



FORUM of
PRIVATE BUSINESS

For our members, not for profit

Pre-contract information

For tied pub tenants

fpb.org

Pre-contract information for tied pub tenants

If you are considering going in to the a tied pub lease, it's a great way to work for yourself and take advantage of the UK's love for the hospitality businesses but there are some important things you need to know before you go ahead a sign a contract.

The different types of pubs available in the sector

The industry has always grouped pubs according to its location, turnover and offer. Therefore, the sector is generally split into the following areas.

- Small community local (c100% drink) turnover c£4,000/week
- Community wet-led (c90:10, drink: food) turnover c£5,000/week
- Community wet-led (c90:10, drink: food) turnover c£8,000/week
- Community wet-led (c90:10, drink: food) turnover c£12,000/week
- Rural character (c50:50, drink: food) turnover c£5,000/week
- Rural character (c50:50, drink: food) turnover c£8,000/week
- Town centre pub/bar (c70:30, drink: food) turnover c£10,000/week
- Town/country food-led (c30:70, drink: food) turnover c£15,000/week
- Town/country food-led (c30:70, drink: food) turnover c£10,000/week

This split provides a simple breakdown of the expectations of the Pub, based on its trading history. However, it is important to recognise that an operator could choose to successfully change the operation using careful marketing and planning

Types of agreement

Leased

A lease is an agreement between either a sole trader or limited company and the owner of the Pub, who could be a private individual or a pub company or brewer.

A lease is normally assignable- that is it is either purchased from the owner of the Pub or the owner of the existing business and can be sold back to the owner or another business owner.

A lease is normally for a 10- or 15-year period.

Tenancy

A tenancy is an agreement either a sole trader or limited company and the owner of the Pub, who could be a private individual or a pub company or brewer.

A tenancy is normally for a short time period between 3 and 10 years.

Tenancy at Will

A TAW is a short-term agreement, normally agreed between Pub Owning Businesses and a self-employed tenant, in which a short-term agreement is signed for. This normally occurs when the Pub is either for sale or awaiting some form of development, or there is little interest to support a longer-term agreement.

Managed

A managed pub, is owned by a brewery or a pub company and run by a manager rather than a tenant.

Industry Sectors

There are approximately 47,000 Public Houses situated throughout the UK.

The ownership of these Pubs is divided in round figures between Pub Companies and Regional Breweries who own about 20,000 Pubs and which are mainly let on Tied Lease or Tenancy Agreements to Self Employed operators. Then Multiple Licensed Retailing Companies who account for about 9,000 Pubs who own and run them by employing Managers and Staff. Finally there are around 18,000 privately owned Freehold and Leasehold Pubs who make up the balance.

Regional Brewers

Marston's and Greene King are two of the largest regional brewers in the Country although the name 'regional' is misleading as they own Pubs all over the Country.

Regional brewers have been reduced over the years as they have been purchased by the growth of pub companies – for example in the Midlands, Ansell's Brewery was purchased by Punch Taverns.

Family Brewers

These are more regional in nature and are classed as family owned brewers of which there are 30 in the Country.

They predominantly operate a leased or tenancy model and tie the operator into selling their own brewed products. Some family brewers just operate a managed operation.

familybrewers.co.uk

Pub Companies

Following the Beer Orders of 1989, the government ruled that the brewers had an unfair grip on the trade and enforced limits on the brewers estates. This led to Pub Companies (Pubco's) purchasing regional brewers, they do not brew any beer themselves but own breweries.

Listed below are the largest pub owning businesses in the UK:

- Ei Group
- Punch Taverns
- Admiral Taverns
- Trust inns
- Wellington Pub Company
- Hawthorne Leisure
- New River Retail

Why do you want to take on a pub?

Going into a Pub takes commitment and hard work and is not without huge levels of risk. In fact, the driving force behind the campaign to reform the Pub industry, is based on rebalancing the levels of risk and reward. In 2011 the Campaign for Real Ale produced analysis that the average “tied” tenant earns less than £13,000 per year.

The industry often refers to “lifestyle” applicants, that is people who like the idea of running a Pub which will offer them a style of life which is cosy and relaxing. This is far from the truth and in reality, it is very rare to be able to run a Pub without working, easily in excess of 100 hours per week for modest returns.

To make a pub work you have to have a multitude of skills and if you don't have those skills then they have to be “bought” in and therefore to do that you have to be profitable.

In many instances we are seeing the rise of the “Community owned” pub in which a village will purchase a failed Pub and run it as a community venture. Often the Pub will include other services such as Post Offices etc. However, it is vital that whatever the venture, it must have a viable business plan and have someone who is knowledgeable about the pitfalls in the industry.

The Plunket Foundation has focused on providing support for the community owned pub and provide a mixture of business support, grants and loan finance to communities across England.

In many instances the fact that a Pub has failed does not mean that it is not viable – there are countless examples of tied Pubs that have had numerous operators, that have gone on to be successful free of tie operations.

If you have an emotional attachment to one pub, or are a community looking to buy a particular one, all your eggs are in one basket and the pubco may take advantage of this. The more options you have the better chance you have of getting a better deal.

Calculating your rent

Rents are calculated according to guidelines set by The Royal Institute of Chartered Surveyors, and they are arrived at by using the "Profits Method".

The rental figure for a Pub is determined using the following calculation:

Turnover (£) (Fair Maintainable Trade)

which is used to calculate the estimated

Gross Profit (£)

from which

Costs

are taken to arrive at what is known as a

Divisible Balance (net profit)

this is then usually divided in to two to produce

Tenant Profit / Rent

Rent calculation example

Turnover (£) (Fair Maintainable Turnover)	£300,000
Gross Profit 50%	£150,000
Costs 37%	£111,000
Divisible Balance (net profit)	£39,000
Rent	£19,000
Tenant Profit	£19,000

The main problem with this method of calculation is that it is effectively based on a number of figures which are estimates and the figures are therefore easily manipulated, which results in an inflated rental figure.

Turnover or Fair Maintainable Trade is based on what can be achieved by what is known as a "Reasonably Efficient Operator". The definition of an REO has never been satisfactorily summarised, with the exception of RICS who state in their guidance that an REO is:

A competent operator, acting in an efficient manner, of a business conducted on the premises. It involves estimating the trading potential rather than adopting the actual level of trade under the existing ownership, and it excludes personal goodwill.

It is at this point that one of the key principles of the RICS guidelines should be used – that the tied Pub tenant should be no worse off than if they were not subject to a service tie.

Every time the Business and Industry Select committee has investigated the tied pub model, they have asked for clarification of the guidelines and yet this has been never forthcoming.

The guidelines are just that – a guide that do not have to be followed by the surveyor who will use their own experience to agree a rent.

However, it is important to be aware that the Trade Related Valuation Group, which is the organisation within RICs that specialises with pub rents, has often seen to be deeply conflicted due to the fact that they are reliant on the POB model for both the assessment of rents and the buying and selling of the lease and freehold of Pubs.

The benefits of being tied

The tied business model exists on the basis that it is recognised that you pay more for your beer but in return you receive a benefit of some kind. This benefit is known as a “Special Commercial or Financial Advantage” or SCORFA.

It was recognised in the first Trade and Industry Investigation in 2004 as a Countervailing benefit as the tied tenant was offered a “lower than commercial or free of tie dry rent and special commercial advantages.

These SCORFA’s were supposed to reduce your costs when taking on a tied Pub and therefore, logically the principle that “the tied tenant should be no worse off than the free of tie” applies when calculating the rent of a tied Pub as it is important to take account of the reduction in the costs to countervail the loss of profit by paying more for your beer.

The Brewer or Pubco should offer an advantage to the tied operator through marketing support or some element of training that the operator would not have if they were running a free of tie pub.

When choosing a Pub company to go into business with, it is important that the value of the SCORFA is quantified as this is critical to the rent calculation.

If no SCORFA is on show, then the question must be asked as to the quality of support that a tied tenant will receive.

The landlord and Tenant Act 1927

The Landlord and Tenant Act was, prior to the Pubs Code the only legal act that gave protection to tenants and landlords.

The Act was written in 1927 and then revised in 1954, although only certain areas were subsequently clarified. For example, the law regarding dilapidations was not amended in the 1954 Act and therefore any issues within the area of dilapidations are covered by the 1927 version.

The L & T Act has many areas within it, which are crucial in terms of the legal processes that are intrinsic to what is a specialised part of property law.

The Act covers important areas such as dilapidations and the distribution of correct notices when an agreement between two parties is coming to an end.

It also covers the legalities when an agreement between two parties breaks down.

One of the common misconceptions when referring to the L & T Act is when a landlord requires a tenant to “opt out of the Act”. This is most common when the landlord does not want the tenant to automatically have the right to renew an agreement, when it comes to an end, which is written into the act.

The key point is that when you “opt out of the act” you do not opt out of the whole of the act, but just the option to renew. Therefore, opting out of the Landlord and tenant act means that you are still covered by the terms of the Act but have agreed to waive your automatic right to renew your agreement.

Opting out of the Act is, in itself a specialised part of law and the law was revised following many tenants and lessees “opting out” without realising it.

The stages are as follows:

- The landlord sends the tenant a warning notice drawing the tenant’s attention to the protection it will be signing away (and usually attached to a copy of the agreed form of lease to which it relates);
- The tenant makes a formal declaration to the effect that it has read and understood the notice and accepts the consequences; and
- The parties sign the lease which expressly contains the contracting out agreement (reference to the notice and statutory declaration must be contained in or endorsed in the document creating the tenancy).

The notice must be served on the tenant at least 14 days before the tenant is contractually bound (this is considered akin to a cooling off period to ensure the tenant has sufficient time to consider their actions).

After these 14 days have lapsed then the tenant would sign a ‘simple declaration’ stating that they have received the notice and accepts the consequences of entering into a contracted-out lease.

However, if the parties cannot or do not want to wait the required 14 days, then the tenant can sign a 'statutory declaration'. This is in a similar form as the simple declaration but must also be signed and witnessed by an independent solicitor or a commissioner for oaths. As it is considered the best course for the notice and declarations to be taken at the latest possible stage, the statutory declaration route is used more often than not.

Dilapidations

Dilapidations are the most widely misunderstood areas of property law and therefore are the most easily manipulated. However, unlike much of the industry, dilapidations are covered by the Landlord and Tenant Act and then subsequently referred to in guidance set out by the Royal Institute of Chartered Surveyors.

Section 18 of the 1927 L & T Act refers specifically to repairs that have to be undertaken under either a lease or tenancy. Despite what the legal agreement may say between landlord and tenant, the fact remains that dilapidations are covered by law and therefore you must know and understand your legal right.

The 1927 L & T Act refers to two specific areas or "Limbs"

The first states:

'Damages for a breach of a covenant or agreement to keep or put premises in repair during the currency of a lease, or to leave or put premises in repair at the termination of a lease, whether such covenant or agreement is expressed or implied, and whether general or specific, shall in no case exceed the amount (if any) by which the value of the reversion (whether immediate or not) in the premises is diminished owing to the breach of such covenant or agreement as aforesaid;'

What this means is that the owner/landlord of the building can only claim for their "loss" which is classed as the reduction of the value of the property if the dilapidations are not completed.

The second Limb states:

'And in particular no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown that the premises, in whatever state of repair they might be, would at or shortly after the termination of the tenancy have been or be pulled down, or such structural alterations made therein as would render valueless the repairs covered by the covenant or agreement.'

This limb means that the Law does not allow the Landlord of the pub to charge for any work that may be deemed necessary, if the landlord has a requirement for the pub to be refurbished or even demolished.

The landlord/pub companies can only claim back from you their "loss" and this loss is restricted by law to the reduction in the capital value of the property if the dilapidations are not done. This is known as – "The Diminution of the Capital Value of the Property or "reversion of the value of the Property".

A dilapidations survey is carried out by a surveyor at the request of the landlord but at a cost to the tenant. This is around £800. In the report they will detail all areas of the property they feel need work or repairs to be undertaken. This will result in a bill payable to the landlord in order to carry out the repairs.

You do have the option to carry out the repairs yourself, this could work out cheaper than paying the dilapidations bill.

It is important to review the survey in detail as the report should only include work or repairs needed in order for the pub to not be reduced in value.

If the tenant does not agree with the report they can appoint their own independent surveyor, this would mean paying another fee. Once completed all parties would need to try and reach an agreement for a fair dilapidations bill...easier said than done.

Terminating your agreement

Whilst most agreements are detailed in the second limb of the Landlord and Tenant Act, the detail within the agreements can differ, even if the name of the agreement is the same. Therefore two 5-year tenancies can have different terms within them such as differing termination times and requirements.

Before you sign your agreement, it is vital that you understand clearly how you get out of it and also what your POB/ Management Company have to do to remove you from site.

Some agreements will require a period of notice, that if breached will require all the loss of profit and rent.

Some lease agreements will require the repayment of the rent for the length of the lease and lost profits.

With regard to the termination from the POB, in the case of the "retail" agreements, they are extremely strict in the reasons for termination of the agreement with targets that are easily missed or reporting procedures which are impossible to achieve.

Tenancy at Wills often have little or no notice requirement from either side

Brulines Dispense Monitoring

Pub companies that "tie" their business partners, often have a measurement system put into the Pub which records the level of dispense that is produced at the pumps.

Dispense Monitoring, records the total volume of liquid that passes through the beer lines 24 hours a day, 7 days a week. It recognises the brand performance of draught beers, ciders, lagers, spirits and post mix — and helps you maintain an effective line-cleaning regime.

This system is known as Bruline's or Vianet and is the name of the operating system.

The system of measurement has been hugely controversial as it has been used to implement fines to tenants as any discrepancies between what was purchased and dispensed is seen by the Pub Owning Businesses (POBs). This is being used as evidence of “buying out” of tie – in some instances this can even result in forfeiture of your agreement.

The reason the system is so controversial is that it has never been shown to be accurate and on a number of occasions the POBs and their representatives have made claims about the system that are simply untrue.

In 2008, the Punch CEO, Giles Thorley stated to the Business and Innovation and Skills committee that Brulines was so accurate it could tell the difference between Beer and water- something that it could not do.

Many licensees have conducted “unofficial” tests on the system, which demonstrate a variance between what has actually been dispensed and what has been recorded, of as much as 30%. This evidence has been provided to the 2008 and 09 investigations into the industry and when the Pubs Code was introduced in 2016, a regulation was placed in the code to address this issue.

Regulation 51 states:

Flow monitoring devices

51.—(1) A pub-owning business must not subject a tied pub tenant to any detriment, or impose any liabilities on the tenant, as a result of any reading taken from a flow monitoring device, without additional evidence in connection with the purchase and stock of alcohol at the tied pub.

(2) A “flow monitoring device” means a device which is at the tied pub at the direction of the pub-owning business—

(a) to measure the amount of alcohol (1) being sold by the tied pub tenant; and

(b) for the purposes of verifying that the tenant does not sell alcohol at the tied pub in contravention of the terms of the tenancy or licence.

The main concerns of the system are based on the fact that any movement of air in the beer lines can be seen to turn the flow meters which measure the dispense. Furthermore, the system is reliant on the interpretation of the individual disseminating the data, and during a period of line cleaning the system will register dispense, which could simply be water.

Pubs Independent Rent Review Scheme (PIRRS)

Following the criticism levelled at the industry following the 2008 BISCOP report, an independent rent review scheme was set up, supposedly to offer a cheaper resolution when rents come into dispute.

Most licensed property Leases and Tenancy Agreements detail that if a landlord and a tenant cannot agree at rent review time, this must be referred either to Arbitration or to an Independent Expert.

Both processes work relatively well in the wider commercial world, but each are time consuming, ideally require specialist knowledge to commit to them and are usually expensive. It was feared that tenants were often agreeing the rentals set before them by their landlords simply because they couldn't financially afford to do otherwise.

The position concerning tenancy or Lease renewals was similarly difficult. If the parties could not agree the new rent the matter was referred to the Courts. Again, time consuming and expensive.

Recognising these anomalies, following a series of British Institute of Innkeeping (BII) rent review road shows across the country, a framework was agreed in 2008 within the industry for a new organisation. The Pubs Independent Rent Review Scheme (PIRRS) was established to provide a low-cost equitable method of resolving rental issues and for the BII to provide the administrative backup for this.

The rent is decided by a PIRRS panel Independent Expert who possesses the requisite level of skill, experience and expertise. The choice of Independent Expert is selected by the tenant from the PIRRS panel. The tenant's selection of an Independent Expert will be considered to be final subject to the potential appointee not declaring that this would result in their being placed in a conflict of interest situation (e.g. if they have represented one of the parties previously within, say, the last five years).

However, like so many initiatives within the industry PIRRS has been dogged by criticism of conflict of interests from the small group of surveyors that have cornered the market when setting rents. The consistent concern is that many surveyors on the PIRRS list are reluctant to adhere to the principle that the tied tenant shall be no worse off, because it may mean they can no longer obtain work from Pub Owning Businesses (POBs) within the industry.

Pubs Independent Conciliation and Arbitration Service (PICA-Service)

In 2010, following the 2009 investigation into the industry, the coalition government introduced the Pubs Independent Conciliation and Arbitration Service (PICA-Service).

The Pubs Independent Conciliation and Arbitration Service offers an accessible, independent, low cost dispute resolution service to the licensed industry, which allows tenants/lessees and Pub Companies/Breweries with 1-499 pubs to resolve disputes in a fair and timely manner.

Unfortunately, the first chairman of the service was Roger Vickers, a surveyor who had close links to Punch Taverns. He was clearly seen as lacking independence and as a result the service gained little traction or support, resulting in the introduction of The Pubs Code

Both of these services now come under the governance of the PGB (Pub Governing Body), provided by six of the industry's leading associations representing both tenants and landlords - the Association of Licensed Multiple Retailers (ALMR), Brighton and Hove Licensee Association, the British Beer and Pub Association (BBPA), the British Institute of Innkeeping (BII), the Federation of Licensed Victuallers Associations (FLVA), and the Guild of Master Victuallers (GMV).

The Pubs Code

Following 4 investigations into the industry, and a further investigation into self-regulation it was decided that the Pub industry was completely unable to regulate itself, having ignored every opportunity and recommendation from the investigations.

The Pubs Code was introduced as part of the Small Business and Enterprise Bill 2015 and formally went live in July 2016.

<http://www.legislation.gov.uk/ukxi/2016/790/contents/made>

The legislation was introduced to combat the perceived, systematic abuse of tied tenants and was underpinned by two core principles:

1. The tied tenant shall be no worse off than if they were not subject to a service tie
2. Fair and lawful dealing.

The legislation is managed by the Pubs Code Adjudicator (PCA) – a surveyor called Paul Newby, who was appointed in early 2016.

The Pubs Code is based on the Grocery Code and has the powers to act as both a regulator and an arbitration service.

The key part of the Code that has the ability to have the greatest impact on the industry is the introduction of the option for a tied tenant to choose to obtain a Market Rent Only agreement.

The MRO has been immensely controversial due to the changes to the legislation during the drafting of the law, which has changed the intent of the MRO effect.

True MRO was introduced as an amendment to the Pubs Code in November 2014 and was designed to enable a tied tenant to choose to go free of tie without changing the terms of their current agreement.

Due to the complexities of the legislation and the challenges made by the POBS, the legislation has failed to achieve this goal and tied tenants attempting to use the MRO option are having to go through a lengthy process to obtain the ability to go free of tie with quite often terms in their agreement which are very different.

The Pubs Code Adjudicator is only used in the event of a dispute between the parties and uses arbitration as its main focus of resolving issues.

Unfortunately, many believe that the failure to regulate in any way has resulted in the PCA being ineffective and has made little impact on the behaviour of the industry.

One of the effects of the threat of the legislation is the changes to the business model that the POBS run. The Pubs Code directly threatens the huge profits that are made through the “tie”, and therefore there is clear evidence that long term agreements are being changed to agreements that are not covered by the Code.

Tenants are facing an increase in unfair business practices as a direct result of this change from

traditional leased and tenanted models to more managed and retail operations.

The Pubs Code is expected to be reviewed imminently and many changes are expected to occur.

Business Development Managers

Pub companies, Brewers and managed operations offer support through Business Development Managers or similar.

BDMs are by definition responsible to the company to which they are employed. It is something of a misconception that the development of the pub is mutually profitable but most often the BDMs emphasis is on making sure that the Pub provides a level of profit for the company.

Many companies have a bonus structure for their BDMs which is based on a number of profit sectors that may not be aligned with the tenant they are supposed to support.

The Pubs Code legislated for this area, due to the number of complaints that were registered through the BISCUM investigations.

As a consequence of this, it is a requirement of the Code that records of meetings are provided, following any discussions between a BDM and the tied tenant.

As a rule, any meetings should be witnessed, and phone calls and texts should be followed up at all times.

Useful support and why you might need it

If you are considering going into partnership with a Pub Owning Business (POBS) then it is vital that you do your homework. The tied model is and has been easily exploited over the years, to the extent that the Government recognised that regulation was the only way to stop the abuse of the tied model.

The brewing industry has changed very little over the years, and what is known fondly as "tradition" is often ruthlessly exploited by those who see confusion as an opportunity to exploit.

For example, the industry refers to turnover in terms of "barrellage". A Pub will turn over so many barrels a year but in fact the brewing industry uses the traditional measure of barrels which is a 36-gallon measurement. Furthermore, this is applied to all areas of liquid sales, so a rent assessment may refer to so many "barrels" of wine that the Pub should sell.

Many of the industry experts are conflicted by the relationship they have with the POBS or are reliant on their ongoing success.

The British Institute of Innkeepers and the Federation of Licensed Victuallers, both champions of the tenants in the past have become much more reliant on financial support from the large Pub owning businesses and have therefore the support offered is limited.

True independent industry support is limited therefore and in 2010, recognising this, the Government recommended that there should be an organisation set up that offered advice to tenants.

The Pubs Advisory service provides an unvarnished and completely objective support mechanism through a membership service.

PAS, run by a debt Management expert, Chris Wright has been involved in all aspects of the Pubs Code legislation and offers support for both MRO and unfair business practices

<https://pubs.expert>

Business advice, support and protection.

The Forum was founded in 1977 as a not for profit membership organisation which supports small, private and family firms who need to comply, but don't have their own internal human resources department and legal teams.

All our profits go back into providing better services and support for our members.

We know how important it is to support our member's businesses, from a start-up in the early years of operation, to businesses that have been trading for many years.

It is vital to have the right advice, support, and protection in place and that means more than just the average one size fits all business advice that is currently out there. We offer friendly, accessible and practical advice, supported by legal protection insurance.

With a forum membership, your business will have access to a team of experienced membership advisors and Forum partner network that will be able to share their knowledge, support and advice in some of the most complex of situations you may come across in business.

We offer support with **Employment Law**, **Health and Safety**, **Finance**, to business planning and **PR** to name a few.

Our members businesses cover many different industries, who don't necessarily have the internal expertise or resources to manage the more complex compliance aspects of their businesses.

- **Employment Law**
- **Health and Safety**
- **Finance & funding**
- **Tax Advice**
- **PR & Marketing**
- **General Business Advice**

Making your business better

Forum of Private Business Ltd
Ruskin Chambers, Drury Lane
Knutsford, Cheshire WA16 6HA

Registered in England and Wales: 01329000