Business and Enterprise Committee

Role of the Pub Companies

CAMPAIGN
FOR
REAL ALE

Submission from CAMRA, The Campaign for Real Ale
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1.0 Introduction

1.1 CAMRA, The Campaign for Real Ale is a consumer organisation that seeks to promote real ale, well run pubs and the interests of consumers. CAMRA has over 95,000 individual members and is wholly independent from the brewing and pub industry.

1.2 CAMRA believes that competition law needs to be more rigorously enforced in the beer and pub market to ensure that the consumer benefits from greater choice and improved value for money when visiting the pub. Market dominance of the pub companies through the beer tie has resulted in:

- a substantial section of the UK's pub market being foreclosed to the products of small and medium sized brewers
- the closure of valued community pubs made unviable by high rents and beer prices - figures for the first half of 2008 reveal that closures have accelerated to 36 pubs a week[1]
- the price of beer sold in pubs increasing at above the rate of inflation

2.0 The UK Pub Market

2.1 The three biggest pub companies tie just over 30% of the UK's pubs.

Pub Company	2008 Number of Pubs
Enterprise Inns	7,756
Punch Taverns	7,575 (excluding managed pubs)
Admiral Taverns	2,400
Total	**17,731**
Total UK Pubs	**57,000**

2.2 In addition to pubs tied by the largest three pub companies a further 6,700 pubs are tied by brewers and a further 5,869 pubs tied by smaller pub companies. In total therefore about 30,300 pubs in the UK are tied, which is just over 53% of the total UK pub stock of 57,000.

3.0 A Guest Beer Right

3.1 The "beer tie" is an exclusive purchasing obligation which forces pub lessees and tenants to buy beer and other products from a nominated supplier(s) at prices substantially higher than those available in the free market. This practice means higher pub beer prices for consumers and reduced consumer choice.

3.2 The introduction of Small Breweries' Relief[2] in 2002, growing consumer preference for local products and the enthusiasm and the commitment of dozens of entrepreneurs has seen a huge increase in the number of UK

[1] British Beer and Pub Association – Press release – Pub closure rate accelerates to five a day – 08/09/08
[2] Small Breweries Relief means small brewers benefit a reduction in excise duty of up to 50%.

small brewers. There are now over 660 independent brewers in the UK compared to just over 440 in 2002.[3]

3.3 Despite the growth in the number of small brewers the pub market is substantially foreclosed to them because they are unable to supply the minimum volumes, discounts and logistics demanded by large wholesale and pub owning companies.

3.4 The Society of Independent Brewers' Direct Delivery Scheme (DDS) has had some success in enabling local brewers to deliver direct to pub company pubs. The growth of this scheme however is hampered by the margin demanded by pub companies, which reduces the profitability of small brewers and means that the prices charged to consumers for these beers can be comparatively high.

3.5 Both small and regional brewers lack the negotiating power and economies of scale enjoyed by the Global Brewers. A guest beer right that would apply to all companies with more than 500 tied pubs would resolve these problems by allowing small and regional brewers to deal direct with local lessees.

3.6 The 2004 DTI Select Committee report concurred with the view that introducing a guest beer right "of a particular type, for example cask ales and regional or national specialities, would run contrary to EU competition law and could lead to the UK Government being challenged in the European Courts." CAMRA disagrees with this view for the following reasons:

- As the function of a guest beer law would be to remove barriers to market access not impose them there could be no conflict with competition laws
- A guest beer right would be open to brewers regardless of location. Cask conditioned beers are brewed worldwide by smaller producers

3.7 While a guest beer right for cask conditioned beers is CAMRA's preferred option consideration could be given to another type of guest beer law that would avoid any perceived complications with EU competition law. A guest beer could be defined as a beer brewed by a brewer anywhere in the world with an annual production below 200,000 hectolitres. This reflects the maximum production limit allowed through the EU's small breweries relief scheme.

3.8 A guest beer right would be a simple and straightforward measure which would address the problem of the UK pub market being substantially foreclosed to small and medium sized brewers. Introducing a guest beer right would be popular among regular pub goers and pub lesees as well as being in the long term interests of pub companies by supporting the long term viability of their pubs.

4.0 Pub Beer Prices

[3] Totals taken from CAMRA's Good Beer Guide 2004 and 2009.

4.1 The current pub company model depends on money generated from the rent charged to lessees, sometimes referred to as a dry rent, and money generated from profit the pub company makes from supplying beer, sometimes referred to as wet rent. Enterprise Inns generate 47% of their total profits from beer sales and 47% from pub rents.[4] Punch Taverns generate 47% of their total profits from beer sales and 43% from pub rents.[5] Their remaining profits are generated from machine income and other drink sales.

4.2 Morgan Stanley estimates that a lessee may typically be charged a wholesale price of £1.10 per pint of lager, compared to 80p charged to a free trader and 60p to licensee of a managed pub.[6] These price differences mean that pub lessees struggle to compete on price with both managed and free trade public houses, which is contrary to fair competition and detrimental to the interests of consumers.

4.3 The UK real ale market is highly competitive and as a result free of tie licensees are able to benefit from large discounts. During August this year real ales from Brakspears, Greene King, Highgate, Batemans and Wadworths were available via a nationwide wholesaler for between 63p and 72p a pint.[7] In contrast one of the very cheapest real ales available to a Punch lessee during August was priced at 96p a pint.[8] Assuming a gross profit target of 50%, a beer purchased by a licensee at 72p a pint would need to be sold for £1.69, whereas a beer purchased at 96p would need to be sold for £2.25 a pint.

4.4 The price of beer in pubs has increased faster than brewery beer prices over the last ten years. Between April 1998 and April 2008 the UK producer price index (including excise duty rises) for beer increased by 31.8%[9], whereas the retail price index for beer on sales increased by 39.4%. This trend indicates a lack of competition and further investigation is required to establish the degree to which the existence of the beer tie is inflating the cost of beer in pubs by restricting competition on beer prices.

4.5 The Interim Results Presentation 2008 for Enterprise Inns show that they make a 50% gross margin (excluding discounts) on the beer and cider that they supply to their lessees. Punch Taverns 2007 Preliminary Results Presentation 2007 shows that they make a 52% gross margin on the beer and cider that they supply to their lessees. This level of gross margin appears excessive when compared to the 25% gross margin made by Enterprise on wines, minerals and spirits for which the majority of lessees are not tied.

4.6 There are few restraints to prevent pub companies earning excessive profits from the sale of tied products, primarily beer and cider. If lessees buy outside of the tie they are liable to a substantial fine, losing their jobs

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[4] Interim Results Presentation 2008 - Enterprise Inn
[5] Preliminary Results Presentation 2007 - Punch Taverns
[6] Morgan Stanley Research – Leisure and Hotels, Leased Pubcos: Avoid – September 2008
[7] Available during August through WaverleyTBS who have a UK wide distribution network.
[8] Figure taken from Punch Taverns' price list dated 7th July 2008.
[9] British Beer and Pub Association – Statistical Handbook 2008

and being evicted from their homes. Lessees are able to challenge rent increases but they are unable to challenge increases in the cost of tied products.

4.7 A column by pub operator, Peter Linacre, in the Morning Advertiser Trade Newspaper claims that it is the pub companies not lessees who have benefited from the increased gap between the price that Brewers sell beer and the price which the consumer ultimately pays in the pub. According to Peter Linacre at the start of the pub company leasehold model the average discount received by pub companies was £120 per barrel, which was shared equally between lessee and pub company with £20 going in other costs. This compares unfavourably to the current situation where a pub company can achieve a discount of £230 per barrel of which they retain £160, £20 goes in other costs and the lessee still receives only £50.[10]

4.8 CAMRA believes that a mechanism needs to be established to ensure that beer price rises in long-term pub company lease agreements are proportionate to the increases in the producer price index for beer. It is both unjust and damaging that a pub company can increase beer prices without effective restraint. The large margin that pub companies achieve on beer sales is not adequately counterbalanced by benefits provided to lessees in terms of investment, business support or rental concessions.

4.9 CAMRA urges this committee to request a study by the Office of Fair Trading to clearly establish whether the existence of the “beer tie” has led to tied lessees being worse off than they would be in the absence of the beer tie. If necessary, the OFT should then take action to regulate the price that pub companies can charge lessees for tied products.

5.0 Pub Rents

5.1 The introduction of the new British Beer and Pub Association’s Codes of Practice Framework in addition to new company Codes of Practice is a welcome result of the 2004 Trade and Industry Select Committee Report. These codes however have not led to an end to lessees faced with rents at an unsustainable level.

5.2 According to a report from Morgan Stanley pub rents have increased faster than pub sales and faster than inflation. An analysis of rent per barrel sold shows a 11% increase per year at Enterprise Inns and a 4% increase per year at Punch Taverns since 2002.[11] This level of increase is considerably higher than rents achieved in the wider commercial sector. Falling beer sales and a shift to consumption of beer at home are two reasons why pub rents should be falling not increasing. The Morgan Stanley report concludes that 20% - 30% of tied pubs could be uneconomic due to high rents.

[10] Peter Linacre – Demand down, price up – please explain. Morning Advertiser – 18th September 2008
[11] Morgan Stanley Research – Leisure and Hotels, Leased Pubcos: Avoid – September 2008

5.3 Rent is generally calculated by deducting overheads and the proposed new rent from the level of trade that a hypothetical competent licensee could be expected to achieve and dividing the remainder equally between lessee and the pub company. The current rent calculation however takes no account of the revenue lost to lessees as a result of being unable to buy beer in the free market. One option to ensure the “beer tie” is fair and not anti competitive would be to reduce pub rents to take into account the higher beer prices that lessees are forced to pay.

5.4 The existence of upward only rent reviews and annual rpi increases regardless of worsening trading conditions can lead to pubs becoming unviable regardless of the merits of the lessee and the potential of the pub. Upward only rent clauses should be made unlawful and annual rpi rent increase should not apply where lessees have suffered a fall in trade as a result of external factors. Given the closure of 36 pubs a week these changes need to be made urgently.

5.5 CAMRA urges the committee to recommend:

- an end to upward only rent agreements
- an end to annual rpi rent increase regardless of trading conditions experienced by lessees

6.0 Pub Disposals

6.1 A pub company will often choose to dispose of a struggling pub rather than work in partnership with a lessee to improve the business fortunes. Where a pub company chooses to go down this route the lessee should be given first refusal to buy the pub. At the moment it is possible for a pub to be sold without the knowledge of the existing lessee.

6.2 A particularly deplorable practice is the use of restrictive covenants to prevent future purchasers from continuing to use the premises as a pub. The result of this is to restrict competition and to strengthen the market dominance of an individual company in a locality. The use of restrictive covenants should therefore be outlawed.

6.3 The ease with which pub companies are able to dispose of struggling pubs, usually for alternative development, reduces the financial incentive they have to work with a lessee to turn around a struggling pub.

7.0 Retention of the beer tie

7.1 CAMRA supports the retention of the beer tie and opposes efforts to secure its abolition. If operated on a fair basis the “beer tie” is in the interests of both lessees and consumers.

7.2 The four largest global brewers operating in the UK brew nearly 8 in 10 pints sold in the UK.

7.3 The abolition of the “beer tie” could result in substantially strengthening the market power of these four global brewers to the detriment of market access for small and medium sized brewers and consequently consumer choice.

7.4 In summary the beer tie is important in:

- providing a low cost entry into pub ownership
- ensuring the survival of the medium sized family brewers
- ensuring that the financial loss associated with any fall in beer sales is shared by the pub company
- preventing domination of the UK pub market by the four global brewers

8.0 Conclusions and Recommendations

8.1 CAMRA supports the retention of the beer tie but believes action is necessary to ensure that the tie acts in the best interests of consumers.

8.2 The consumer has been faced with above inflation increases in the price of beer sold in pubs partly as a result of pub companies earning a large margin on their beer sales. The consumer has also lost out on greater consumer choice as the beer tie restricts the choice of products available to lessees.

8.3 CAMRA recommends the following:

- The introduction of a guest beer right to address the foreclosure of the pub market to smaller brewers and lack of consumer choice.
- That the the Office of Fair Trading conducts a study to clearly establish whether the existence of the "beer tie" has led to tied lessees being worse off than they would be in the absence of the beer tie. If necessary, action should then be taken to ensure lessees and consumers are no longer disadvantaged.
- That where a pub company chooses to sell a pub they must first offer it for sale to the existing lessee.
- That it should be unlawful for a pub to be sold with a restrictive covenant in place preventing any purchaser from continuing to run the pub.
- An end to upward only rent agreements.
- An end to annual rpi rent increase regardless of trading conditions experienced by lessees.

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