EXPLANATORY MEMORANDUM TO

THE PUBS CODE ETC. REGULATIONS 2016

2016 No. XXXX

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Pubs Code etc. Regulations 2016 regulate practices and procedures to be followed by large pub-owning businesses (defined in the Small Business, Enterprise and Employment Act 2015 (the SBEE Act) as those owning 500 or more tied pubs) in their dealings with their tied pub tenants. The Regulations are consistent with the principles of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants, and that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 A draft of this instrument was previously laid before Parliament on 14 April, and considered by the Joint Committee on Statutory Instruments. The Committee sent a memorandum on 27 April 2016 to which a response was sent by the Department on 28 April 2016. The regulations were withdrawn by the Department on 4 May 2016 in order to correct a small number of drafting errors. The instrument now laid is therefore a revised version of the regulations previously laid.

3.2 The changes to address the drafting errors principally involve amendments to provisions relating to the interaction of the Landlord and Tenant Act (LTA) 1954 and the market rent only (MRO) process to ensure that if a tied tenancy was 'contracted-in' under the LTA, then the new MRO tenancy should also be contracted-in.

3.3 Other drafting amendments clarify: the MRO procedure including for example the arrangements for making MRO-related referrals to the Pubs Code Adjudicator and independent assessor; the procedures for recovering rent at the end of a rent assessment; the procedure in Part 5 for demonstrating that a trigger event has occurred; the documents which may be regarded as containing unreasonable terms and conditions and the grounds for referring an investment agreement to the Adjudicator.

3.4 In addition, following feedback from key stakeholders, the opportunity has been taken to improve the procedures in Part 1 for assessing a significant increase in price for tied products and services.

3.5 New drafting provides that the comparison for establishing whether there has been a significant increase in price would take place only if it was shown that the unit price of at least one product had actually increased.

3.6 Other refinements mean that the comparison would include only products that were the same in each period. This means for example that for regulation 4 (alcoholic drink other than beer) there is no longer the possibility of comparing premium products against non-premium products. The regulations require the comparison of all relevant products to determine whether there has been a significant increase in price.

3.7 Further changes require that the comparison is made of the cost at comparison period prices (12 months ago) against the cost at current period prices (now) but on the basis of the same quantity (that invoiced in the comparison period). This is to prevent the scenario that changes in the amount of product or service ordered might itself trigger MRO. This also has the effect of simplifying the calculation and removes the requirement to calculate the average unit price.

3.8 Finally amendments to elements of the formula for calculating the significant increase in price comprise: (i) replacing Producer Price Indices with the Consumer Price Index (CPI), with any negative movements in the index treated as zero, (ii) amending regulation 4 'other alcoholic drinks' so the tolerance in the formula is increased from 6 to 8 percentage points, and (iii) disregarding non-contractual discounts, VAT and duty from the prices used.

3.9 This instrument will commence on the day after the day on which it is made. There would usually be a 21-day period between the making and commencing of such an instrument since it will have the effect of requiring different patterns of behaviour due to a change in the nature of the obligations imposed on pub-owning businesses and tied tenants. This 21-day period is being curtailed in light of the statutory deadline for introducing the Pubs Code, being 26 May 2016, and for the following reasons.

3.10 The pub-owning businesses and tied tenants affected by these Regulations have been aware since March 2015 that the Pubs Code, and associated regulations, should have come into force by 26 May 2016 and have been planning on this basis. This implementation date was a duty placed on the Secretary of State via the SBEE Act, and was also made clear in the detailed consultation documents and associated draft regulations that were published on 29 October and 4 December 2015. This date for implementation reflected the will of Parliament, both through the SBEE Act and during discussions in both Houses about the Pubs Code during the passage of the Enterprise Act 2016. Pub-owning businesses and their tied tenants in England and Wales were expecting it to come into force on 26 May 2016 regardless of whether they expected its impact on them to be positive or negative.

3.11 Unfortunately due to drafting issues which necessitated the withdrawal and revision of the previous version of this instrument, that statutory deadline has not been met. However, it is the Department's intention that the delay should be kept to an absolute minimum and this instrument should be in force as close to that deadline as possible in order to offer the protection of the Code to tied tenants. Accordingly, in all the circumstances, there are strong reasons for curtailing the usual 21-day period, and providing instead that this instrument commences the day after it is made.

Other matters of interest to the House of Commons

3.12 This entire instrument applies only to England and Wales.

3.13 This instrument applies only in England and Wales because Part 4 of the SBEE Act applies only in England and Wales.

3.14 In the view of the Department, for the purposes of House of Commons Standing Order 83P the subject-matter of this entire instrument would be within the devolved legislative competence of the Northern Ireland Assembly if equivalent provision in relation to Northern Ireland were included in an Act of the Northern Ireland Assembly as a transferred matter and the Scottish Parliament if equivalent provision in relation to Scotland were included in an Act of the Scottish Parliament.

4. Legislative Context

4.1 Part 4 of the SBEE Act requires the introduction of a statutory Pubs Code for England and Wales setting out obligations on certain pub-owning businesses in their dealings with their tied pub tenants, and provides for an independent Pubs Code Adjudicator to enforce it. Part 4 also provides additional powers to make regulations on matters relating to the Pubs Code which are now included in this instrument. An earlier draft of this instrument was published for consultation, with responses due by 18 January 2016. The Pubs Code (Fees, Costs and Financial Penalties) Regulations 2016, also made under Part 4 of the SBEE Act, contain related provisions and are being laid at the same time as these regulations.

Commitments were made by ministers during the passage of the SBEE Act to make and consult on certain provisions within secondary legislation. These were:

- To provide 'extended code protections' for tied tenants whose pub is sold to a business not in scope of the Code.
- To ensure that under the Code tied tenants can receive a Parallel Rent Assessment as well as an MRO option.
- To provide for a deferral of certain points at which the MRO option would be available for tenants in exchange for 'significant investment'.
- To provide for an exemption for 'genuine pub franchise agreements' from the right to MRO.

4.2 The provisions relating to the MRO option reflect the provision made in the Enterprise Act 2016 to ensure that the Pubs Code will require pub-owning businesses to offer tied pub tenants a MRO option in connection with a rent assessment whether the rent proposed is an increase, decrease or stays the same.

5. Extent and Territorial Application

5.1 The extent of this instrument is England and Wales only.

5.2 The territorial application of this instrument is set out in Section 3 under "Other matters of interest to the House of Commons".

6. European Convention on Human Rights

6.1 The Minister for State for Small Business, Industry and Enterprise has made the following statement regarding Human Rights:

"In my view the provisions of the Pubs Code etc. Regulations 2016 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 Further to recommendations by Trade and Industry Select Committees from 2004 onwards, the pubs industry introduced a voluntary code of practice to address shortcomings in the relationship between tied pub tenants and their brewery and pub company landlords. Despite some improvements, in November 2011, the Government announced that it was giving the industry one last chance to deliver a self-regulatory approach that would address the problems.

7.2 Following a call for evidence in October 2012, it became clear that the self-regulatory approach has not been sufficiently far-reaching. Although many pub companies treat their tenants well, publicans continued to highlight cases in which they had been treated unfairly and suffered significant hardship. The Government consulted on a statutory framework in 2013 and published a response in 2014 that concluded that two core principles were critical to address the problems. These were: that tenants should be treated fairly, and that the tied tenant should be no worse off than the free-of-tie tenant. It also concluded that "the best way to deliver these core principles is to introduce a Statutory Code to govern the relationship between pub owning companies and their tied tenants."

7.3 Part 4 of the SBEE Act implemented these findings by requiring the Secretary of State to make regulations – The Pubs Code – about practices and procedures to be followed by pub-owning businesses in their dealings with their tied tenants in England and Wales. The SBEE Act requires the Code to be consistent with the two core principles, redefined slightly as: the principle of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants and the principle that tied pub tenants should not be worse off than they would be if they were not subject to any product or service tie. The SBEE Act also defines a tied pub tenant and a pub-owning business for these purposes, establishes a Pubs Code Adjudicator and lists various issues on which the Pubs Code must or may contain provisions. These include, among others, provisions relating to the offer of an MRO option to tied tenants in particular circumstances, the provision of information by pub-owning businesses to their tied tenants, requirements relating to rent assessments, and whether some provisions of the Code should be non-arbitrable.

7.4 The Pubs Code sets out the requirements on pub-owning businesses – defined in the SBEE Act as those with 500 or more tied pubs in England and Wales – in relation to procedure and information to be provided to tenants and licensees in connection with new tied tenancy and licence agreements, assignments, rent proposals, rent assessments, repairing obligations and the MRO option. The MRO option allows the tied tenant to continue to occupy their pub but under a tenancy or licence that does not contain any product or service ties (other than for buildings insurance) and for which the tenant pays a market rent. The tenant has a right to establish the market rent through referral to an Independent Assessor under the MRO procedure in the Pubs Code. The Pubs Code also defines conditions that qualify a tenancy or licence as MRO-compliant.

7.5 Other information and advice that pub-owning businesses have to provide to their tenants and licensees relate to specific events such as buildings insurance renewal and the sale of the superior lease or freehold.

7.6 The Code also sets out the applicable timetables and processes to be followed when these different events occur. These include:

- The rent assessment and MRO processes;
- Ensuring that new tenants consider independent professional advice in preparing a sustainable business plan, which must have been agreed with the pub-owning business before the two parties may sign a new agreement; and
- Details of dispute procedures not covered fully by Part 4 of the SBEE Act.

7.7 Six businesses are expected to meet the definition of pub-owning businesses when the Pubs Code comes into force. They own approximately 12,000 tied pubs in England and Wales.

7.8 Part 4 of the SBEE Act contains regulation making powers for matters relating to the Pubs Code. The remaining parts of this instrument are made in exercise of those powers.

7.9 There are exemptions from all or part of the Code for certain categories of tied pub (short agreements and franchises), of landlord (those no longer qualifying as a pub-owning business or who have purchased a tied pub from a pub-owning business) and of event (investment agreements between a pub-owning business and its tied tenant). These exemptions are set out in the regulations. The regulations also cover what constitute void and unenforceable terms in a tenancy or licence.

7.10 There are requirements relating to representatives and employees of pub-owning businesses (business development managers and compliance officers); circumstances in which a group undertaking of the pub-owning business may be treated as a pub-owning business itself, e.g.: during investigations and arbitrations; and transitional arrangements in the period following the commencement of the Pubs Code.

Consolidation

7.11 There is no need for any consolidation.

8. Consultation outcome

8.1 A consultation on the measures in these regulations was carried out in two parts, from 29 October 2015 and 4 December 2015, with a common closing date of 18 January 2016 – see https://www.gov.uk/government/consultations/pubs-code-and-adjudicator-market-rent-only-option-and-rent-assessments and https://www.gov.uk/government/consultations/pubs-code-and-adjudicator-fees-enforcement-and-other-parts-of-the-code.

8.2 The consultation sought views on how to implement the Pubs Code and make the related regulations, including disputes arising in relation to the MRO process, the exception from MRO entitlement in return for significant investment, the rent assessment trigger for the MRO option and in particular whether to remove its rent increase condition, plans to ensure the regulations fulfil the objectives of a parallel rent assessment in relation to the MRO option and requirements to provide information on a tied rent offer, arrangements for rent assessments, types of agreement outside the scope of some or all of the code, the type and timing of information provided to tied tenants, repair and maintenance obligations, Pubs Code Adjudicator fees, the maximum financial penalty for breaches of the Code, and extended code protection when a tied pub's landlord stops being a 'pub-owning business' as defined in the legislation.

8.3 80 responses were received. These included responses from all six of the pub-owning businesses expected to come within scope of the Code; from organisations representing tenants, consumers and businesses that own pubs; from individual pub tenants/ex-tenants; and from other professionals and organisations working with the industry. Further comments and feedback were received at meetings and workshops organised by the Department of Business, Innovation and Skills for that purpose and from discussions in Parliament, particularly during the passage of the Enterprise Bill.

8.4 The Government decided to make a number of changes and improvements as a consequence of helpful and constructive responses to the consultation. The principal ones were: to remove the proposed restriction that the MRO option should become available only when an increased rent was proposed but to allow it regardless of the level of rent proposed; to change the basis on which a 'significant price increase' would be calculated for the purpose of triggering an MRO option; to cut back the weight of information requirements on pub-owning businesses in ways that would still offer similar protections to tied pub tenants; and to clarify that pub-owning businesses would be permitted to carry out routine checks – though not to negotiate terms – before providing stipulated information to prospective tenants.

8.5 The responses to the consultation also helped the Government with decisions on other matters. These included:

- Conditions for the investment exception which allows the deferral of the right to an MRO option in exchange for a significant investment in the tied pub – including the minimum size of such an investment and the maximum period for the exception;
- The maximum period for which short agreements should be exempted from most Pubs Code provisions (12 months); and which provisions should still apply to them;
- The definition of those tied pub franchises which would be exempt from some parts of the Code; and some additional requirements in respect of those franchised tenancies;
- To make some Code provisions non-arbitrable: relating to the role and duties of compliance officers and the training of business development managers.

8.6 The Government's response to the consultation was published on 14 April 2016 and can be found at: www.gov.uk/government/consultations/pubs-code-and-adjudicator-fees-enforcement-and-other-parts-of-the-code .

9. Guidance

9.1 It is a requirement of section 61(1) of the SBEE Act that the Pubs Code Adjudicator must issue guidance within 6 months of being established about:

- Criteria the Adjudicator intends to adopt in deciding whether to carry out investigations;
- Practices and procedures the Adjudicator intends to adopt in carrying out investigations;
- Criteria the Adjudicator intends to adopt in choosing whether to use the enforcement powers and which ones;
- Criteria the Adjudicator intends to adopt in deciding the amount of any financial penalty following an investigation.

9.2 In addition, sections 61(2) and (3) state the Adjudicator may publish guidance on:

- Practices and procedures the Adjudicator intends to adopt in carrying out other functions;
- The application of any provision of the Pubs Code;
- Steps that pub-owning businesses need to take in order to comply with the Pubs Code;
- Any other matter relating to the Pubs Code.

9.3 Before publishing guidance under section 61 the Adjudicator must consult any persons he thinks appropriate.

10. Impact

10.1 The impact on business, charities or voluntary bodies is estimated to be an annual reduction on the burden of business of £73,000. This reduction is as a result of the secondary legislation, and is relative to the overall impact estimated in the primary legislation of an annual net cost to business of £2.69m.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment is submitted with this memorandum and has been published at http://www.legislation.gov.uk/ukdsi/2016/9780111146330/impacts.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 The Pubs Code Adjudicator is required by section 62 of the SBEE Act to prepare and publish a report each year covering the period to 31 March; and to send a copy to the Secretary of State, who must lay it before Parliament. That report must include a summary of his enforcement activities in relation to this instrument; arbitrations conducted, investigations carried out, and enforcement measures applied.

12.2 The Pubs Code Adjudicator is required by section 40 of the Enterprise Act 2016 to report to the Secretary of State on cases of pub-owning businesses engaging in what the Adjudicator considers to be unfair business practices. The report should include recommendations for actions to prevent these practices and how to provide redress for tied pub tenants affected by them. The Secretary of State is required to issue a statement within three months saying what action he intends to take or the reasons for not taking action.

12.3 The Secretary of State is required by section 46 of the SBEE Act to review the operation of the Pubs Code and, as soon as practicable after a review period, to publish a report of the findings of that review and to lay a copy before Parliament. That report must set out the extent to which in his opinion the Pubs Code is consistent with the principles described in paragraph 7.3 above, and whether there are any revisions of the Code which would enable it to reflect more fully those principles. The first review period will end on 31 March 2019. Subsequent review periods will end every three years after that. In respect of additional provisions contained within this instrument which are not within the Pubs Code, regulation 68 provides for a review of those to be carried out to the same timetable as the review of the Pubs Code.

12.4 The Secretary of State is required by section 65 of the SBEE Act to review the Adjudicator's performance and, in particular, how effective he has been in enforcing the Pubs Code, to publish a report of those findings and to lay the report before Parliament. The first review period will end on 31 March 2019. Subsequent review periods will end every three years after that. As a result of the findings of a review, the Secretary of State may give guidance to the Adjudicator about any matter relating to the Adjudicator's functions and the Adjudicator must take account of that guidance.

12.5 If as the result of the findings of this performance review, the Secretary of State is satisfied that there is no further need for an Adjudicator to secure compliance with the Pubs Code or that the Adjudicator has not been sufficiently effective in securing compliance with the Code, he may by regulations abolish the Adjudicator.

13. Contact

13.1 Michael Penry at the Department for Business, Innovation and Skills (Tel: 020 7215 0345 or email: mike.penry@bis.gsi.gov.uk) can answer queries regarding the regulations.