

<b>Title:</b> Pubs Statutory Code and Adjudicator – secondary legislation <b>IA No:</b> BISCCP 007 <b>Lead department or agency:</b> Department for Business, Innovation and Skills <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 04/04/2016		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Primary legislation		
<b>Contact for enquiries:</b> Analyst – Alex Shirvani 0207 215 0238 Policy John Wright 027 215 3507			
<b>Summary: Intervention and Options</b>			<b>RPC Opinion:</b> Awaiting Scrutiny

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
0.73	0.73	-0.07	Yes   OUT

**What is the problem under consideration? Why is government intervention necessary?**

To address long-standing concerns about the relationship between large pub-owning businesses and their tied tenants, Part 4 of the Small Business, Enterprise and Employment (SBEE) Act 2015 requires the Secretary of State to introduce a Statutory Pubs Code by the end of May 2016, as well as an Adjudicator to enforce the Code. Implementation of the Code and Adjudicator measures require secondary legislation. The secondary legislation will also implement commitments made during the parliamentary passage of the Act. This impact assessment considers the additional impacts from the secondary legislation and the implementation of these commitments. The main impacts of the Code and Adjudicator are considered in the primary legislation impact assessment.<sup>1</sup>

**What are the policy objectives and the intended effects?**


The objective of this package of secondary legislation is to ensure that the measures in the Act work as intended, including the Code, while minimising the burden on business.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

Introduce a Pubs Code: Doing nothing or an alternative to regulation are not viable options because there is a requirement in the primary legislation to introduce a Code.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 03/2019					
Does implementation go beyond minimum EU requirements?				N/A	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> No	<b>&lt; 20</b> No	<b>Small</b> Yes	<b>Medium</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)				<b>Traded:</b>	<b>Non-traded:</b>

**I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.**

Signed by the responsible Minister:  Date: 14 April 2016

<sup>1</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf)

# Summary: Analysis & Evidence

Policy Option 1

Description: Introduce a Pubs Code (Preferred option)

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.07	High: -1.49	Best Estimate: -0.73

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			
High			
Best Estimate			

### Description and scale of key monetised costs by 'main affected groups'

N/A

### Other key non-monetised costs by 'main affected groups'

Many requirements in the Code replicate existing practice and so are not monetised as additional costs. There are a number of new additional requirements in the Code, but the cost of these will be negligible, involving the one-off generation of some simple information. Examples of these include providing information on the events that would entitle a tenant to request an MRO offer, providing details on what happens to rent deposits and giving worked examples of the effect of indexation on future rents.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low		0.2	1.5
High		0.0	0.1
Best Estimate		0.1	0.7

### Description and scale of key monetised benefits by 'main affected groups'

Excluding genuine franchises from the Code will reduce the envisaged burden of the Pubs Code and Adjudicator by an estimated £100k. This is a result of pub owning businesses no longer incurring costs for independent assessments and arbitration by the adjudicator for an estimated 560 pubs.

### Other key non-monetised benefits by 'main affected groups'

Tenancies-at-will and other short-term agreements will be exempt from most of the Code. This will reduce the burden of the code. This benefit has not been quantified.

A waiver from Market Rent Only in return for significant investment has been introduced. This will reduce the risk that less investment is made as a result of uncertainty around whether pubs will remain within the beer tie. We have not quantified this benefit as responses to the consultation focussed on the impact this had on reducing risk, rather than as a quantifiable benefit.

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	3.5
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As these regulations largely set out how the intent of the primary legislation will work in practice, the additional risks are minimal.

The key sensitivity for the quantified benefit is the number of genuine franchises. This has been assessed from our understanding of the nature of current agreements compared to the definition of genuine franchises.

## BUSINESS ASSESSMENT (Option 2)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>In scope of OIOO?</b>	<b>Measure qualifies as</b>
Costs: 0.0	Benefits: 0.07	Net: -0.07	Yes	OUT

## Background and rationale for intervention

1. The Small Business, Enterprise and Employment (SBEE) Act 2015, which received Royal Assent in March 2015, requires the Secretary of State to introduce a statutory Pubs Code. The Code will govern the relationship between large pub-owning businesses (those that own 500 or more tied pubs) and their tied tenants. The Act requires that tenants will be entitled to request the offer of a Market Rent Only (MRO) agreement that is an agreement without the beer tie. The Act also provides for a new independent Adjudicator to enforce the Code. The Code and Adjudicator measures will be introduced through secondary legislation. This impact assessment covers this secondary legislation.
2. A draft Pubs Code was published in June 2014 as part of the Government Response to the 2013 consultation on pub companies and tenants; and a revised version was published in November 2014 during Parliament's scrutiny of the SBEE Bill. Further revisions have now been made to reflect changes made during the passage of the Act, and to take account of comments and information received and a draft was published as part of the latest consultation in December 2015.
3. The overall purpose of the legislation is to address long-standing concerns about the relationship between large pub-owning businesses and their tied tenants. The primary Pubs Statutory Code and Adjudicator impact assessment<sup>1</sup> includes further background on the pub industry, the beer tie and the overall problem addressed by the pubs code.

## Options

4. The potential options are limited by the requirements in the primary legislation. Doing nothing or an alternative to regulation are not viable options because there is a requirement in the primary legislation to introduce a Code. As such, there is only one option:
  - Introduce a Pubs Code as required under the SBEE Act

## Detail of Preferred Option

5. While the vast majority of the shape and impact of the Pubs Code has been decided, secondary legislation is required to finalise the detail and reflect commitments made during the passage of the primary legislation.
6. In broad terms, the areas where details are finalised in the secondary legislation are:
  - Defining processes and terms in the Act
  - Contractual inconsistencies with the Code
  - Defining Market Rent Only triggers
  - Information provision
  - Financial penalties

The potential for these areas to have additional impact beyond that quantified in the primary legislation impact assessment is considered below.

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<sup>1</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf)

7. In addition to these, there were commitments made during the parliamentary process that are now being implemented. These are:
  - to exclude genuine pub franchise agreements from the MRO option and rent assessment provisions;
  - to exclude short term tenancies from most of the Code; and
  - to provide for a deferral of when MRO is available in certain circumstances for a limited period in exchange for significant investment.

The impacts of these changes were not included in the primary legislation and so are included in this assessment.

## **Analysis of benefits and costs**

8. This section considers the relevant parts of the code and analyses the impacts in turn. It is in two parts firstly looking at those requirements from the Act and then the changes committed to during the passage of the Act.
9. When assessing the costs and benefits of the secondary legislation it is important to bear in mind that the baseline is the impact as considered in the primary legislation impact assessment. This is important to avoid counting burdens again and to understand the context of any savings, i.e. reductions to burdens to business reduce the envisaged burden of the Pubs Code and are not reductions in the current level of regulatory burden.

## **Requirements from the Act:**

### **Defining processes and terms in the Act**

10. A number of processes and terms in the Act need to be specified in secondary legislation, including the MRO option which was added during the passage of the primary legislation. These involve measures were set out in the primary legislation or draft Code published in November 2014 during Parliament's scrutiny of the SBEE Bill. In a number of areas these are where it has to be set out what is meant by certain terms in the primary legislation. One example is specifying what is meant by "when a tenancy or lease ends" in section 69 of the SBEE Act. This section provides for tenants who are protected under the Code to continue to be protected under future landlords even if those landlords are not usually subject to the Code. These regulations do not change the impact of the Pubs Code, instead they just ensure legal clarity.
11. Similarly, the secondary legislation sets out the fees for arbitration and for exercising the Market Rent Only option. As with the more straightforward definitions, this just enacts the processes previously set out in the draft Code or in the primary legislation Impact Assessment and so does not result in costs to business beyond those already assessed.

### **Contractual inconsistencies with the Code**

12. Section 47 of the SBEE Act is intended to prevent the impact of the Code being circumvented by contracts between the pub-owning business and tied tenant, in which the pub-owning business and tied tenant agree to terms that are inconsistent with the legislation. The primary legislation specifies a number of possible inconsistencies and this secondary legislation extends that to other terms that seek to prevent, inhibit or penalise a tied tenant from relying on any of the protections provided in the Code. It also provides that, where a term in a tenancy agreement is void it will not bind the tenant. This will better

ensure that the Code works as intended and so does not have any additional impact on business.

## Defining MRO triggers

13. The primary legislation requires the Pubs Code to provide tenants with the option of requesting an MRO offer from their pub-owning business following certain events. Two specified events were:
- where they have experienced a significant increase in the price of any tied product or service that was not reasonably foreseeable when the tenancy was granted or when the last rent assessment was concluded
  - where there has been an event which has a significant impact on the level of trade that they could reasonably have expected; and where the impact is beyond their control; and where it could not have been foreseen
14. The follow up regulations in the Code define what is meant by significant increase in price and significant impact on the level of trade. The definitions have been chosen to ensure that the criteria for these events are infrequently met and the provision acts more as a back up to the right to request an MRO offer at any rent assessment or at least every five years. As a result there is not expected to be a significant impact on business from this choice of definition.

## Information provision

15. The Code specifies what information pub-owning businesses have to provide to tenants and prospective tenants. The primary legislation impact assessment assumed that the cost of abiding by the statutory code, excluding market rent only option and parallel rent assessments, was the same as for the voluntary code at £40 per pub. It is still our assessment that the cost of complying with the Pubs Code, excluding the cost of the MRO provisions and the adjudicator, will be the same as complying with previous voluntary Codes and Company Codes. This is largely because the requirements in the code either replicate previous requirements or involve negligible additional cost. This is in line with the Government's preferred approach to fulfil the requirements of the Act in a way that minimises as far as possible the burdens being placed on business. This is worked through in more detail in the following paragraphs.
16. The large majority of information provision requirements in the statutory code replicate existing practice. Many, though not all, of the information provision requirements put on the pub-owning business are already covered by the voluntary UK Pub Industry Framework Code or by pub-owning businesses' own codes of practice. Most notably this includes the information provided to tied tenants ahead of a rent assessment or renewal/replacement of a tenancy or tie agreement. There are further information requirements that while different to the voluntary code impose the same burden. Examples include:
- providing a copy of the statutory code rather than the voluntary code
  - providing details on how to complain about a breach of the statutory code rather than voluntary and company codes
  - specifying when pub-owning businesses have to provide information on insurance<sup>2</sup>
17. Other information requirements are not part of the voluntary code but are provided already. Examples of this include stating the length of tenancy and the tenant's right to buy food, drink or services not subject to a tie, which will be in the lease and tied agreement. Other

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<sup>2</sup> This is already a requirement in the voluntary code if the pub-owning business is entitled to charge a tied tenant/licensee for insurance, to allow tenants to obtain an alternative quote on the same terms. The statutory code specifies when this information must be provided.

requirements are often already part of POBs' own company codes, such as information requirements about building works that a POB knows is required when an agreement with a tenant is entered into.

18. There are some additional requirements that involve very small one-off costs. Examples of these include providing information on the events that would entitle a tenant to request an MRO offer, proving details on what happens to rent deposits and giving worked examples of the effect of indexation on future rents. These will be standardised pieces of information that will need to be generated once and then provided to tenants alongside already existing information requirements on websites or by email. As such the costs will be negligible.

#### Prospective tenants

19. One area where POBs expressed concern was with the requirements to provide prospective tenants with various items of information before the prospective tenant negotiates an agreement with the pub-owning company. This information includes details of repair obligations, assignment rights and a general requirement to seek to comply with any reasonable request for information by prospective tied tenants or their professional advisors. This largely mirrors current practice ahead of signing an agreement set out as part of existing codes and details in leases. As confirmed by POBs in their consultation responses, this means that POBs already provide prospective tenants with thorough information as part of the recruitment process.

20. The main concern for POBs expressed in their responses to the consultation was that these requirements would apply to prospective tied tenants early in the application process. This was linked to concerns that someone who merely visited a pub and expressed an interest in becoming a tenant would be protected by the Code. One pub-owning business noted that it had 46 initial enquires for each actual letting and only 7 per letting that could reasonably be regarded as a prospective tenant. However, the regulations allow them to undertake various due diligence checks (credit, work permit, licence, etc), conduct interviews and ask applicants to fill in application forms before any information need be provided. This means that pub-owning businesses have to supply the required documentation only to those whom they wish to consider seriously.

#### Intention to sell

21. The Pubs Code requires pub-owning businesses to inform their tied pub tenants/licensees as soon as practical if they advertise a pub, place one on the market or employ an agent to sell one. They will still need to inform the tenant when they have agreed to sell the pub. Pub-owning businesses may already contact tenants when they are publicly taking steps to sell their pub, so this requirement may not be additional to current practice. Even if this isn't already done the additional cost will be negligible as informing tenants does not require gathering any additional information and can be done by email.

#### Financial penalties

22. Any financial penalty that the Adjudicator chooses to impose on a pub-owning business following an investigation must not exceed a maximum level, which the Secretary of State is required to set in secondary legislation. This is being set at 1% of UK turnover of all the group undertakings related to the pub-owning business. If applied to the six pub-owning businesses in scope of the Code, the maximum financial penalty would range from under £1million to more than £13 million. This could have a considerable impact on business. However, we would expect financial penalties to be used to penalise only the most serious

and persistent breaches of the Pubs Code and for the maximum limit to be imposed extremely rarely. Any cost would only apply to non-compliant businesses, i.e. those that were found to have breached the Pubs Code.

### **Further changes committed to during the passage of the Act:**

#### Excluding genuine pub franchises from the MRO and rent provisions of the Code

23. Genuine pub franchise agreements can ensure that the interests of tenants and pub-owning businesses are better aligned than in a traditional tied tenancy and can deliver a fair share of risk and reward for the tied tenant. Where this is the case it is intended that those agreements are exempted from the MRO and rent negotiation provisions of the Pubs Code. Based on our understanding of existing tied pub agreements, and subject to further detailed information on the nature of those pubs, we estimate that between 520 and 600 fewer pubs will be covered by the code as a result. We use these as our low and high estimate respectively with the midpoint as our best estimate. This could underestimate the number of affected pubs if POBs introduce more types of arrangement that meet the definition of genuine franchises. Based on the primary legislation impact assessment<sup>3</sup> and the costs that vary per pub, i.e. the adjudicator's arbitration costs<sup>4</sup> and the cost of independent rent assessments<sup>5</sup>, the saving is estimated as £170 per pub (low of £20 and high of £330)<sup>7</sup>. This results in a best estimate of the reduction in cost to business of £100k with a high estimate of £200k and a low of £10k.<sup>8</sup>

#### Excluding short-term agreements from the Code

24. Tenancies-at-will and other short-term agreements will be exempt from most of the Code. As with franchises, this will mean a number of pubs will not be covered by the Code, reducing the burden on business. One estimate from the British Beer and Pub Association is that around 10% of pubs at any one time are on short-term tenancies. This will reduce the burden of the Pubs Code. However, it is unclear whether these types of agreement were included in the estimate of the number of assessments each year that was the basis of the estimate the cost of the Pubs Code. As such, it seems inappropriate to quantify any reduction in costs as a result of these agreements being excluded.

#### Extended rent assessment period in return for significant investment

25. Pub-owning businesses expressed concerns about the effect of the Market Rent Only (MRO) option on their ability to get a return on investments they make in their tied pub estates. They claimed that the lack of certainty at the start of an investment – not knowing whether a tenant would choose to go free of tie during the investment period and therefore whether the pub-owning business could recoup its investment – would mean fewer investments would be made. As the Act stands, pub-owning businesses and tenants can choose at any time to enter a new agreement which continues the tie for a further five years and defers a rent assessment, and therefore MRO, for the same period (provided no other MRO eligibility criteria are met).

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<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408449/bis-15-64-pubs-statutory-code-and-adjudicator-final-stage-impact-assessment.pdf)

<sup>4</sup> The best, high and low estimates for the adjudicator's arbitration cost were £260k, 450k and 70k respectively

<sup>5</sup> The best, high and low estimates for the cost of independent rental assessments were £2m, £3.8m and £150k respectively.

<sup>6</sup> The parallel rent assessment costs are not considered as Government has now concluded that there is no need for these.

<sup>7</sup> These are calculated by dividing the total cost by the 13,000 estimated affected pubs from the primary legislation impact assessment

<sup>8</sup> The full calculation is = (number of franchises)\*(estimate of arbitration costs + estimate of independent assessment cost)/(total number of affected pubs). For example the best estimate is calculated as follows = (560)\*(£260k+£2m)/(13,000).

26. It is proposed that outside of this option, the Code will make provision to defer rent assessments for a period of up to seven years in return for a significant investment from the pub-owning business. There may be some cost of negotiating this deferment; however this is unlikely to be additional to those negotiations around investments that already occur. The extended rent assessment period will have to be agreed by both parties and so will only be used if beneficial to both businesses. As such it will be of net benefit to business compared to the baseline of what is in the primary legislation.
27. Responses to the consultation did not attempt to value this extended period, instead focusing on its role in reducing the risk of an unintended reduction in investment and the risk of the extended rent assessment period being used to avoid the requirement for a Market Rent Only option. While we are not able to quantify this benefit, there are reasons to believe it may not be large. There did not appear to be a consensus even amongst pub-owning businesses on whether investments needed more than five years to pay off suggesting that the extended rent assessment period may not be used that often. Furthermore, some return on the investment may be possible even after a tenant chooses to go free of tie, if it increases the free of tie rent. This again suggests that many investments may not require the extended period.

### **One-in, Two-out (OITO) assessment - summary**

28. As part of the Government's goal to reduce the burden of regulation on business, costs imposed by regulation and removed by deregulation are measured in accordance to a common set of rules that are included in the Better Regulation Framework Manual.<sup>9</sup> The estimated impact of the secondary legislation is a £100k reduction on the burden of business. While this seems to imply that this is deregulatory, it should be seen in the context of the overall regulatory burden resulting from the Pubs Code and Adjudicator.

### **Risks and unintended consequences**

29. The primary legislation impact assessment noted that "as with any market intervention the outcomes are highly uncertain due to the dynamic and unpredictable nature of markets" and detailed some specific risks. The risks involved with the details assessed in this IA are obviously less. One area where risks have been reduced as a result of changes in the Code is with the extended rent assessment period for investment. This addresses one potential unintended consequence of there being less investment as a result of pub-owning businesses lacking certainty at the start of an investment about the future status of tied pubs.

### **Small and Micro-Business Assessment**

30. The code will apply to pub-owning businesses with 500 or more tied pubs; none of these are small businesses.
31. It should be noted that the beneficiaries of this policy, pub tenants, are largely micro and small businesses. This is why the trade bodies the Federation of Small Business and Forum for Private Business are supportive of government action in this area.

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<sup>9</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/421078/bis-13-1038-Better-regulation-framework-manual.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/421078/bis-13-1038-Better-regulation-framework-manual.pdf)