Delegated Powers and Law Reform Committee
Tuesday, 21 May 2024
17th Meeting, 2024 (Session 6)

Instrument Responses

Scottish Pubs Code Regulations 2024 (SSI 2024/Draft)

On Friday 10th May, the Committee asked the Scottish Government:

1. The parent Act for this instrument, the Tied Pubs (Scotland) Act 2021, was considered by the court in the context of a challenge to its legislative competence and compliance with the European Convention on Human Rights. The court rejected the challenge. In considering the compatibility of the Act with Article 1 of Protocol 1 of the Convention, the Inner House said that "the achievement of a fair balance between the rights of the individual (in this case the landlord) and the community as a whole is something which, as the Lord Ordinary found, cannot be assessed until at least the promulgation of a Code…" (*Greene King Limited and others v Lord Advocate* [2023] CSIH 27, paragraph 41). Could a summary be provided of the Scottish Government's consideration of the compatibility with A1P1 of: (1) the provisions of the code which require landlords to offer a "market rent only" lease (in part 4); and (2) the provisions of the code which require landlords to offer a guest beer agreement (in part 5)?

2. Paragraph 5(1)(c) of schedule 1 of the parent Act provides that the code "must" require a landlord to use its best endeavours to enter into a market rent only ("MRO") lease as soon as possible following the tenant's request that the landlord offer to enter into such a lease. The code itself imposes this "best endeavours" requirement on the landlord only during the negotiation period (regulation 16(5)). To comply with paragraph 5(1)(c), should the code impose the "best endeavours" obligation on the landlord also:

   (a) before the negotiation period (that is, from the day the landlord receives the tenant's request until the day the tenant receives the offer of the MRO lease (which can be up to 4 weeks after the date of the tenant's request (reg. 16(2)(a)); and

   (b) after the negotiation period (that is, during the process of appointing a rent assessor and during the rent assessment period provided for in regulation 17 (which includes the landlord making an offer of a lease under reg. 17(8) after the assessor has determined the market rent))?

3. Regulation 17(10) of the instrument provides that the rent assessment period comes to an end if the offer of an MRO lease has not been accepted by the tenant within 2 weeks after the tenant receives the market rent determination. However, at that point (2 weeks after receipt of the determination), the tenant may not yet have received the MRO lease offer,

because the landlord has 4 weeks from receiving the determination to make the offer (under regulation 17(8)). Does this achieve the policy intention?

Please confirm whether any corrective action is proposed, and if so, what action and when.

On Tuesday 14th May, the Scottish Government responded:

1. The Scottish Government has carefully considered the compatibility of the code including the provisions which require landlords to offer a "market rent only" lease (in part 4) and a guest beer agreement (in part 5) with Article 1 of Protocol 1 of the Convention ("A1P1").

   The Scottish Government considers that the MRO lease and guest beer agreement provisions have the potential (since the interference depends on a tenant actually exercising the new rights created by the code) to interfere with a pub landlord's peaceful enjoyment of their possessions (namely the lease with their tenant). The Scottish Government therefore considers these provisions, for the purposes of A1P1, to be a control on the use of property.

   A control on the use of property, in order to be compatible with A1P1, must (i) be lawful, (ii) pursue a legitimate aim (iii) use means that are reasonably proportionate to that aim.

   A court's assessment of proportionality will follow the well-known structure of the Bank Mellat test: (i) whether the objective is sufficiently important to justify the limitation of a protected right; (ii) whether the measure is rationally connected to the objective; (iii) whether a less intrusive measure could have been used; and (iv) whether the severity of the measure's effects on the rights of those to whom it applies outweighs the importance of the objective.

   Taking each of these requirements in turn, the Scottish Government considers the provisions to be lawful. They are provided for by S.S.I. and are sufficiently precise and foreseeable.

   The Scottish Government considers the provisions to have a legitimate aim (to redress the balance between tied pub landlords and tenants). The Inner House expressly held that the Act has a legitimate purpose. The introduction of the Code is rationally connected to that objective. The Act mandates that the Code require a landlord to offer to enter into a guest beer agreement (schedule 1, paragraph 4) and to offer to enter into an MRO lease (schedule 1, paragraph 5).

   Turning to the assessment of the proportionality of the MRO and guest beer provisions, the Scottish Government is satisfied (as was the Inner House) that the provisions, as set out above, have a legitimate purpose and that these measures are rationally connected to that objective.

   A court will not go about identifying whether a less intrusive measure could have been adopted, but will consider whether the measure is one which is reasonable for the legislature to adopt. The Scottish Government considers the

MRO provisions, in respect of which various exceptions are set out at regulation 15(2) and for which a process is set out to establish an open market rent, are reasonable. The Scottish Government also considers that the guest beer provisions, where a tenant is entitled to one guest beer brand with the choice of brands limited by production level (set at the lowest of the options considered), to be reasonable.

Finally, the fourth stage of the test, is whether the measures achieve a fair or proportionate balance between the public interest being promoted and the other interests involved. There are qualifications which apply to both sets of provisions, various protections for landlords are provided, and tenants have to request these rights before they come into operation. The existence of the Scottish Pubs Code Adjudicator, who will oversee the operation of the Code, provides a procedural safeguard. Section 5 of the Act provides a procedure through which the proportionality of the measures can be reviewed and adjusted over time. Taking all these factors into account, the Scottish Government considers that a fair and proportionate balance is achieved.

The Scottish Government considers that the requirement that the code must require a landlord to use its best endeavours to enter into a market rent only ("MRO") lease as soon as possible following the tenant's request that the landlord offer to enter into such a lease within paragraph 5(1)(c) has been fulfilled.

2. Regulation 16(2)(a) provides that a pub-owning business must make the tenant an offer of an MRO lease in writing as soon as possible and in any event within a period of 4 weeks beginning with the day on which the tenant's request was received by the pub-owning business. Regulation 16(5) then provides that there is to be a negotiation period after the offer of an MRO lease, during which the parties are to use "their best endeavours to agree terms and enter into an MRO lease as soon as possible". The Scottish Government considers that the combination of the requirements to (i) make an offer of an MRO lease in writing as soon as possible, and (ii) agree terms and enter into a lease as soon as possible, delivers the requirement in paragraph 5(1)(c) of schedule 1. The references in regulation 16(2)(a) and (6) to periods of time do not change the underlying requirement to act as soon as possible.

The Scottish Government refers to the explanatory note to understand the true purpose of paragraph 5(1)(c) of schedule 1 of the Act: -

"Under sub-paragraph (1)(c) the code must require pub-owning businesses to make every effort to enter into an MRO agreement as soon as possible following a request from a tenant. As a result, the adjudicator will be able to investigate allegations that a pub-owning business has not been making a genuine attempt to conclude an MRO agreement and could impose a financial penalty if a pub-owning business was found not to have been complying with this requirement of the code."

The explanatory note explains that the purpose and intent of the obligation on pub-owning businesses to use their best endeavours is to encourage pub-owning businesses to act in a manner that does not cause undue delay for

entering into and concluding an MRO agreement with a tenant. Following the statutory timeframe imposed on pub-owning businesses to make the tenant an offer in writing as soon as possible and in any event within a period of 4 weeks, the next practical step for a pub-owning business to enter into and conclude an MRO agreement with a tenant is during the negotiation period. It is at this next practical stage within the process under regulation 16 that the Scottish Government considers that the obligation of best endeavours that a pub-owning business must meet requires to be clearly drafted to ensure that the obligation is certain and unambiguous and where the intention of the requirement under paragraph 5(1)(c) takes practical effect.

3. The Scottish Government agrees with the Delegated Powers and Law Reform Committee that the regulation 17(10) does not currently achieve the policy intention. The correct drafting should reflect that the rent assessment period comes to an end if the offer of an MRO lease has not been accepted by the tenant within 2 weeks after the tenant has received an offer in writing of an MRO lease from the pub-owning business under regulation 17(8).

The Scottish Government intends to make an amending instrument correcting the error to come into force at the same time as the principal regulations.

Tied Pubs (Fees and Financial Penalties) (Scotland) Regulations 2024 (SSI 2024/Draft)

On Friday 10th May, the Committee asked the Scottish Government:

1. Regulation 4 sets the maximum permitted penalty that the adjudicator may impose on a pub-owning business for failure to comply with the Scottish Pubs Code. Regulation 4(2) provides that:

> "Where a pub-owning business **is part of a group undertaking**, the permitted maximum penalty is 1% of the combined annual turnover of the pub-owning business and any person who is a group undertaking in relation to the pub-owning business." (emphasis added)

"Group undertaking" is defined (by regulation 2) by reference to section 1161 of the Companies Act 2006. Section 1161(5) provides that:

> "…"group undertaking", in relation to an undertaking, means an undertaking which is–
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> (a) a parent undertaking or subsidiary undertaking of that undertaking, or
> (b) a subsidiary undertaking of any parent undertaking of that undertaking."

"Group undertaking" therefore appears to mean a single company (which is in the same group); it does not appear to mean the group. The second part of regulation 4(2) reflects this as it refers to a "group undertaking" as being a

single person rather than the group: “the [business] and any person who is a group undertaking in relation to the [business]”.

Is the reference in regulation 4(2) to a pub-owning business being “part of” a group undertaking sufficiently clear, particularly given the significance of the provision (which imposes a substantial financial penalty)?

2. Regulation 4(5) provides how the annual turnover of a business is to be determined, for the purposes of calculating the permitted maximum penalty, where the business has not published accounts within the last 12 months. Sub-paragraph (a) applies where there is relevant turnover in each of the 12 preceding months (in that case, the annual turnover is the sum of the relevant turnover in each of those months). Sub-paragraph (c) applies where this is no relevant turnover in any of the 12 preceding months (in that case, the annual turnover is nil). Sub-paragraph (b) applies in the in-between scenario. It provides:

   “…the annual turnover is….

   (b) where there is relevant turnover for some but not all of those 12 months, the relevant turnover for those months, divided by the number of those months, and multiplied by 12.”

   Could this have the result that the annual turnover, as assessed under sub-paragraph (b), could be more than the total of the relevant turnover of the business during the previous 12 months? For example, if the business had relevant turnover in only one of the 12 previous months, and zero turnover in the other 11 months, would the annual turnover be assessed as: the one month’s turnover, divided by 1 (being the number of months where there is relevant turnover) and multiplied by 12, which would give a figure for annual turnover that is 12 times more than the actual total relevant turnover over the 12 months? Does sub-paragraph (b) achieve the policy intention, and, particularly given the significance of this provision in determining the amount of a fine, is it sufficiently clear?

3. Please confirm whether any corrective action is proposed, and if so, what action and when.

On Tuesday 14th May, the Scottish Government responded:

1. The Scottish Government agrees that the reference in regulation 4 to a business being part of a group undertaking is not sufficiently clear and should refer to scenarios where a pub-owning business is a group undertaking in relation to another undertaking.

   The Scottish Government intends to make an amending instrument correcting the error which should come into force at the same time as the principal instrument.

2. The Scottish Government are required under section 10 of the Tied Pubs (Scotland) Act 2021 ("the Act") to define the permitted maximum penalty by regulations. Section 10(2) states that a financial penalty imposed by the adjudicator may not exceed the permitted maximum.

   The intent of regulation 4(5)(b) is to calculate an amount, equivalent to 12 months turnover, of a pub-owning business or group undertaking, where there is no relevant turnover for all of the previous 12 months. It is the Scottish Government's position that the sub-paragraph achieves this policy intention.

   Regulation 4(5)(b) requires to be read in conjunction with regulation 4(6), which defines relevant turnover as: -

   > [...] all income receivable by a business or undertaking [...] that is—
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   > (a) derived from the provision of products and services falling within the ordinary activities of the business or undertaking in the United Kingdom,
   >
   > (b) rent or money payable in lieu of rent, in respect of land in the United Kingdom, or
   >
   > (c) gifts, grants, subsidies or membership fees receivable in the course of the ordinary activities of the business or undertaking in the United Kingdom,

   after deduction of trade discounts, value added tax and other taxes based on that income.

   Under regulation 4(5)(b), the determined annual turnover could be more than the total of the relevant turnover of the business during the previous 12 months. That is the policy intention. The purpose of the provision is to calculate turnover which would be equivalent to that received over a 12 month period. While the turnover calculated could be greater than the actual turnover in the previous 12 months, the fine imposed upon a person can be no more than 1% of that figure and the actual level of the fine, within that parameter under regulation 4(1), is ultimately a matter for the adjudicator, as under sections 9 and 10 of the Act.

   The provision is drafted to follow the approach taken by regulation 5(3)(b) of the Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016, which has the same effect.

   The Scottish Government does not propose to take any corrective action.