TIME FOR ACTION TIME FOR CHANGE:

CALLING TIME ON THE TIE

For further information on the Fair Pint campaign go to

www.fairpint.org.uk

ABOUT FAIR PINT

Fair Pint represents tied tenants. The group has 1,000 member publicans and is funded by donations. We are supported by the Federation of Small Businesses, trade unions, Licensed Victuallers and many more.

Fair Pint was established in order to give individual tied tenants a voice and to draw attention to the damage being done to the pub sector by the pubco business model and the tie.

Fair Pint has been fighting to ensure that publicans are represented in debates about the future of the industry. Our campaign has led the way and, through the oral and written evidence that Fair Pint gave to the Business and Enterprise Select Committee inquiry into pub companies, we played a central role in ensuring that the Committee considered the problems faced by individual pub tenants and how the operation of the tie is threatening the future of our pubs. We believe that there is an inherent unfairness resulting from the current model – where both the consumer and the tied tenant suffer.

WHERE DID THE TIE COME FROM?

The tied tenancy model means that as well as charging rent, tied tenants are tied into buying beer and other products from the companies who own their pubs at a higher price than the same products are available on the open market. About 30,000 pubs (which is about half the pubs in the UK) are tied.

The origins of the tie date back to the days when most pubs in the UK were owned by breweries. Breweries tied their tenants in the pubs that they owned into just selling the products they produced.

In an attempt to increase competition into the sector and to ensure that consumers had access to a greater variety of products, the 1989 Beer Orders were introduced forcing Breweries to divest themselves of their large pub estates and restricting them from owning more than 2,000 pubs.

The intention was that more pubs would become free houses and be able to sell beer from a variety of sources or that that smaller regional breweries would be able to expand their market share. The reality was that the Beer Orders provided an opportunity for property investment companies to buy-up public houses. Because they weren't brewers there was no restriction on the number of tied pubs these companies could own. The combination of rents and the income that could generate through the beer tie provided for a very profitable investment opportunity and the birth of pubcos.

Using securitised debt, pubcos borrowed billions of pounds from the credit markets to fund their pub purchases and promised bond holders a generous return. This system of financial engineering survived at a time when the economy was booming and more people were drinking in pubs.

Regional brewers who own pub estates sought to copy the pubco business model as a way of extracting more income from their pub estate. The tied relationship between publicans and their brewers changed from a relationship of a shared risk and reward to breweries seeing their tied estates simply as property assets from which a growing income could be gained.

The pubco business model is broken. The economy is in recession and beer sales are falling. Pubcos are however locked into a vicious cycle needing to service their debt repayments by extracting more and more income from their tied pubs. Brewers who own tied pub estates have become addicted to the income that they have been able to extract from their estates through the tie. Both pubcos and brewers seem set on continuing with this exploitative system despite the fact that this model is driving thousands of tenants out of business and is putting the long term future of the whole of the UK pub sector under threat.

WHY DOES THE TIE NEED TO GO?

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Throughout the centuries the British pub has been able to adapt to changing circumstances and changing fashions and maintain its place at the centre of local communities. The pubco model doesn't allow that flexibility.

If you are a Tied tenant:

- you can't lower prices because margins are so small
- you can't invest in the pub because the profit is taken by the pubco
- you can't borrow because all the liquidity in the sector is tied up in the pubcos' debt

The two biggest pubcos are Punch Taverns and Enterprise Inns, own over 7,000 pubs each. Together, they owe nearly £9 billion and need to find £731 million a year to meet their obligations. If you divide the £731 million by their combined pub estate of nearly 15,000 pubs this works out at about £50,000 per pub per year.

The fact that landlords have to make an average £50,000 of profit on top of all their costs just to pay their landlord's debt is stark evidence of the weakness of the pubco model and how it is unlikely to survive in a difficult market. Over the years pubcos have increased the cost of the beer they supply to their tenants and increased rents. Many tenants have busy pubs with significant turnover, but they aren't making any money. **67% of pub tenants earn less than £15,000 per year**. Half of tenants with pubs with a turnover of more than £500,000 per year earn less than £15,000, which is a return for them of 3%.[1]

The Campaign for Real Ale has recently submitted a super-complaint to the Office for Fair Trading. CAMRA have pointed out how the pubco business model has lead to higher prices and reduced choice for consumers. The super-complaint shows how the operation of the tie has led to higher prices in pubs and how the tie restricts access to the market for small brewers.

Tied tenants face a choice of watching their businesses fail, strangled by the tie as the over-geared financial model of the pubcos unravels, costing thousands of jobs of people employed in the sector,or taking steps to give tenants more freedom over the way they run their business and therefore give them a chance to adapt and survive.

The British Beer and Pub Association (BBPA) represents property companies (pubcos) and brewers. The BBPA does not represent the interests of pub tenants. Along with its clients the BBPA has argued that the fact that free of tie pubs are closing as well as tied pubs means that the tie isn't a significant cause of pub failure. In many cases, however, tied tenants are either forced out of business or to abandon their tenancy and their investment – as the tie combines to works against them. In such cases, the pubco simply finds a new tenant to run the pub until they in turn, are also faced with the same pressures and forced out of business. Quite simply, this means that one single pub could be the cause of a number of business failures but these casualties do not show up in the closure statistics.

Analysis of the churn rate in the Punch Taverns estate of 8400 pubs undertaken by the GMB showed that **a total of 2,682 pubs changed hands in the three years since 2006**. This is 32%of the entire tenanted estate of the company. Half were then run on short-term tenancies. These 2,682 pubs changed hands on 5,766 occasions over the same three year period. 58 percent changed hands when the tenants threw in the towel and a further 27 percent when the pub failed.

[1] Business and Enterprise Select Committee report. *Pub Companies*. May 2009

It is clear that the tie is the major cause of business failures in the pub sector. Tied pubs pay significantly higher prices than free of tie operators for their beer and face rents which are unsustainable.

This is why free of tie operators have been the ones who have been better able to adapt to current circumstances and build market share whilst thousands of tied tenants are being forced into bankruptcy or are walking away from their tenancies losing their investment.

HOW PUBCOS FORCE UP THE PRICE OF BEER FOR TENANTS AND CONSUMERS

The pubco model relies on selling beer and other supplies at a significant mark up on the price they buy it from brewers.

Over the years the differential between the prices at which beer can be bought wholesale on the open market and the price at which pubcos sell it to their tied tenants has increased by a significant amount. Fair Pint research has shown that the wholesale price differential can be over 70p a pint for the most popular larger brands.

The pubcos and the trade association the British Beer and Pub Association (BBPA) have claimed that the tie is similar to the franchise model used by companies such as McDonalds, Dominos Pizza, Pizza Hut, Burger King etc. This is not the case. Most franchise arrangements offer franchisees significant benefits in, for example, sharing the purchasing power of the parent company and accessing the power of the huge marketing spend that these companies invest to make their brands a household name. This is not true of the pubco model. In contrast to franchises, tied tenants pay a much higher price for their beer which they could easily buy on the open market. Each tied pub is operated as – and is presented as - a distinct business; the tied publican, therefore, gains no benefits from operating under a well known brand.

The accounts of Punch Taverns and Enterprise Inns show that their margins on beer sales are typically **85-99%.** As the Business and Enterprise Select Committee pointed out, ***"it is seriously misleading for any pubco to promote to potential lessees that a pubco has benefits from 'purchasing power' when that benefit is not passed on to lessees."***[2]

Despite the pubcos' claims to the contrary, beer is available at a significant discount to even small pubs either from a wide variety of brewers and wholesalers.

The pubco system has led to artificial inflation in the list price of beer. Pubcos will sell beer to their tied tenants at a small discount to the list price, but the list price has become totally unrelated to the price at which beer is sold to free of tie purchasers on the open wholesale market. Pubs selling lower than average volumes of beer are able to negotiate discounts of up to £200 from a typical £400 list price for a 36 gallon barrel of beer.

Pubcos do use their buying power to purchase beer at the lowest price possible, and in most cases will purchase a 36 gallon barrel for less than £100, but the savings are not passed on to tenants but are taken as profit by the pubco. Tenants are left struggling trying to make a profit on beer sold at close to the list price when a free of tie tenant down the road would have typically paid £150 a barrel less for the same product.

[2] Business and Enterprise Select Committee report. *Pub Companies*. May 2009 (paragraph 98)

Fair Pint has produced an analysis of the difference in price for an 11 gallon keg of Carling lager supplied to medium sized pub in the South East of England direct from the brewer Coors and the price at which a pub tied to Enterprise would be forced to buy it.

TABLE 1: Comparison of Costs from Enterprise Inns compared to costs directly from a brewer

Costs of an 11 gallon keg of Carling

	Price available to an untied tenant direct from Coors	Price at which Enterprise Inns sell to tied tenants	Price that Enterprise Inns pays Coors
11 gallon keg	£63.11	£128.00	£45.00
Price per pint	£0.72	£1.45	£0.51
Duty	£0.36	£0.36	£0.36
Gross profit per-pint to supplier	£0.36	£1.09	£0.15
Gross profit if a pint is sold at £2.50	£1.46	£0.72	
Difference in cost to tied tenant and untied tenant per pint	**74p**		

The brewer Scottish and Newcastle has an arm called Scottish and Newcastle Pub Enterprises, which manages a tied estate of 1,000 pubs owned by the Royal Bank of Scotland and also has a wholesale arm from which free of tie operators can buy from directly. The table below shows the Fair Pint's analysis of the difference in the price at which free of tie landlords can buy beer from Scottish and Newcastle and the cost at which the same products are sold to RBS's tied publicans

Table 2: The price difference between leading beer and larger brands supplied by Scottish & Newcastle Pub Enterprises (which manages tied pubs on behalf of RBS) to its tied tenants and the price that Scottish & Newcastle as a wholesaler sells the same product to untied pubs

Brand	Price from Scottish & Newcastle Pub Enterprises to their tied tenants	Price from Scottish & Newcastle to untied pubs	Difference
Fosters	£117.01	£74.10	57%
Amstel	£128.27	£83.85	52%
Kronenbourg	£134.27	£92.55	45%
Heineken	£139.74	£97.81	43%
Theakston Best	£104.37	£59.62	75%

The situation for tied tenants has got increasingly worse over recent years as pubcos have driven up their prices making it more difficult for tied publicans to make a profit and increasing the price for beer that customers pay in tied pubs.

The table below shows how much Enterprise Inns have raised their prices for key brands since 2002.

Table 3: Increase in prices which Enterprise Inns charges to its tied tenants for key popular brands between 2002 and 2009

Brand	2002 price/pint	2009 price/pint	% increase
Heineken	**£1.09**	**£1.67**	**53%**
Stella Artois	£1.15 (5.1% ABV)	£1.55 (5.0% ABV	34%
Hoegarden	£1.30 (5.0% ABV)	£1.82 (4.8% ABV)	40%
Boddingtons Draughtflow	£0.88 (3.8% ABV)	£1.35 (3.5% ABV)	53%
Banks Bitter	£0.88	£1.22	38%
Greene King IPA	£0.86	£1.25	45%

The increases shown are made worse when you consider that in many cases the ABV is reduced thereby reducing the duty paid.

The average rate of inflation per annum across the same period, excluding mortgage interest, was 2.84%, giving a compound rate for the period from 2002- 2009 of 21%. Price increases in the sample of brands shown demonstrate and average increase of 43.8%; constantly twice the rate of inflation.

Duty on a pint of beer has increased by 7p from 29p to 36p (24%) in the same period.

HOW ARE RENTS CALCULATED?

Pubcos argue that higher beer prices are balanced out by lower rents and other business support. This is simply not the case. Many tied tenants find themselves paying rents which are equivalent to, or even higher, than those who are free of tie.

Recent Morgan Stanley research has found that of the 1,500 rent reviews that Punch has completed between 2006 and 2008, under 100 have seen rents drop, and of the 900 renewals completed since 2006, only 40 have seen lower rents. The report also states that a survey of 31 leased Enterprise and Punch pubs in London, **87% believed that their rent was around 20% too high**. In addition, not one said that they would take on another tenancy.[3]

In our own Fair Pint survey, 91% of tenants felt that their Pubco charged them an unreasonable and unsustainable rent.

[3] Morgan Stanley Research, *Leased Pubcos: Avoid*, September 9th 2008,

As a recent IPPR report pointed out the method of calculating rents in the pub sector lacks transparency.[4] The system of Fair Maintainable Trade relies on a projection of the level of trade that a competent hypothetical united tenant would be expected to achieve. The idea is that the publican's costs are then subtracted from this and the rent is typically 50 percent of the remaining profit, the so called divisible balance. The way this is calculated is far from transparent and Calculations of expected profits are massaged upwards and the costs faced by tenants are under estimated. In most cases the extra costs of buying beer through the tie are not properly accounted for. This means that tenants often face paying well in excess of 50% of the their actual profit in rent.

The basis of these calculations are not always clear but a lack of a low-cost way of challenging rent calculations, means that many tenants are faced with a choice of accepting what the rent set by the pubco or taking on an expensive legal challenge. Most tenants are, therefore, faced with ever increasing rent demands until they are either forced out of business or forced to surrender their tenancy.

Members of The Royal Institution of Chartered Surveyors (RICS) are used to determine rents and act as experts. They follow guidance and practice notes issuesd by the RICS. That guidance has recently been authored by a sub-group of the RICS, the Trade Related Valuation Group (TRVG). That group was until late last year chaired by a direct employee of Enterprise Inns plc. It is currently chaired by one of the main letting and selling agents for pubcos. The TRVG is dominated by representatives of pubcos and brewers.

THE PUBCO MODEL DOES NOT GIVE LOW COST ENTRY INTO THE MARKET

Pubco's argue that the tied model offers a low cost entry route into the pub trade. They argue that because tenancies are available with a low initial investment it offers a route of entry into the sector for many entrepreneurs.

As the Business and Enterprise Select Committee pointed out, many potential tenants would prefer to take on a free of tie leased pub, but end up taking a tied pub because these are the only ones available on the market.

The reason why tenancies are available at such a low cost is because of the difficulty in making tied pubs pay. There is clear evidence that pubcos entice inexperienced people into the market with a low initial investment who are tied into long leases before they realize that the tie and the level of rent makes it impossible for them to make a profit out of the pub.

Figures produced from the GMB show that the churn rate in big pubco estates is very high. For example, one third of pubs in the Punch estate changed hands in a three year period as tenants either gave up their pubs and their initial investment because they could not make it pay, or were forced out of due to bankruptcy. The pubco will then try and find another tenant to run the pub until they in turn are forced out of the business. The GMB figures showed some pubs changed hands up to ten times over three years.[1] Therefore, an initial low cost investment often leads to tenants losing huge amounts of money over the longer term.

[4] Dr Rick Muir, *Pubs and Places: The Social Value of community pubs,* IPPR 2009

The claim of low cost entry is false. Even in the current market pubcos demand premiums and 'ingoing' costs for new leases. Such costs are not required in the case of normal free of tie leases. In the current economic climate free of tie tenants are often able to secure concessions such as rent free periods, capital contributions or even reverse premiums. Pubcos are even now still demanding personal guarantees for the term of the tenancy as well as rent deposits.

Low cost entry systems to business can, in any event, be a cause for concern. The normal financial barriers to entry to any market can be useful in ensuring that new entrants are properly resourced, have the necessary experience or training and are fully prepared. Promises of easy and low cost entry can lead to higher rates of failure later when the real costs and risks emerge, and particularly where entrants are inexperienced.

WHAT DID THE BUSINESS AND ENTERPRISE COMMITTEE REPORT SAY?

- The Committee was clear in their view that there was little evidence of any benefits from the tie. The Committee concluded that the pubcos offer little support that cannot be found by normal market methods. The survey of publicans which was undertaken on the Committee's behalf found that **63% lessees did not think that their pubco added any value**.

- The Committee also questioned the accuracy of the evidence given by Ted Tuppen, the Chief Executive of Enterprise Inns and Giles Thorley, Chief Executive of Punch Taverns in defence of the their business model. The report stated that both made assertions which on investigation, proved to give a "partial picture" or were "positively false".

- The combination of the tie and high rents mean that most lessees are facing serious financial difficulties. The Committee's survey found that 67% of lessees surveyed earned less than £15,000 per year, even on turnovers of more than £500,000 a year**. On a typical 70 hour week this means that publicans are earning significantly less than the national minimum wage**. **The Committee felt it clear that whilst lessees share the risks with the pubcos they do not share the benefits.**

- Supporters of the tie sometimes argue that without the tie, on trade sales would become dominated by the big international brewers because the tie offers some element of price support for smaller breweries. The Select Committee's report showed that the evidence doesn't support this claim. The report pointed out that there is clear evidence that the tie is restricting consumer choice as tied tenants are restricted to purchasing beers on their pubco's supply list. The Committee reported that this meant that it is more difficult for small brewers to access the market. The free of tie sector was shown to be far more likely to sell beers from local small brewers than the tied sector. Figures from the Society of Independent Brewers, quoted in the report, show that 56% of free houses stock a locally brewed beer, compared to just 31% of tied pubs.

- Over half of the country's pubs are free of tie and are not dominated by international brewers as the BBPA has suggested would be the case if the tie were abolished. Free of tie pubs have a choice of around 2500 real ales in the UK. This is around 8 times more than some pubcos and no tied lessees are offered the same choice. The pubco model restricts access to the market for many UK brewers. The pubco lists are already dominated by large regional and international brewers such as Heineken/S&N, Molson Coors, Greene King, Fullers, Marstons and Shepherd Neame.

- Pubcos have argued that free of tie pubs are closing at a faster rate than tied pubs, but as the Committee pointed out, figures for pub closures do not adequately cover cases where individual lessees go out of business without the pub actually closing. When you look at the number of individual lessees going out of business it is clear that there is a significant failure rate in the tied sector.

- The Committee recommended that the tie as a model ought to be investigated by the Competition Commission in order to ensure that the removal or reform of the tied model doesn't lead to unforeseen consequences in the same way as the beer orders of 1989 led to the development of the pubco model.

- The Office of Fair Trading is currently looking at the tied pub sector in response to a Super-Complaint from CAMRA. We hope that the OFT will refer the issue to the Competition Commission for a market investigation.

- If the OFT decides to take no action we believe that the Secretary of State should use the powers he has under Section 132 of the Enterprise Act 2002 to refer the issue to the Competition Commission.

TIME FOR ACTION, TIME FOR CHANGE:

The pubco model is broken. Fair Pint believes that action needs to be taken to ensure that the weaknesses of the pubco financial model doesn't cause the destruction of the UK pub sector.
Pubs are closing at a rate of circa 40 per week and the rate of closures will continue to accelerate unless action is taken. If the Government are serious about securing the future of pubs and the social benefits they deliver they need to start taking urgent action to rebalance the relationship between pubcos and their tenants.

Freedom from the Tie

- Fair Pint is calling for the tie to be removed. We believe, however, that there are benefits from a Competition Commission investigation into the effect of tied arrangements on the market. The pubco model is as clear subversion of the aims of the 1989 Beer Orders. We hope that a Competition Commission inquiry will provide an opportunity for the development of proposals about reform of the sector which will avoid similar unforeseen consequences.

- The OFT should carry out a market study in response to the CAMRA super-complaint leading either to a reference to the Competition Commission or undertakings from the sector to end anti-competitive practices in lieu of a reference to the Competition Commission.

- The Secretary of State should be willing to use the powers he has under section 132 of the Enterprise Act to refer the issue to the Competition Commission if the OFT refuse to take any further action in response to the CAMRA super-complaint.

- Fair Pint has met the senior officials in the EU Commission's Competition Directorate. We believe that the European Commission should consider using the powers they have under section 6 of the Vertical Restraints Exemption to remove the benefit of the Exemption from the pub sector in the UK. Alternatively the OFT should use the powers they have under article 7 of the Vertical Restraints Exemption to remove the protection of the exemption for the pub sector in the UK. Any one of these actions would mean that the onus would be on pubcos to prove that their agreements were not anti-competitive.

- Pubcos argue that the tie provides a number of benefits which balance out the higher cost of beer. The Business and Enterprise Committee argued that that if this was the case tenants would choose to stick with the tie if they were given the option. The Business and Enterprise Committee suggested that pubcos should offer their tenants the option of running their pubs on a free of tie basis. **Fair Pint is calling on the Government to create a statutory code of practice that will enable tenants to opt out of the tie when leases are granted, reviewed or renewed.**

Fair Pricing

- The Business and Enterprise Committee made it clear that the tie reduces tied pubs' profitability and makes beer in tied pubs more expensive for the consumer. Fair Pint believes that a statutory code of practice would help to ensure that pubcos are transparent about pricing. Pubcos need to be open about the discounts they receive from brewers and the proportion of that discount which is passed on to tenants. **Fair Pint is calling for greater transparency.**

Fair Rents

- The fact that the rent review system is balanced in the interests of pubcos rather than tenants means that most tenants face high rents as well as higher prices for beer and other supplies. Pub tenants end up simply having to accept any increases in rents and beer prices or risk losing their pubs and - as many tenants live in their pubs - their home as well. Something which looked like an acceptable deal when agreed can quickly become unfair when rents and beer prices are relentlessly increased. Fair Pint believe that the Department for Business Enterprise and Regulatory Reform needs to take immediate action in response to the Business and Enterprise Committee's recommendation that **the fairness of rents and how they are calculated between pubcos and their tenants needs to be reviewed**.

- The Business and Enterprise Committee reported that the current system of calculating rents was a product of history and custom. The fact that there is a lack of transparency in rent calculations means that the system is open to manipulation by pubcos. Fair Pint are calling for action to ensure that there is full transparency about the way that rents are calculated and that this should become part of a statutory code of conduct.

- Tenants are often left with no option but to accept the pubcos' view about the levels of rent they are charged because they do not have the resources to challenge their landlords. The Committee recommended that a low cost but totally impartial arbitration system should be established. Fair Pint believes that the Government ought to take action to ensure that such a system is established as a matter of urgency.

- There is concern that the conduct of rent reviews in the pub sector is not following recognised law. Fair Pint is calling on Government to ensure that any reform the rent review system and guidance followed by RICS members are subject to proper legal scrutiny to ensure that the law is applied.

Fair Measurement

- Pubcos enforce the tie through a measuring system supplied from a company called Brulines. The Committee made it clear that in their view pubcos should not rely on Brulines equipment to enforce claims against publicans accused of buying outside of the tie, because their accuracy was doubtful. **Fair Pint believe there is an urgent need for the Government to take action to ensure that measuring equipment used to enforce the tie are regulated under the Weights and Measures Act 1985 so that tenants can be certain of their accuracy**.

Freedom from the AWP Tie

- Most pubcos operate a tie for fruit machines (so called amusements with profits) in 2004 the Trade and Industry Select Committee recommended that the tie ought to be abolished because they were unconvinced that any benefits from the tie could justify pubcos taking over 50% of the profits, the Business and Enterprise Committee's report states the Committee feels that this conclusion remains valid. **Fair Pint believes that action should be taken to outlaw AWP ties.**

Freedom from Restrictive Covenants

- When tied pubs have been forced to close, pubcos often sell them off for development as houses or frequently as supermarkets. The pubcos argue that the pub is unviable and therefore a change of use is necessary. Many of these pubs would be viable if they were free of operated on a free of tie basis, but as the Business and Enterprise Committee report pointed out, pubcos tend to sell their property with a restrictive covenant meaning that the property cannot be used as a pub in the future. This reduces competition in the market by reducing the number of properties that can be run as pubs**. Fair Pint call on the Government to take steps to make such restrictive covenants illegal.**

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