TIED PUBS (SCOTLAND) BILL AT STAGE 2

G1 GROUP PLC / IONA PUB PARTNERSHIP

Timescales for implementation

Implementation of a Scottish Pubs Code would be a significant undertaking for the vast majority of tied pub landlords, ourselves included, and it is critical to the successful operation of any code that sufficient time for consultation and implementation is allowed.

In this respect, the impact of Covid-19 cannot be understated. The vast majority of staff in our business are on some form of furlough arrangement, allowing the support of tenants and other basic business functions to continue but nothing beyond that. At this point in time, it is impossible to predict the manner in which restrictions will be eased and the timing of that. We have assumed, within our business planning, that any easing will be gradual and will likely involve a lengthy timetable of steps from initial limited reopening to full business operations resuming in something resembling life before Covid-19.

When we are able to, our business will deploy significant staff resources in the processes required to reopen our own business and assist tenants in reopening their businesses. Were it not for Covid-19, an element of this staff time could reasonably be set aside for matters concerning the Bill. However, given the presence and impact of Covid-19, we respectfully suggest that consultation in respect of any Scottish Pubs Code cannot feasibly begin until full business operations have resumed across the pub industry, in a pre-Covid-19 manner (or as close to that as practicable). While we continue to consider the Bill unnecessary in principle, any timetable attached to it must take account of the current circumstances.

Retrospection

We agree with the Minister that tenants should not be entitled to raise cases long after they have ceased trading.

If the Bill was to progress, we suggest that claims should not be permitted more than three months after the tenant in question leaves the pub. For reference, this is the same timescale as is applied to the bringing of employment tribunal claims by employees. Although not completely analogous, we respectfully suggest this policy approach should be followed in respect of pub arbitration.

Levies to be proportionate

As reflected in our initial submission, we are concerned by the impact of the proposed levy on pub-owning companies.

We note one MSP stated during the Stage 1 debate that sometimes the sign of a good law is that it is not often used. While that general principle may ring true, in this case it ignores the fact that a considerable levy will be placed on the industry to facilitate a little-used Scottish PCA.

This will clearly be a significant burden on a relatively small industry. While the equivalent cost is borne by pub-owning companies in England and Wales, the businesses bearing such costs are generally much larger in scale.

We repeat our significant concerns in respect of the quantum of the levy. Given the Bill envisages, at section 16, that pub-owning companies will separately bear the cost of arbitrations in most circumstances, it appears the levy is not intended to cover these costs.

Therefore, the appropriateness of the proposed levy is perhaps best assessed by considering the quantum of the levy by reference to the number of enquiries the Scottish PCA is estimated to receive. In terms of Table 3 in the Financial Memorandum to the Bill, 55 enquiries are envisaged in year one, with this decreasing significantly to 16 in year two and 11 in year 3.

With an estimated initial levy of £260,000, this would give a cost per enquiry in year one of £4,727. If we assume there was no increase in the estimated levy in years two and three (which has not been borne out in England and Wales, where the levy has increased year on year), the cost per enquiry would increase to £16,250 in year two and £23,636 in year three.

Assuming the levy was maintained at broadly the estimated level for the first four years of a Scottish PCA, this would result in the industry being asked to contribute approximately £1m in order to facilitate a system where the Scottish PCA is assisting with less than 100 enquiries over the same period. We submit a burden of this level would be difficult to justify in normal times but the economic crisis we are currently going through, during which pub-owning companies have offered significant support to tied tenants, makes the levy appear even less justifiable.

While our position remains that the Bill is unnecessary, we suggest that if the legislation is genuinely considered to be in the wider public interest, the cost of operation of the legislation should be borne by the public purse rather than by a levy on pub-owning companies.

Beyond the issue of the levy, we believe the proposals in section 16 of the Bill are extremely concerning and contrary to the principles of reasonableness and equity. These proposals suggest that pub-owning companies should bear the costs of arbitration of any dispute except where the arbitrator has found that the tenant's submission of the matter to arbitration was vexatious.

This lies contrary to the standard arbitration provision in commercial leases and other contracts, to the effect that the parties will bear arbitration costs equally, unless the arbitrator found that one party should bear a greater share of the costs (which would most commonly arise if that party took a particularly inappropriate position in the run up to or during the arbitration). There appears to be no justification given for the Bill taking this divergent path from normal commercial practices. We suggest normal commercial practices should be reflected here.

Thresholds

As set out in your Committee's Stage 1 Report, the Scottish market contains a relatively small number of tied pubs (as a proportion of all pubs) and ownership of these tied pubs is relatively diverse. All of this ensures competition among operators. The difference in negotiating power that is perceived to exist in England, as between the largest pub-owning companies and individual tenants, simply does not exist in Scotland.

The only pub-owning company which could be said to have a particularly significant Scottish market share is Star Pubs & Bars, with 250 pubs (over a third of the total). However, we have seen no evidence to suggest their market share has resulted in a disparity in negotiating power between landlord and tenant.

Against this backdrop, we remain unconvinced that the Bill is necessary. However, if it is progressed, we agree a threshold is necessary to protect smaller pub-owning companies.

We see the logic in the proposal from Tennent Caledonian Breweries that the Bill could apply to pub-owning companies with over 500 pubs across the UK, thus focusing on the largest operators and avoiding penalising pub-owning companies simply for investing and operating in Scotland.

If there was to be a separate Scottish threshold for pub-owning companies, we suggest this be set at 200 pubs. Although bringing this level of regulation to smaller business is arguably more penal than the English threshold, we suggest this would provide appropriate balance.

Court Appeal Process

We have no comment to make on this matter.

Guest Beer Agreement

We refer the Committee to the comments in our earlier submission, where we explained our existing arrangements in respect of guest beers and our support for smaller brewers. For these reasons, we remain unconvinced that a guest beer arrangement is genuinely necessary.

We note the comments made at the tied pub tenants focus group which your Committee held during August 2020. Half of the tenants represented already had access to guest beers. Those participating in the forum viewed the proposed guest beer arrangement as being something which may assist them in stocking more products from small Scottish brewers. It is clear the support behind the guest beer arrangement is predicated on the fact it is intended to support local businesses and we are supportive of that intention. Indeed, our recognition of the importance of local and craft beers in the overall product mix at some pubs is the reason we have guest beer arrangements of the type we previously described.

We are alarmed by Neil Bibby's comments, referred to in the Stage 1 Report, that the guest beer arrangement could just as well support the stocking of a mass-produced lager as a local craft beer. These comments suggest tenants would be entitled to effectively bypass the tie but without the resultant rebalancing of financial obligations that would occur through the MRO option. This appears to sit contrary to the spirit of the remainder of the Bill, as drafted.

We also note, in the context of the then-proposed English legislation, that the London School of Economics modelling (prepared for the UK Department of Business, Innovation and Skills in December 2013) estimated that a guest beer arrangement of the type suggested by Mr Bibby (where the guest product could be a mass-market lager) would result in around double the number of pub closures as compared to the number of pub closures likely to arise without such a guest beer arrangement being in place. This wider impact should be closely considered by the Committee.

We submit that any guest beer arrangement should be framed in a manner which ensures that it fulfils its purpose of supporting independent local brewers. We suggest this might be achieved by allowing guest beers to be purchased from small Scottish brewers with an annual output below a certain level of hectolitres. It may be appropriate to include small brewers in the north of England, who may be local to some Scottish pubs in the Borders and Dumfries & Galloway regions.

We recognise that not every pub has a choice of independent brewers in its local area and, for that reason, we do not believe it would be appropriate to limit guest beers specifically by reference to the distance between brewer and pub.

MRO Triggers

As noted in our earlier submission, we do not agree that a MRO option is required. We submit that, if the Bill was to be taken forward, any MRO option should only be available at certain appropriate trigger points, similar to the system in England and Wales, so that parties can be certain of their position in the short term.

These trigger points allow tenants to seek a MRO option if the economics of the pub operation change significantly or if the lease term renews. This gives both parties a level of certainty as to their position in the short term, allowing for appropriate budgeting, supply chain negotiation and allocation of resources. It should be recognised that this short-term certainty is critical for pub-owning companies.

Operating a wider system in Scotland, where any tied tenant could seek a MRO option at any time, would cast uncertainty on the industry and unfairly prejudice pub-owning companies. It may also cause them to fall into breach of commercial contracts within their supply chain. Uncertainty around demand within the supply chain may also ultimately lead to remaining tied tenants being unduly prejudiced, as any unexpected reduction in economies of scale may result in increased supplier pricing.

We also submit that any mechanism for determination of rent should be drawn on broadly similar terms to the standard mechanism for rent review determination in the

Scottish commercial leasing market, including the fact that both parties must contribute equally towards the cost of independent determination, except where it is found that one party took a particularly inappropriate position during the process.

Income tied tenants receive

As the Committee will appreciate, we do not have full visibility of tenant accounts and so cannot authoritatively comment on income received. We tend to only have sight of tenant income and profit figures during any rent review process. This usually occurs on a five-yearly basis.

However, we have reviewed the published accounts (on Companies House) of those of our tenants which are incorporated companies, in order to provide input in respect of this point. We should note that many of our tenants are sole traders and do not publish accounts. A fair number of our tenants which are limited companies publish abbreviated accounts and it is not possible to discern much useful information from these accounts in respect of annual income and profit. That leaves a relatively small pool to sample and we give two examples below. Albeit this information is in the public domain, we have anonymised the tenant details for the purposes of this submission.

Tenant 1 – a limited company leasing two tied premises on the outskirts of Edinburgh. Accounts disclose that shareholder dividends of £70,000 were paid to the two shareholders/business owners for the year ending 31 March 2020. We do not know whether the two shareholders also drew a salary from the business.

Tenant 2 – a limited company leasing one tied premises in Glasgow. The last published accounts, for the year ending 31 March 2020, do not disclose any dividends but show cash at bank of over £900,000 and shareholder funds of over £700,000 once current liabilities are accounted for.

We acknowledge this small sample will not be completely representative of our estate, as tenants dealing with lower sums are less likely to be required to publish full accounts.

Like any commercial landlord and like our tenants, we seek to make a profit from our business. That will not surprise the Committee, as commercial operations must make a profit to continue trading. Like any commercial landlord, we cannot make a profit if our leased properties are vacant, so we must ensure that our tenants are able to make a sustainable profit from their operations at our pubs, so as to keep them in occupation. We do this by ensuring that rent and tied income levels are sustainable for the tenant.

If a tenant reports they are struggling financially, we ask for full disclosure of financial performance data to understand what support is required. Sometimes the tenant requires business operations support to increase revenues and we have the expertise to provide that support. In other cases, we have supported tenants through rent reductions, reductions in tied beer pricing, investment in the property to increase revenue or even support with payment of utility bills.

We note the income figures given in the CAMRA survey. We do not consider these figures are truly representative of tied tenant income, at least in respect of our own estate.

We note it is unclear from the CAMRA survey reporting as to whether the income reported by tenants is gross or net of tax implications and whether it takes into account, for example, the benefit of any tenant's accommodation provided with the pub.

Additionally, there is a body of international research suggesting that self-employed individuals are likely to underreport income on household surveys by something in the order of 20-30%. The CAMRA survey should be considered in the context of this research.

Divergence of tenant views

We agree the Committee is right to question the need for this legislation, given the divergence of tenant views. If Neil Bibby's submission that there are deep-rooted problems within the tied pubs sector was correct, we would have expected to see almost universal support for legislation, among tied tenants. This level of support clearly does not exist.

Sandra White MSP referred, in her speech during the Stage 1 debate, to receiving 19 submissions from publicans, all of whom were against the Bill. Bob Doris MSP referred to ten tenants of Hawthorn Leisure who had contacted the Committee directly to express their opposition to the Bill.

We appreciate there are tenant comments in favour of the legislation, some of which have been marshalled by those proposing and supporting the legislation.

The basic proposition made to tenants, by those supporting the legislation, is as follows: you have an outgoing at level [x]. Under this legislation you would have the option, at little cost to yourself, to have that outgoing reviewed and be offered an alternative level [y]. If you prefer option [y], you can change to that but you can equally stick with option [x] if you wish. It is, therefore, unsurprising that there is some tenant support for the legislation, when tenants are presented with that proposition alone. It appears to be a win-win for them.

However, that proposition ignores some of the likely consequences of the MRO option. These include the divestment and closure of the poorest performing pubs, where an already marginal financial proposition for pub-owning companies may be tipped into a loss-making proposition. At the other end of the market, if a MRO option is likely to result in material reduction in income from the best performing pubs in a portfolio, some landlords, including ourselves, would likely look to take these pubs under management in the fullness of time and run them without a tenant. Other negative consequences are referred to in our previous submission.

We believe that if tenants understood the full ramifications of the Bill, the current divergence of views may sway more towards those negative views which you have heard.

Indeed, the small number of tenants who have previously told us that they have an issue with their tie have all run businesses that were very successful. As with all successful businesspeople, they looked for ways to make greater profit from their pub, for instance by seeking to negotiate a greater discount on tied products or lower rent.

It remains the case that the tied model has provided the vast majority of our tenants with an opportunity to run their own pub business, without having to invest the large sums of cash that a free of tie option would require. It is a model in which both parties share the risk and reward of the business, on terms which are clear to both parties at the outset.

Before we lease a pub to a new tenant, we take them through a long and thorough recruitment process. There is a lengthy application form and SWOT analysis then a first interview with one of our business development managers. The tenant must then complete a detailed business plan, including a projected cash flow and profit and loss account for the first two years of the business. The business development manager will provide the tenant with detailed barrelage information, machine income and prices for all the tied products, as well as details of the other expenses that go with running the pub.

There is then a second meeting between the tenant and the business development manager, when the business plan and cash flow are discussed in detail. The tenant is asked to provide evidence of their available funds, for initial rent, stock and other ingoing expenses. The tenant must also provide us with a credit check from a Credit Reference Agency.

All of this is done to ensure that the tenant embarks on its tenancy fully informed, having considered all aspects of the operation. Such tenants are less likely to fail, which is to the benefit of both parties.
Ultimately, the contractual terms of the tied relationship are clear to the parties at the outset of the arrangement and the parties each have an opportunity to negotiate and consider whether the arrangement is suitable for them before proceeding with it.

Investment on hold due to pandemic

Due to the pandemic, we have put on hold £2m of investment expenditure across eight projects.

Support of non-tied tenants during pandemic

We have offered bespoke support to tenants, depending on the nature of the relationship, the Covid-19 restrictions applying to the area in which the pub is related and the tenant’s ability to trade partially, for example by offering takeaway services.

Although support is bespoke, the nature of the support offered means a tenant of a tied pub in our estate would receive greater support than a tenant of an identical (hypothetical) free of tie pub in our estate.

MRO option in other sectors

We are not aware of any other sectors where a market rent only option is applicable. We draw the Committee's attention to our earlier submission in relation to the Bill, where we noted other examples of landlord and tenant parties sharing in the risks and rewards of a business on a far larger scale than the tied pub industry. These included (i) franchised fast food retailers who are tied to purchase products from the brand, and (ii) numerous shopping centres imposing turnover rent provisions in their leases, whereby tenants pay a sum to the landlord based on the tenant's turnover at the premises. Given there is no proposal to regulate these relationships, we do not believe it is appropriate for parliament to legislate to curtail the commercial relationship which two parties have chosen to form within the tied pub industry.