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Case Commentary

Constraining the Power of the Pubs Code Adjudicator: Imposing Terms on a "Market Rent Only" Offer

Punch Partnerships (Ptl) Ltd v Highwayman Hotel (Kidlington) Ltd [2020] EWHC 714 (Ch)

For the first time, an arbitration award made by the Pubs Code Adjudicator (PCA) – created under the Small Business, Enterprise and Employment Act 2015 and with powers detailed in the Pubs Code Etc Regulations 2016/790 – has been subject to a substantive judgment by the High Court (Punch Partnerships (Ptl) Ltd v Highwayman Hotel (Kidlington) Ltd [2020] EWHC 714 (Ch)). The PCA is a Janus-faced creature: they exercise both regulatory and arbitration functions. The decision in Highwayman Hotel provides welcome clarification on the interaction between these two roles. However, in constraining the PCA's ability to impose lease terms when making awards, the court acts against the underpinning statutory purpose of the code and blunts the PCA's teeth at some of the most challenging times for the pub sector in its modern history.

Background

At its core, the Pubs Code is the use of statutory arbitration and regulation to constrain a power imbalance between tied-tenants and the largest pub-owning companies. Established under the Small Business, Enterprise and Employment Act 2015, the Pubs Code and the PCA are a result of long-standing market failure in the UK pub sector: tied-tenants, who face heavy restrictions on procurement (known as "wet rent") and rents based on estimated trade in the premises, have long suffered a lack of negotiating power in comparison to their far larger, generally well-resourced landlords.

In response, the Pubs Code Regulations 2016/790 provide, *inter alia,* for tied tenants with England and Wales' largest pub operators a right to request a "market rent only" (MRO) offer from their landlords. This (in theory) provides the opportunity to operate the pub as if they were free of the tie imposed by the current lease, instead paying only the market rent without the additional "wet rent" tie. This mechanism was designed with the Pubs Code Regulations key operating principles in mind, as outlined in s. s.42(3) of the 2015 Act:

> (a) the principle of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants;
>
> (b) 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 Code details a series of non-exhaustive criteria that this MRO offer must satisfy to be compliant and a broader requirement that any such offer is "reasonable": see, s.43(4)-(5) of the

2015 Act, and Reg.30 Pubs Code Etc Regulations 2016/790. Disputes can be referred by the tied tenant to the PCA for arbitration: see, s.48 of the 2015 Act.

Facts

In *Highwayman Hotel*, the tied-tenant at the Highwayman Hotel triggered their right to an MRO offer, to which Punch Taverns responded with a new lease lasting only until the end-date of the current one (three years). After an initial round of arbitration dealing with other objections, the tied-tenant applied for a second arbitration to the PCA on the basis that the MRO offer was not compliant with the Pubs Code as its length was unreasonably short: at [19].

Prior to the conclusion of these second arbitration proceedings, the PCA had – in the course of their regulatory work – attained a statement from *Star* detailing a "10-year policy" on MRO responses. As a subsidiary, Punch Taverns operates under the same policy:

> "…it is Star Policy to offer to the Tied Pub Tenant (TPT) an agreement which is as long as the remaining term of the existing tenancy, as stipulated in the Pubs Code or a term of 10 years whichever is longer." (see, at [21]).

The PCA duly forwarded this information to the tied tenant at the Highwayman Hotel and asked *Star* to indicate why it had not followed its own policy in relation to this MRO offer. Star's lawyers were quick to object to the disclosure of this "10-year policy" in the course of a live arbitration and maintained that they considered the MRO offer to be reasonable: at [23].

The arbitration proceeded. In their award, the PCA considered that Star had not provided a good reason to depart from their "10-year policy" and should, in order to maintain compliance with the Pubs Code, issue a revised MRO offer with a minimum term of five years: at [27]-[28]. The key paragraph that formed the focus of these proceedings states:

> "…I must arbitrate the dispute, and that means that I should ensure that [the Tenant] obtains a compliant MRO proposal without the need to refer for further arbitration on the terms of the MRO lease. History indicates to me that the parties are unable to negotiate to an effective agreement, and therefore in this case I have determined that I should order the compliant lease term on which the revised proposal must be made. [The Landlords'] interpretation of my powers under regulation 33(2) is such as to provide the potential for locking a tied pub tenant into a cycle of litigation. Such delay would place a greater burden on the tenant than on [the Landlords] as a huge international brand with deep pockets." (see, para. 62 of the PCA award, detailed in [28]).

Punch Taverns challenged this award in the High Court under ss.68-69 of the Arbitration Act 1996 on, *inter alia*, three main grounds:

1. Reg.30(2) of the Pubs Code Regulations 2016 requires that, to be reasonable, an MRO lease should be for at least as long as remains on the existing tenancy. Star argued that, if an MRO offer meets this minimum, this term must also be reasonable under s.43(4)-(5) of the 2015 Act.

2. In disclosing material attained via its regulatory function in the course of arbitration proceedings, the PCA had acted unlawfully. Documents seized by a public authority in exercise of a statutory power can only be used for the purposes contemplated by that legislation (the so-called "Marcel Principle").

3. The PCA does not have the power to specify the terms of any subsequent MRO offer in their award.

Decision

The first two grounds failed and the third succeeded. First, the court determined that the requirements imposed by Reg.30 that any MRO offer must be for at least the period of the remaining lease term are "cumulative" with the broader requirement for the reasonableness of the terms under s.43(4)-(5): at [46]. Put another way, terms that are reasonable under Reg.30 may still be unreasonable (and, therefore, non-compliant) under s.43. As noted previously in this journal, the ambit of "reasonableness" under the Pubs Code is a broader one and admits for a wide range of relevant factors to be considered: see, Jed Meers, "The Pubs Code: The Reasonableness of 'Market Rent Only' Offers", (2020) 24(1) L. & T. Review, at pp. 5-8.

Second, the landlord's arguments that the regulatory and arbitration functions should be exercised separately – akin to a Chinese wall between the two – did not accord with a plain reading of the underpinning regulations. The court noted that "the functions of the OPCA as regulator sit in harmony with its arbitrations": at [66]. The landlord had sought to argue that the Pubs Code Adjudicator's regulatory power to require PubCos to disclose documents (see para.19, Schedule 1 to the 2015 Act), could only be used for its regulatory work. To disclose this material to third parties in their arbitration function would pervert this power. The PCA argued that they cannot "unknow" information raised in their course of their regulatory work when arbitrating; it was only fair therefore, to provide this information to the tied tenant. In dismissing the landlord's arguments, the court underscored that the underpinning regulations support an "integrated view of the [Office for the Pubs Code Adjudicator's] dual functions": at [65]. There is – as the court puts it – no "absolute dichotomy": at [66]. Instead, the PCA's regulatory functions work in harmony with their arbitration role. The underpinning regulations provide no indication to the contrary.

Third, the landlords sought to argue that the PCA's assumption that they can impose a five-year lease period was both outwith their powers under the regulations and an unlawful interference with the PubCo's fundamental right to dispose of their property as they choose (under the first part of the first protocol, A1P1). The PCA argued that their powers under Reg. 33(2) of the Pubs Code Regulations 2016 were permissive and broad ranging:

> "(2) Where—
>
> (a) a matter is referred to the Adjudicator under regulation 32(2)(a) to (c);
>
> and
>
> (b) the Adjudicator rules that the pub-owning business must provide a revised response to the tied pub tenant,

> the pub-owning business must provide that response within the period of 21 days beginning with the day of the Adjudicator's ruling or by such a day as may be specified in the Adjudicator's ruling."

The court disagreed. Although the Pubs Code provides the PCA with the power to require a PubCo to issue a revised response, they could not determine the terms within that response: that is to be left to the PubCo, and then subject – if needed – to further arbitration. Put another way, the court determined that there is "a major distinction between finding that an offer is unreasonable because it contains a proposed period of less than five years, and an order that the revised offer contain a period of at least five years": at [100].

The court noted that, where the Pubs Code does provide powers to interfere with the PubCo's property rights, it is explicit in doing so. The landlords pointed to the power to appoint an independent assessor (who, in turn, can determine the market rent for the property) under regs. 36, 37 and 59 as one such example: at [94]. The permissive language in reg.33 was not enough to "empower the arbitrator to interfere with the economic and property interests of the parties" – for the court to be satisfied that such a power exists, it needed to be more clearly expressed in the underpinning legislation: at [102].

Commentary

At a time when many tied-pubs are confronting the greatest threats to their viability they have ever faced as a result of the Covid-19 pandemic, this decision pulls teeth from the PCA's powers to direct the conclusion of arbitrations. In the writer's view, there were two elements to the courts' assessment of the third ground that warrant attention. First, the Pubs Code's *raison d'etre* are the principles detailed under s.42(3) of the 2015 Act, namely:

> "(3) The Secretary of State must seek to ensure that the Pubs Code is consistent with—
>
> (a) the principle of fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants;
>
> (b) 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."

Any interpretation of the powers conferred under the Code need to be interpreted with these two principles at front of mind. Indeed, these "basic principle[s]" are returned to as the court interprets the statutory framework, particularly in its assessment of the second ground on disclosure of information (see, at [45], [63], and [72]), and the judgment promises a return to the "overarching intention of the 2015 of the Act and the Pubs Code…" when dealing with ground three: at [40].

However, the court's analysis of the third ground does not deal explicitly with these underpinning principles. The inability of the PCA to impose terms where (as in this case) a protracted cycle of arbitration exists, could lead to larger, far better resourced PubCos gaming the arbitration process to exhaust the resources of tied tenants. Indeed, the court accepts that their position poses "a risk of further delay, cost and attrition involved in repeated offers and arbitration" that "might harm the Tenant more than the Landlords": at [107]. It is difficult to

find an issue that bites more on the underpinning "principle of fair and lawful dealing" in s.42(3) of the 2015 Act, yet this principle does not feature in the court's statutory interpretation of the reg.33 power.

Second, the court situates their analysis under the rubric of a fundamental rights inference, leveraged under the right to property (first part of the first protocol, A1P1) and the requirement imposed by s.3 of the Human Rights Act 1998 to interpret legislation in a convention compliant manner. It is difficult to see, however, how the proportionality of any such interference could be properly interpreted without reference to the overarching legitimacy of the aims detailed in s.42(3) of the Small Business, Enterprise and Employment Act 2015. Indeed, the court concludes, in relation to ground two, that any intrusion on the PubCo's rights "may be a proportionate, due response to the purposes and needs of the system set up under the 2015 Act and the Pubs Code": at [68]. The question of whether any such interference is proportionate is not dealt with in relation to the third ground. Nor does the court provide any reasoning for why their same conclusion on proportionality from the second ground does not bite on the third.

These two points are significant as the finding of the court risks undermining the ability of the PCA to exercise its statutory functions. There is ample evidence in published arbitrations of protracted disputes, with a revolving door of MRO-offers followed by referrals for arbitration, followed by further revised offers. As noted by the PCA (at the time, the Deputy PCA) in *Cask and Butcher Ltd and EI Group Plc* [2018] ARB/000282 (at: https://tinyurl.com/y8mhpl8r), at [61]:

> "Based on my experience, where I find an MRO proposal to be non-compliant and direct a revised response without specifying its precise form, there is a significant risk of ongoing disagreement between the parties about interpretation of my award."

Likewise, the ability of the PCA to direct the content of the agreement – should the parties fail to reach an agreement – can help to draw protracted disputes to a close even where no such terms are specified (see an anonymised arbitration award released by the PCA, *Re EI Group* [2019] at https://tinyurl.com/y8w3n79e). Ongoing disagreements come at the expense of the tied tenant. Elongating disputes imposes significant additional costs and denies the timely exercise of the MRO rights contained within the underpinning regulations: the tied tenant remains locked into their current lease throughout and pays the price for doing so.

A narrow reading of the PCA's powers under reg.33 also raises practical considerations where external experts are appointed under s.37 of the Arbitration Act 1996 at the agreement of both parties. A good example is *Magpie and Stump Limited and Ei Group PLC* [2019] ARB/000292 (at: https://tinyurl.com/ycsemn3q). Where protracted arbitrations lead to the appointment of a joint expert to determine the compliance of MRO terms (for instance, as to their commonality in free-of-tie leases) can the PCA impose that their conclusions are reflected in the revised offer? The vehicle for this remains reg.33 (see, *Magpie and Stump,* at [18]-[19]), but the narrow reading of the High Court in *Highwayman* suggests that any such expert evidence should only inform any revised response, to then be subject to further arbitration (and, perhaps, further expert evidence, and so the revolving door continues).

There is no doubt that the decision of the High Court in *Highwayman Hotel* brings much needed clarity to the "dual functions" of the PCA. The underpinning regulations envisage both the regulatory and arbitration functions of the adjudicator to sit side-by-side and to inform one another; they cannot not, as the court notes, be "chopped apart": at [83]. Likewise, further clarification on the wide scope of "reasonableness" of terms within the legislation (see, s.43(4)-(5) of the 2015 Act and Reg.30 of the Pubs Code Regulations 2016) accords with the practical reality of the PCA's adjudication work. No two pubs are the same and what is reasonable for one may not be for another.

However, the court's narrow reading of the PCA's powers to impose terms on revised MRO responses under reg.33 of the Pubs Code Regulations 2016/790 blunts their teeth unduly. To prevent the PCA from directing the content of revised responses is to provide an avenue for endless, revolving door arbitrations as the PCA requests revised responses and the tied tenant refers them for arbitration. The PCA is no stranger to protracted disputes where – either as a result of persistent disagreement, or less charitably, to deplete the resources of their opponents – PubCos have stretched MRO disputes over long time frames.

One of the two animating principles of the Pubs Code Regulations is "fair and lawful dealing by pub-owning businesses in relation to their tied pub tenants": see s.42(3) of the 2015 Act. All the functions and powers conferred to the PCA must be interpreted with this principle in mind. In failing to do so, the High Court jeopardises the ability of the Pubs Code and its PCA to address the historic power imbalance between the largest PubCos and their tied-tenants at a time of historic threats to the pub sector.

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