivity to tenants problems than others. (Paragraph 188)
29. It is not clear that removing the beer tie would make tenants better off. In practice, pubcos, as property companies, would offset their loss of income from the wholesale price differential (wet rent) they charge by charging higher rents. The pubcos have the right to do this through clauses in their leases and would undoubtedly do so. Pubcos would maximise the rent for their properties as they would have no interest in expanding tenants' businesses. (Paragraph 198)

30. There is a danger that splitting the wholesaling and property functions of the pubcos would only benefit the international brewers who currently control the national distribution of beer. In the main, distribution companies owned by certain international brewers already deliver to the majority of tenanted public houses for the pubcos. Removing the tie would enable them to supply free from tie tenants with wholesale products directly. The national brewers would then have a virtual monopoly on the wholesaling of beer, as they did in the days before the Beer Orders. (Paragraph 199)

Code of conduct

31. Since the British Beer & Pub Association (BBPA) code of practice was updated in 1997 the industry has changed and we suggest that this code of practice should be revised as a matter of urgency. This should involve consultation with the widest range of interested parties. The areas we believe a code should cover include: rent reviews, the role of BDMS; complaint and dispute procedures; disclosure and the availability of information; and the taking of legal and professional advice by prospective tenants. (Paragraph 203)
32. At this stage we do not think a legally binding code of practice necessary, but if the industry does not show signs of accepting and complying with an adequate voluntary code then the Government should not hesitate to impose a statutory code on it. (Paragraph 204)
33. We hope that our successor Committee in the next Parliament will review the situation in the public house industry, in particular whether the code of practice is working. (Paragraph 205)

Formal minutes

Wednesday 8 December 2004

Members present:

Mr Martin O'Neill, in the Chair

Mr Roger Berry
Mr Richard Burden
Mr Nigel Evans
Mr Lindsay Hoyle

Ms Judy Mallaber
Linda Perham
Sir Robert Smith

The Committee deliberated.

Draft Report (Pub companies), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 205 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (reports)) be applied to the Report.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.—(*The Chairman*)

[Adjourned till Monday 13 December at Five o'clock.]

Witnesses

Tuesday 22 June 2004	<i>Page</i>
Mr David Bishop, Mr Alan Dunton, Mr Richard Harvey and Ms Linda Newport , Federation of Small Businesses.	Ev 1
Mr Mike Benner and Mr Jonathan Mail , Campaign for Real Ale(CAMRA).	Ev 12
Mr Arthur Brian Jacobs , A B Jacobs & Co and Mr John Tracy Kelly , Ferdinand Kelly Solicitors.	Ev 16
Tuesday 6 July 2004	
Mr Tony Payne , Federations of Licensed Victuallers Associations.	Ev 23
Mr Nick Bish, Ms Kate Nicholls and Mr Alex Salussolia , Association of Licensed Multiple Retailers.	Ev 30
Mr Martin Rawlings and Mr Rob Harward OBE , British Beer and Pub Association.	Ev 38
Tuesday 20 July 2004	
Mr Ted Tuppen, Mr Gordon Harrison and Mr Simon Townsend , Enterprise Inns plc.	Ev 46
Mr Ralph Findlay and Mr Stephen J Oliver , The Wolverhampton and Dudley Breweries plc.	Ev 65
Mr Giles Thorley, Mr Robert McDonald and Mr Francis Patton , Punch Taverns plc.	Ev 73
Wednesday 8 September 2004	
Mr Nicholas Stafford and Mr Keith Bott , Society of Independent Brewers.	Ev 84
Mr John Vickers, Ms Christiane Kent and Mr Bob MacDowell , Office of Fair Trading.	Ev 91

List of written evidence

Association of Licensed Multiple Retailers	App 1
Association of Licensed Multiple Retailers	App 2
British Beer & Pub Association	App 3
British Beer & Pub Association	App 4
The Campaign for Real Ale	App 5
Name confidential	App 6
Department of Trade and Industry	App 7
Enterprise Inns plc	App 8
Enterprise Inns plc	App 9
Enterprise Inns plc	App 10
Federation of Licensed Victuallers Associations	App 11
Federation of Small Businesses	App 12
Federation of Small Businesses	App 13
Ferdinand Kelly Solicitors	App 14
Linda Hudson, The Square & Compass (North Rigton)	App 15
InnSpired Group Ltd	App 16
A B Jacobs & Co.	App 17
Kossway Automatics Ltd	App 18
Paula Maddison	App 19
Morgan Stanley (Equity Research)	App 20
Ms Linda Newport and Mr Michael Parker, Brasenose Arms (Cropredy)	App 21
Office of Fair Trading	App 22
Punch Taverns plc	App 23
Punch Taverns plc	App 24
Mr S. Rennison	App 25
Society of Independent Brewers	App 26
Tim Wiggins, Golden Lion (Ashton Hayes)	App 27
Wolverhampton & Dudley Breweries plc	App 28

List of unprinted written evidence

Additional papers have been received from the following and have been reported to the House but to save printing costs they have not been printed and copies have been placed in the House of Commons Library where they may be inspected by members. Other copies are in the Record Office, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Record Office, House of Lords, London SW1. (Tel 020 7219 3074) hours of inspection are from 9:30am to 5:00pm on Mondays to Fridays.

Michael Adams	Mike Cattell
Shirley M Addy	Richard Caven
Stephen Alambritis	Phillip Clapham
Mr M A Allingham	Mr J C Clarke
J Anderson	Robert Clarke
James and Melanie Andriola	Ms Margaret Clark-Monks
Matthew 'Boris' Atha	Mr Fraser Cochrane
Hugh Archibald Peter Avis	Mr Chris Colley
Kenneth J Baines	The Commercial Hotel, Haslington
Michael Baines	Charlie D Corcoran
Ian Barley	Ian Cosford
Alvin H Barratt	Neale Coules-Miller
Mike Barter	Fiona Coulson
Mark Bates	Mr J Cozens-Hardy
Paul Beamiss	Caroline Cox
Chris Beaumont	Graham Cundall
Ann and Kevin Bedford	Alan Cross
Barbara Bell	John Cryne
Mike Bell	Simon Curzon
John Bell	Brian Dalby
Mr Tony Billings	Mr C P Davies
Ann Binns	Nigel Davies
Mrs P Binns	M J Devay
Mr Francis Blaitwaite	Mr D A Donaldson
David Blythe	T W Dooner
Mr T Booth	Mrs Maxine Doyle
Alan Bowker	Bernard Duffield
Bowland Beer	Duke of Cambridge Public House
Donna Brayshaw	Steve Dyson
Stephen Breen	John W Eddleston
Ken Brewster	Alan and Margaret Edwards
The British Association of Pool Table Operators Ltd	Mr Charles G Edwards
	Martin Elliot
The British Institute of Innkeeping	Mr V Ellis
Mr Ray Brooks	Philip Elsley
Mr R Broomhead	Bilgin Ersin
Jeremy Brunning	Dave Evans
Andy Burdon	Mr G Evans
John Burn	Mrs Geraldine M K Evans
B D Bush	Ray Evitts
Martin Carmichael	Keith Farman
Terence M Carter	Mr G A Farmer
Nick Cassell	R Feal-Martinez
	Flying Firkin

The Foresters Arms
Austin Foy
Mr Michael Freeman
Denis Frost
Mary Galliers
Gascoynes Ltd
Michael Ginley
Mr C Galloway
Mr E S Gardner
Mr Chris Gordon
Keith Gowthorpe
John Gray
Paulette Graydon
Dr Alan Green
Michael Hahn
Mr S P Haines
James Alexander Hall
Mr Barry Hamblin
Mr Donald Hamilton
Ray Hannon
Mr R S O'Hara
Mr A J Haresnape
Henry Harris
Mr Ron Hartley
Mr Martin Harvey
Mr Peter Harvey
Colin Hedderwick
Mrs M Hellawell
Mr C M Hems
Mike Hepworth
Matthew Heritage
Mrs B A Hewitt
Mr D Hilden
Nigel Hiley
Mr Laurence Hobday
Mr John Holland
Mr Gary Holman
M A Holt
Mr Peter Honeywill
Mr Michael Hooper-Immins
Mrs C Hault and Mrs Dale
Ken G Howard
Stephen R Howe
Linda Hudson
Ron Jackson
Adele Jenkins
Alan Jepson
Mr John Jewitt
Charles P Johnston
D Jones
Mr J W Jones
Ms Julie Jones
Nigel Jones
Rhys Jones

Bob Jolly
Mr T Joyce
Howard L Kay
Mr and Mrs Kenny
Eddie Kerins
Barry Kerslake
B Kidd
J W Kirman
Mr N W Kroner
Mr F J D Lambert
Graham Larkbey
Mrs Margaret Laventure
Brian Lawrence
Mr J Laws
Gary Lawson
Robin Leake
R W Leather
Adrian R Leith
Christine and Stephen Letch
Keith Lockett
Lurgashall Winery
Mr R J MacRae
Dr Ellis Maginn
Marbury Restaurants and Taverns
Limited

Aner Marcelo
John Marriott
Ian Martin
Geoff Mason
Steve McAulay
Ms Lorraine McCarthy
Kevin McGrath
Jim McIntosh
Nigel McNally
Mr G McNeilly
Bill Measure
Charles Melchford
Mrs J H Melton
Brett Midgley
A J Miller
Mr G E Moffat
Mr Keith Mortimer
Geoffrey Mumford
Mr D M Neale
Frank Nicholson
Mr Martin Orme
Mr Roger Parker
Patrick Moran Parsons
Divesh Patel
Richard M Payne
Mrs Karen Pendlebury
Mr J B Phillips
Mr A Phillipson

Mr Peter W Pipe
David Pollack
Mick Portman
A M J and L Powell
Richard Pressland
Mr B Pretty
Martin Price
Tony Prior
Roger Purdy
The Queen's Head Hotel
Mr David Rackham
Stephen Raine
David and Diane Raines
Mr J H Ralph
Adam Randall
Julie Reeman
James Rees
Harold Reeves
David Reid
Mrs M J Rhoden
Phil Rixon
David Roberts
Ms Michelle Roberts
Mr Alan Robinson
Mr Gavin Robinson
Tony Robinson
Andrew Ronnan
Peter Rose
David Rosling
Kim Ross
Brian Rothera
John Rothery
Barrie Rowsell
Lorraine Rowson
Royal Institution Chartered
Surveyors

Philip Ryder
Roger Saxon
Ulric Schwela
Mr P A Shakeshaft
Hugh Shipman
Philip Simmons
Mr Stephen Simpson
Mr S Sinclair
Mr Smith
Graham Smith
Graham and Sandra Smith
Lynda Smith
Mike Smith
Ms Sal Smith
Mr T A Spearing
Nick Stanton
Colin Steele

Geoff Strawbridge
Mrs Michaela Sweeney
Mr Clive Taylor
Stewart Taylor
Mr & Mrs P Taylor-Jones
Mr Andrew Theobald
Mr David Thompson
Vincent Thornton
Laurie Tighe
Mr K J Trace
Kevin Travers
Mrs W Turnbull
Patrick Twort and A P Clatworthy
Peter Underwood
Mr David C Wade
Ms Gail Wagstaff
Barry Walker
Alan Walsh
Mr P E Walshaw
Mr Nick Ward
Mr Peter Ward
K H Watson
Ken Watson
Edward Wegorzewski
Mrs Barbara Weightman
Jeremy Westcott
Trevor Wingate
Mr John Wheeler
Mr E J Whitaker
Jonathan C Wilson
Mr G W Wiggin
Tim Wiggins
Mr Robin Wignall
David Wilkes
N B R Williams
Mr Alan Wilson
Kevin Wilson
Mr M Witherford
John Wood
Mr J Woodin
Bob Woodruffe