

Response to CAMRA's super-complaint

October 2009

OFT1137

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EXECUTIVE SUMMARY

Background

On 24 July 2009, the Campaign for Real Ale ('CAMRA') submitted a super-complaint to the Office of Fair Trading ('OFT') regarding the UK pub industry (the 'super-complaint').

A number of the issues raised in the super-complaint relate to the operation of exclusive purchasing obligations by pub-owning companies ('pub companies')¹ which require their tenant or lessee (both are referred to in this response as the 'lessee') to purchase beer and other drinks solely through the pub company (the 'beer tie'). CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK in relation to beer, and other drinks.²

The super-complaint refers in particular to the existence of 'serious market failures which create the wrong incentives for market participants' within the beer and pub market.³ The key issues that CAMRA recommended that the OFT investigates further are:

- the foreclosure of tied outlets to suppliers unable to access these outlets directly

¹ Pub-owning companies may be brewers which own pubs, or companies which do not have a brewing dimension and are not affiliated to a particular brewer.

² These companies are: Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle UK Limited, Greene King plc, Marston's plc and Trust Inns Limited.

³ Paragraph 1.5 of the super-complaint.

- the wholesale prices paid by tied pubs for beer and other tied drinks and the level of rent paid by tied lessees⁴
- the basis upon which rents for pub lessees are calculated
- barriers to entry at the retail level of the supply chain, particularly the use of restrictive covenants on the sale of premises by pub companies and the lack of free of tie premises available to prospective pub lessees, and
- arrangements for the provision of technical services equipment ('TSE') and technical services ('TS') in pubs.⁵

The super-complaint recommended that:

- the OFT should carry out a market study into the issues raised by CAMRA and, following this
- the OFT should consider making legally binding certain measures in the form of undertakings in lieu of making a market investigation reference ('MIR') to the Competition Commission ('CC'), and
- in the event that such undertakings cannot be agreed, the OFT should make a MIR to the CC.

⁴ Paragraph 1.3 of the super-complaint mentions the existence of exclusive purchasing obligations relating to other goods and services. Our assessment of the super-complaint has focused on the impact of supply ties relating to the supply of beer, given that this is the primary focus of the evidence provided in the super-complaint.

⁵ TSE is used to dispense draught beer and cider. TS comprises the installation and servicing of equipment, including maintenance and refurbishment, replacement and removal of equipment.

The super-complaint process

A super-complaint is defined under section 11(1) Enterprise Act 2002 ('EA02') as a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. CAMRA is a designated consumer body. Following the receipt of a super-complaint, the OFT has a statutory period of 90 days to respond to the super-complaint (see sections 1.5-1.7 below).

In considering the issues raised in the super-complaint, the OFT's focus is on whether effective competition can be expected to deliver choice and value to consumers within the beer and pub market. In markets where competition is working effectively, the OFT has no mandate to intervene in commercial negotiations of particular parties.

OFT assessment

Having considered the issues raised in the super-complaint regarding the operation of tied lease agreements, the OFT has not found evidence of competition problems that are having a significant impact on consumers.

At a national, regional and local level, the evidence indicates that there is a large number of competing pub outlets owned by different operators and that there is competition and a choice between different pubs. We consider that in a competitive market, any strategy by a pub company which compromises the competitive position of its lessees would not be sustainable, as this would be expected to result in sales and margin losses for the lessee and, in turn, for the pub company. To that extent, pub companies' commercial interests would appear to be aligned with the interests of their lessees.

Further, we do not consider that tied lease agreements prevent pub offering a wide choice to consumers. Generally, large pub companies source from a number of suppliers.

We are aware that some lessees are dissatisfied with the prices and rent

levels that they pay to their pub landlord, and/or with the rent assessment process more generally. We received a large number of submissions from individual pub lessees outlining such concerns.

Given the degree of competition between pubs and also between retail on-trade outlets more generally, we do not consider that issues relating to the negotiation process between pub companies and lessees can generally be expected to result in consumer detriment.⁶ As such, we consider that lessees' concerns regarding terms of supply, the conduct of negotiations with their pub company, or issues raised in the super-complaint regarding rental valuation methods used in the pub industry, are either matters for pub companies to address with individual lessees or are issues for industry or other relevant bodies to consider.⁷

Restrictions relating to the ongoing or future use of pub outlets which are imposed when those premises are sold ('restrictive covenants') can in certain circumstances give rise to competition concerns, but, on the basis of our assessment of the scale of this issue, we are of the view that any potential adverse effects on competition are not likely to be significant.

Overall, the OFT has reached a view that further investigation of competition problems within the beer and pub market is not warranted. In particular, we do not propose to undertake further investigation either in the form of a market study, or investigation under the provisions of the Competition Act 1998 ('CA98'). Further, we do not consider that the

⁶ We regard agreements between pub companies and their lessees as business-to-business contracts, and we have not considered further action under the OFT's consumer powers in response to these aspects of the super-complaint.

⁷ Since the super-complaint was made to the OFT, the British Beer & Pub Association has announced proposals for a revised Framework Code of Practice on the Granting of Tenancies and Leases. Further, the Royal Institution of Chartered Surveyors has published a report entitled: 'Pub Industry Forum Report and Recommendations' which sets out proposals for greater transparency regarding rent assessment methods used in the pub industry.

issues raised in the super-complaint warrant a reference to the CC under the market investigation provisions of the EA02 and as such, we would not be able to accept undertakings in lieu of making a MIR to the CC.⁸

A more detailed summary of our findings in relation to the issues raised in the super-complaint is set out below:

Impact of tied lease agreements at the brewing level

CAMRA argues that the cumulative impact of the operation of tied lease agreements by pub companies forecloses a substantial proportion of pubs in the UK to small brewers⁹ and other market entrants, as they are unable to supply to these pubs directly. The super-complaint also refers to a number of difficulties experienced by small brewers, including pub companies' requirements for minimum order quantities from brewers; the requirement to deliver to a centralised distribution network; and demands for unrealistic discounts on wholesale prices.

Having considered CAMRA's concerns, we have not found that tied lease agreements operated by large pub companies are foreclosing brewers seeking to secure access for the supply of beer to retail outlets, or prevent pubs offering a wide choice of drinks to consumers.

Small brewers appear to face significant scale and logistical difficulties in accessing wholesale and distribution markets. We do not consider that these difficulties result from the operation of tied lease agreements as such. Rather, these are issues inherent in smaller suppliers dealing with large retail chains with centralised distribution networks. Sales to the on-trade through a delivery scheme established by the Society of Independent Brewers indicates that there are market-led solutions to these issues.

⁸ As set out more fully in section 8, below.

⁹ The super-complaint defines small brewers as those producing less than 200,000 hectolitres of beer per annum.

Since 2004, there has been consolidation among national and regional brewers and we understand that their combined share of total volumes of beer supplied to the on-trade has increased. The market share of 'micro' brewers (those producing less than 60,000 hectolitres of beer per annum) has also increased between 2004 and 2008.

Wholesale prices and rents paid by tied lessees

CAMRA is concerned that because lessees are tied to a pub company for the supply of beer and/or other drinks, pub companies are able to charge excessive wholesale prices for beer/other drinks to their lessees. CAMRA suggests that pub companies are exploiting their position as a result of the tie, by increasing profits on sales of beer/other drinks to their lessees at the expense of their lessees' own profitability. CAMRA states that the beer prices and property rents charged by pub companies to their lessees together lead to higher retail prices in tied pubs; deprives tied lessees of the opportunity to invest in their pubs; leads to reduced levels of customer service; and ultimately leads to less choice for consumers as a result of pub closures.

The super-complaint refers in particular to: (i) retail beer prices increasing at a faster rate than wholesale beer prices (based on the Producer Price Index¹⁰) as evidence that pub companies are selling beer to their lessees at increasing margins and are not passing on the discounts that pub companies are able to negotiate with brewers; and (ii) retail beer prices being higher in tied pubs as evidence that tied pubs are paying higher beer prices than free of tie pubs and are passing these higher prices on to consumers.

In our assessment of the issues raised in the super-complaint, we have considered the competitive constraints faced by pub companies and, in

¹⁰ The Office of National Statistics Producer Price Index measures brewer prices and indicates changes in the prices that brewers charge for goods destined for the UK market (net of VAT and after discounts). These prices are an average across the on- and off-trade.

particular, whether the operation of tied lease agreements enables pub companies to act independently of competition in terms of the beer prices and/or rents charge to their lessees.

The evidence indicates that at a national, regional and local level, there is no significant concentration of pubs owned by an individual pub company and there is generally competition between a number of different pub operators. Further, we have not found evidence to suggest that pub companies are acting jointly to increase prices or rents for their lessees. In a competitive market, any strategy by a pub company which compromises the competitive position of its lessees would be expected to result in sales and margin losses for the lessee and, in turn, for the pub company.

In the last 10 years, retail prices have not increased at a faster rate than service sector inflation, which appears to be the appropriate measure of inflation relevant to increases in retail beer prices.¹¹ Although retail prices have increased at 10 per cent above the rate of brewery prices in the last 10 years, the evidence does not indicate that these increases are likely to be a reflection of pub companies increasing margins on sales of beer and other tied products to their lessees. Rather, the evidence suggests that the higher rate of increases in retail beer prices compared to brewery prices is the consequence of increased pub and service sector costs.

We have found marginal differences in the average retail prices for lager in tied pubs compared to free houses (we estimate that average retail prices for a pint of lager are 8 pence higher in tied pubs than in free houses, 3 pence higher for a pint of cider and at the same level for standard bitter prices).

Competition between pubs does not take place only on price. Customers look for a package of features when choosing a pub, which include the 'amenity' (for example, quality of surroundings and service), food

¹¹ Rather than RPI 'all goods' inflation, which is the measure referred to in the super-complaint. See further paragraph 3.23 below.

offering, value/prices, and choice of drinks offered by a particular pub. Given the degree of competition between pubs, we do not consider that differences in the average retail prices in tied, free of tie and managed pubs are likely to result from a lack of effective competition. Rather, these differences in average prices appear more likely to reflect many other factors that characterise the overall package of features offered by a particular pub. In addition, these average price trends disguise a significant variation in prices charged by different tied, free houses and managed pubs.

Rent assessment and the contractual relationship between pub companies and lessees

CAMRA has raised a number of concerns with the methodology and transparency of the 'profits valuation' approach to calculating a pub's rent, the use of upward-only rent reviews and the bargaining power of lessees in relation to their pub company landlord. Similar concerns were raised by the House of Commons Business and Enterprise Committee ('BEC') in its 'Pub Companies' report published in May 2009.¹²

Given the degree of competition between pubs, we do not consider that issues regarding the conduct of negotiations between pub companies and lessees, or specific issues regarding the assessment of rents, can generally be expected to result in consumer detriment. As we have noted above, in considering the issues raised in the super-complaint, the OFT's focus is on whether effective competition can be expected to deliver choice and value to consumers. In markets where competition is working effectively, the OFT does not have a mandate to intervene in commercial negotiations between particular parties.

We consider that individual lessees' concerns regarding the conduct of negotiations with their pub company and the assessment of rents are

¹² House of Commons Business and Enterprise Committee Seventh Report of Session 2008-09: 'Pub Companies', May 2009:

www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/26/2602.htm

either matters for pub companies to address with individual lessees or are issues for the industry and other relevant bodies to consider. These are not issues for the OFT to address or investigate further.

Restrictive covenants

CAMRA has argued that the imposition of restrictive covenants on the sale of a pub outlet by pub companies restricts competition in a local area, and removes a potential outlet for prospective pub lessees. CAMRA has also referred to barriers to entry at the retail level resulting from the planning and licensing regime, the lack of suitable premises for use as a pub, and also the lack of free of tie pubs available to prospective lessees.

We consider that in certain circumstances, the use of a restrictive covenant on the sale of a pub outlet may restrict or distort competition in a particular area. Restrictive covenants are most likely to give rise to anti-competitive effects where geographic markets are highly concentrated and localised, there are high barriers to entry and the number of suitable sites is limited.

Responses to the OFT's requests for information from the large pub companies which tie more than 500 pubs indicate that the use of restrictive covenants is not widespread in the pub sector. Further, certain of these pub companies have stated that they do not intend to impose restrictive covenants in future sales of pubs.

Given these factors, and in light of the degree of competition observed at the retail level, we do not consider that the potential impact on competition and consumers resulting from the barriers to entry referred to in the super-complaint (in particular the imposition of restrictive covenants by pub companies) is likely to be significant.

Our response to the super-complaint on this issue does not preclude further action being taken by the OFT in future in relation to the imposition of restrictive covenants, in particular if such practices become persistent and widespread.

Technical services equipment and technical services

CAMRA has argued that the bundling of prices for a barrel of beer with charges for TSE and TS results in ineffective competition for the provision of such services. CAMRA also states that charges for access to shared TSE represent a further barrier to entry or expansion for small brewers.

The OFT has previously considered the case for further action in this market under the MIR provisions of the EA02, in response to concerns raised by the CC regarding the same practice in its assessment of the acquisition by Serviced Dispense Equipment Limited of Coors' TS for dispensing draft beer and its TSE assets.¹³ We subsequently concluded that there were no grounds for a MIR to the CC in relation to the supply of TSE/TS.¹⁴ We also noted that we had not received any complaints about the provision of TSE/TS and that the provision of TSE/TS would be likely to have a relatively minor impact upon the cost of beer to consumers.

In terms of CAMRA's concerns regarding charges by pub companies to small brewers for the use of TSE/TS for cask ale provided by other suppliers, the evidence does not indicate that this issue represents a significant barrier to entry or expansion for small brewers.

¹³ Competition Commission: 'A report on the proposed acquisition by Serviced Dispense Equipment Limited of the Technical Services Function of Coors Brewers Limited', paragraph 37.

¹⁴ OFT Press Release: Supply of Beer, 20 July 2005:
www.offt.gov.uk/news/press/2005/beer

1. INTRODUCTION

Issues raised in the super-complaint

- 1.1. On 24 July 2009, the Campaign for Real Ale ('CAMRA') submitted a super-complaint to the Office of Fair Trading ('OFT') regarding the UK pub industry.
- 1.2. A number of the issues raised in the super-complaint relate to the operation of exclusive purchasing obligations by pub-owning companies ('pub companies')¹⁵ which require their tenant or lessee (both are referred to in this response as the 'lessee') to purchase beer and other drinks solely through the pub company (the 'beer tie'). CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK in relation to beer, and other drinks.¹⁶
- 1.3. The key issues that CAMRA recommended that the OFT investigates further are:
 - the foreclosure of tied outlets to suppliers unable to access these outlets directly
 - the wholesale prices paid by tied pubs for beer and other tied products and the level of rent paid by tied tenants lessees
 - the basis upon which rents for pub lessees are calculated

¹⁵ Pub-owning companies may be brewers which own pubs, or companies which do not have a brewing dimension and are not affiliated to a particular brewer.

¹⁶ These companies are: Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle UK Limited, Greene King plc, Marston's Pub Company plc and Trust Inns Limited.

- barriers to entry at the retail level of the supply chain, particularly the use of restrictive covenants on the sale of premises by pub companies and the lack of free of tie premises available to prospective pub lessees, and
 - arrangements for the provision of technical services equipment ('TSE') and technical services ('TS') in pubs.¹⁷
- 1.4. CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK.¹⁸
- 1.5. The super-complaint made the following specific recommendations to the OFT:
- that the OFT should carry out a market study into the issues raised by CAMRA and, following this
 - the OFT should consider making legally binding certain measures in the form of undertakings in lieu of making a market investigation reference ('MIR') to the Competition Commission ('CC'), and
 - that if such undertakings cannot be agreed, the OFT should make a MIR to the CC.

The super-complaint process

- 1.6. The right to submit a super-complaint was created by section 11 of the Enterprise Act 2002 ('EA02'). A super-complaint is defined under section 11(1) EA02 as a complaint submitted by a designated

¹⁷ TSE is used to dispense draught beer and cider. TS comprises the installation and servicing of equipment, including maintenance and refurbishment, replacement and removal of equipment.

¹⁸ Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle Pub Enterprises, Greene King plc, Marston's plc and Trust Inns Limited.

consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. CAMRA is a designated consumer body.¹⁹

- 1.7. Section 11(2) EA02 requires the OFT, within 90 days after the day on which it receives a super-complaint, to publish a response saying whether it has decided to take any action, or take no action, in respect of the complaint and, if it has decided to take action, what action it proposes to take. The response must state the reasons for the OFT's proposals (section 11(3) EA02).
- 1.8. This document represents the OFT's response to the specific issues which are explicitly referred to in the super-complaint. We do not comment in this response on any wider issues affecting the pub industry.
- 1.9. We note that paragraph 5.8 of the super-complaint mentions the existence of exclusive purchasing obligations in relation to wine, spirits, games machines and insurance products. Given that the focus of the issues raised and the evidence presented in the super-relates primarily to beer, our response to the super-complaint focuses on the supply of beer in pubs.

Information gathering

- 1.10. In accordance with the focus of the super-complaint, the OFT's approach to information gathering has focused on the conduct of pub companies (both brewers and non-brewing pub companies, together referred to in this document as 'pub companies') which own more than 500 leased pubs in the UK that are 'tied' for the purchase of beer and/or other drinks.

¹⁹ Pursuant to UK Statutory Instrument 2005 No.2340, The Enterprise Act 2002 (Bodies Designated to make Super-complaints) (Amendment) Order 2005.

1.11. As part of our information gathering process, we have received responses to our information requests from stakeholders at all levels of the supply chain, including:

- pub companies which tie more than 500 pubs in the UK
- pub companies which own more than 500 free of tie pubs or managed pubs
- national brewers
- the Society of Independent Brewers (SIBA) and the Independent Family Brewers of Britain (IFBB)
- a major industry wholesaler
- a number of different industry associations and trade bodies, including the British Beer and Pub Association (BBPA), British Institute of Innkeeping (BII), the Royal Institution of Chartered Surveyors (RICS), the Association of Licensed Multiple Retailers (ALMR), the Federation of Small Businesses (FSB) and the Federation of Licensed Victuallers Associations (FLVA), and
- interest groups representing lessees including the Fair Pint Campaign, Justice for Licensees and the All Party Parliamentary Save the Pub Group.

1.12. We have also conducted meetings with a number of parties that have made submissions to us in response to our requests for information.

1.13. The OFT has received a number of submissions from interested parties who did not receive an information request from the OFT, including individual licensees. These submissions have been considered in the context of our information gathering process, although we are unable to respond to the specific facts or circumstances of the submissions provided to us by individual lessees.

1.14. We have also conducted background research and drawn upon previous reports and case law regarding this sector.

2. PREVIOUS ASSESSMENTS OF THE UK PUB SECTOR

- 2.1. The supply of beer in the UK and the operation of tied lease agreements have been the subject of a number of previous assessments in the UK and also by the European Commission and European courts.

Monopolies and Mergers Commission report, 1989

- 2.2. In 1989, a report by the Monopolies and Mergers Commission (MMC)²⁰ (under the Fair Trading Act 1973, which preceded the EA02) highlighted concerns regarding the vertical links between the brewing and retailing levels of the supply chain, at a time when brewers owned around 75 per cent of the public houses in Great Britain and specified which beers should be sold in those pubs (usually those of the brewer itself) under the terms of the lease. Around half of the 25 per cent of pubs that were not owned by brewers at that time were subject to 'loan ties', where a brewer offered a loan to the owner of the free house pub at below market rates of interest in return for the free house owner purchasing beer or other drinks exclusively from the brewer, or committing to a minimum purchase requirement.
- 2.3. The MMC noted in particular that in many towns and rural areas, one or two brewers owned a large proportion of public houses and therefore choice and competition was limited.²¹

²⁰ MMC report: 'The Supply of Beer: A report on the supply of beer for retail sale in the United Kingdom'

www.competition-commission.org.uk/rep_pub/reports/1989/245beer.htm#full

²¹ Paragraph 12.26 of the MMC report summarises the MMC's findings that in over half of the 'Petty Sessional Divisional' licensing areas in Great Britain, an individual brewer owned at least 25 per cent of all full on-licensed premises; in 29 per cent of such areas a brewer owned over a third of full on-licensed premises; and in six per cent of such areas, a brewer owned 50 per cent of full on-licensed premises.

- 2.4. The MMC found that a 'complex monopoly' existed between the brewers who operated tied lease agreements and loan ties and that these practices restricted competition because this prevented other brewers and wholesalers from supplying beer to those outlets and also prevented those outlets from responding to consumer demand for different brands/products.
- 2.5. The MMC found that the brewers' complex monopoly gave rise to higher wholesale prices than would have been the case if there had been greater competition between brewers, and that the higher wholesale prices would inevitably feed through into higher prices at the retail level.
- 2.6. The MMC found that consumer choice of beer and non-beer drinks within outlets owned by national and most regional brewers was limited, because practically all draught beer on sale in those outlets would have been produced by the brewer itself. The MMC found that brewer-owned or loan-tied premises would not be able to respond fully to consumers' demands for products and this would have particularly serious effects in particular localities of high concentration where an individual brewer or a small number of brewers owned a large proportion of retail outlets.
- 2.7. Further, the MMC stated that the lack of security of tenure for short-term tenants and the lack of an enforceable code of practice made it possible for brewers to limit the independence of their tenants and reinforce their position of economic strength in relation to their tenants.
- 2.8. The MMC made a number of recommendations which aimed to reduce the extent of vertical integration between the brewing and retail levels of the supply chain and to facilitate market access and increased competition between competing brewers, wholesalers and retailers.

2.9. The MMC report led to the Beer Orders,²² which placed a cap on the number of tied pubs owned by brewers owning more than 2,000 tied pubs. This cap on the number of tied pubs owned by brewers resulted in the disposal of around 11,000 pubs by brewers, mostly to independent pub companies not affiliated to a particular brewer. In addition, a 'guest beer' provision was introduced, pursuant to which brewers' tied and loan-tied lessees were permitted to source one brand of cask-conditioned beer outside of the tie and, by a later Order made in 1997,²³ one brand of bottle-conditioned beer from any supplier.

OFT report into the Supply of Beer, 2000

2.10. The OFT's 2000 report into the Supply of Beer²⁴ considered whether the existence of the Beer Orders was still justified. We found that as a result of the Beer Orders, a third of pubs in the UK had been transferred into the ownership of large pub companies and these pub companies had acquired a degree of countervailing buyer power in relation to the national brewers. Further, a decline in the overall volume of beer supplied in the UK, together with the increased buyer power of pub companies, had forced consolidation between brewers at both the national and regional level. We noted that independent wholesalers had not grown as anticipated as a result of the Beer

²² Statutory Instrument 1989 No.2390, The Supply of Beer (Tied Estate) Order 1989: www.opsi.gov.uk/si/si1989/Uksi_19892390_en_1.htm and Statutory Instrument 1989 No. 2258, The Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices) Order 1989: www.opsi.gov.uk/si/si1989/Uksi_19892258_en_1.htm).

²³ Statutory Instrument 1997 No. 1740, The Supply of Beer (Tied Estate) (Amendment) Order 1997: www.opsi.gov.uk/si/si1997/19971740.htm

²⁴ The Supply of Beer, December 2000, OFT 317: www.of.gov.uk/shared_of/reports/comp_policy/oft317.pdf.

Orders and national brewers still distributed the vast majority of beer sold to the on-trade sector.²⁵

- 2.11. We also found that increased buyer power at the retail level was contributing to a reduction in beer wholesale prices, although this was not matched by a decrease in the average retail price of beer in the on-trade. We found that above inflation retail price increases did not necessarily imply a failure of competition at the retail level and considered that these price increases could relate to improvements in amenity offered by pubs. We also noted that average retail prices disguised a considerable increase in the range of prices offered to consumers, and that consumers had a greater choice between different price/amenity combinations at the retail level.
- 2.12. We concluded in 2000 that the market for the supply of beer was very different at all levels of the supply chain compared to the 1980s and we recommended that many provisions of the Beer Orders should be revoked. The Beer Orders were repealed in their entirety in 2003.

Trade and Industry Committee report, 2004

- 2.13. The House of Commons Trade and Industry Committee ('TIC') 'Pub Companies' report of December 2004²⁶ investigated concerns regarding the extent to which the ownership of pubs in the UK was becoming concentrated in the hands of large pub companies and the operation of the tied model relationship between pub companies and their lessees. The report considered, in particular, the beer tie as

²⁵ That is, pubs, clubs, restaurants and other licensed premises where provision is made for the sale and consumption of alcoholic drinks on the premises.

²⁶ House of Commons Trade and Industry Committee Second Report of Session 2004-05 'Pub Companies', December 2004:
www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/128/12802.htm#evidence.

enforced by pub companies, and the basis on which pub rents were calculated.

- 2.14. The OFT made a submission to the TIC, which referred to the case law noted at paragraph 2.26 below and noted that we would take into account the application of European Community ('EC') law when applying provisions of UK competition law to similar questions raised under it. We also noted that a remedy could not be imposed under UK competition law (either the Competition Act 1998 ('CA98') or the EA02) if that remedy were inconsistent with the treatment of corresponding questions under EC law.
- 2.15. We concluded that action under the prohibition of anti-competitive agreements under Chapter I of the CA98 and the prohibition of abuses of dominance under Chapter II of the CA98 (which are both closely modelled on the equivalent prohibitions under Articles 81 and 82 of the EC Treaty) did not appear to be justified. We also considered that there was no case for action under the market investigation provisions of the EA02.
- 2.16. The TIC found that there was 'scope for eliminating the root causes' of contractual disputes²⁷ between pub companies and their lessees, in particular, recommending that the way that rent is calculated and the rights and obligations on both parties should be more transparent to potential tenants/licensees. The TIC also called upon pub companies to remove upward only rent reviews and recommended that rents should be reasonable and sustainable.
- 2.17. The TIC also recommended that the pub companies' voluntary codes of practice should be strengthened in areas including: rent reviews; the role of business development managers; fair and equitable complaint handling and dispute procedures; the disclosure and the availability of relevant information regarding rent assessment; and the need for prospective lessees to obtain legal and professional

²⁷ The TIC report on 'Pub Companies', December 2004, page 3.

advice before entering into lease agreements. The TIC did not consider that a legally binding code of practice was necessary but recommended that, if the industry did not adopt an adequate voluntary code, the Government should impose a statutory code.²⁸

OFT assessment of the technical services equipment and technical services market in 2005

- 2.18. In 2005 the CC blocked the acquisition by Serviced Dispense Equipment Limited ('SDEL') of Coors' TS for dispensing draft beer and TSE assets. In its report on the proposed acquisition, the CC suggested that the OFT should consider making a MIR to the CC in relation to the supply of beer to retail outlets, with specific reference to the market for TS and TSE.
- 2.19. The OFT subsequently examined the case for a making a MIR to the CC relating to the narrow market for TS and TSE. The OFT found that neither a narrow market investigation or a wider market investigation relating to the supply of beer in the UK were warranted.²⁹

Business and Enterprise Committee report, 2009

- 2.20. The House of Commons Business and Enterprise Committee ('BEC') reported in May 2009 on the relationship between pub companies (in particular those companies which operate a tied estate) and their lessees.³⁰

²⁸ In 2005, the BBPA published a Framework Code of Practice and this led to changes to companies' individual codes of practice.

²⁹ OFT press release dated 20 July 2005: www.oft.gov.uk/news/press/2005/beer.

³⁰ House of Commons Business and Enterprise Committee Seventh Report of Session 2008-09: 'Pub Companies', May 2009: www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/26/2602.htm

2.21. The BEC report highlighted a number of concerns relating to the contractual relationship between pub companies and their lessees regarding the inequality of bargaining power between pub companies and their lessees, and the transparency of negotiations, in particular the assessment of rents.

2.22. In addition, the BEC was concerned that the operation of tied lease agreements was giving rise to competition problems and considered that a MIR to the CC was justified. The BEC considered that the position of market power exercised by brewers prior to the Beer Orders had been replaced by a powerful group of pub companies and that certain market conditions present at the time of the MMC report could be observed in the market today.

2.23. BEC referred to evidence which it considered to be an indication of a lack of effective competition in the retail market. In particular:

- the price of a pint of beer in pubs rising too quickly compared to brewery beer prices and compared to off-trade beer prices; and average prices per pint of lager being higher in leased pubs compared to managed pubs
- consumer choice being restricted because lessees are obliged to source from a pub company's approved list of suppliers rather than source directly from independent suppliers
- the weaker bargaining position of lessees compared to that of their pub company landlord and lessees being unable to negotiate discounts, guest ale provisions or lower rents, which would benefit consumers through lower prices and wider choice, and
- the pub market being foreclosed to small brewers who are unable to supply minimum volumes, discounts and logistics demanded by large wholesale and pub owning companies.

2.24. The BEC report also raised concerns about the pub companies' use

of restrictive covenants to prevent the continued use of premises as a pub and recommended that the Government make the use of such restrictions illegal.³¹

Consideration of tied lease agreements by the European Commission and European courts

2.25. The European Commission and the European courts have previously considered in detail under Article 81 EC tied pub lease arrangements that are operated in the UK.

2.26. The European Commission and European courts have concluded that the beer tie agreements between pub companies and their tied lessees do not infringe the prohibition of anti-competitive agreements within the meaning of Article 81(1) EC where pub companies (be they brewing or non-brewing pub companies) buy their drinks from a number of sources rather than predominantly from one source, or are not of a scale that would significantly contribute to the foreclosure of retail outlets to suppliers.³²

³¹ The BEC's conclusions are set out at paragraphs 193-194 of its report on 'Pub Companies', May 2009.

³² Case T-25/99 Roberts v Commission [2001] ECR II-1881 and European Commission decision of 29 June 2000 relating to a proceeding pursuant to Article 81 of the EC Treaty – Inntrepreneur/Spring OJ [2000] L 195/49, [2000] 5 CMLR 948. In Inntrepreneur/Spring, the Commission found that tied lease agreements were not caught by the provisions of Article 81(1) EC in circumstances where a pub company sourced a diversified portfolio of brands from national and regional brewers and the duration of contracts with supplying brewers (typically two to five years) were typically structured so that a proportion of purchases were retendered at frequent intervals. The Commission found that this multi-sourcing had the effect of mitigating rather than reinforcing any network effect of brewers' tied agreements in the UK on-trade beer market.

2.27. The European Courts and the European Commission have also previously found that tied lease agreements caught by Article 81(1) EC (on the basis that the agreements in question contributed to the foreclosure of on-trade outlets to other producers of beer) may fulfil the conditions for individual exemption set out in Article 81(3) EC, where the agreements in question lead to an improvement in the distribution of goods and provide countervailing benefits for tied lessees.³³

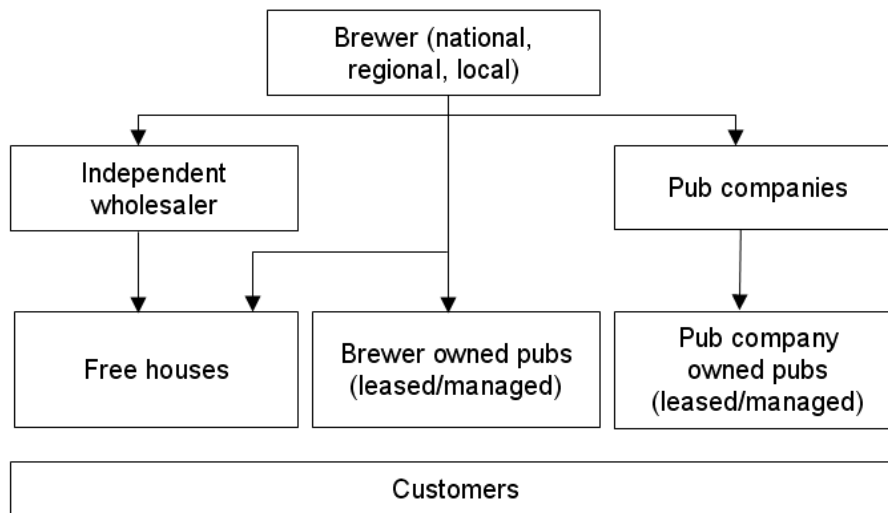
³³ See, for example: Case T-131/99 *Shaw v Commission* [2002] ECR II-2003, [2002] 5 CMLR 81; Case T-231/99 *Joyson v Commission* [2002] ECR II-2058, [2002] 5 CMLR 123; *Scottish and Newcastle OJ* [1999] L 186/28 [1999] 5 CMLR 831. In order to qualify for individual exemption under Article 81(3) EC, agreements must give rise to an improvement in the production or distribution of goods, allow consumers a fair share of the resulting benefit of an agreement, any restrictions on competition must be indispensable, and the agreement must not give rise to an elimination of competition in a substantial part of the relevant market.

3. OVERVIEW OF SUPPLY CHAIN

- 3.1. Pubs form part of the on-trade sector, which is comprised of premises which have a licence to serve alcoholic drinks for consumption on the premises, including outlets such as hotels, restaurants, clubs and cinemas.
- 3.2. The focus of this section, and of the response more generally, is the supply of draught beer to pubs in the on-trade.³⁴ Draught beer comprises both ales and lagers. Ales are a diverse group of beers which can be further sub-divided into cask-conditioned and keg ales, and tend to be regionally/locally produced. Lager is a more homogeneous product than ale, with a large proportion of sales attributable to international brand names.
- 3.3. The following diagram provides a simplified overview of the supply chain regarding the supply of beer to pubs in the UK. The section below provides a further outline of the brewing, wholesale and retail levels of the supply chain for the supply of beer to pubs.

³⁴ Draught beer is still the most popular type of beer consumed by on-trade customers in the UK, accounting for approximately 92 per cent of beer sales to the on-trade. Source: BPPA submission to the OFT.

Figure 3.1: UK supply chain for supply of beer to pubs



3.4. As demonstrated in Figure 3.1 above, brewers supply (either directly or indirectly) to a number of different pub outlets at the retail level of the supply chain:

- leased pubs – pubs which are owned by a landlord and are rented or leased to a pub tenant, who runs the pub as a stand-alone business and pays rent to the landlord
- managed pubs – pubs which are operated by a manager employed by a pub company, and where the pub company will set retail prices, and
- free houses - pubs owned on a freehold basis by the individual running the pub.

The supply of beer - brewing

3.5. There is no standard approach to sub-dividing different sizes of brewers operating in the UK. Brewers can be divided into the following groups, based mainly on the geographic coverage of their business:

- global/national brewers - brewers with operations in the UK which are owned by international companies, and brewers operating exclusively in the UK, who produce many of the major branded lagers present in pubs, bars and supermarkets
- regional brewers - brewers whose business is generally concentrated within a single area of the UK, with a proportion of production volumes being sold through the brewer's own pubs, and
- micro brewers - brewers whose production is typically focused on supplying to pubs and bars in a particular local area.³⁵

3.6. Table 3.2 below sets out shares of beer sales to the on-trade and off-trade³⁶ at the brewing level of the supply chain in 2008. This table demonstrates the degree of concentration at the brewing level of the supply chain, with the largest five brewers in the UK supplying around 89 per cent of beer to the on-trade and off-trade, by value of sales.

³⁵ BBPA's submission to the OFT categorised global brewers as brewers selling more than one million barrels of beer per annum, national brewers as brewers selling between 250,000 and 500,000 barrels per annum, regional brewers as those producing over 60,000 hls per annum (but less than 250,000 barrels) and micro brewers as those producing less than 60,000 hls per annum.

³⁶ The 'off-trade' sector is comprised of premises which have a licence to sell alcoholic drinks for consumption off the premises, including supermarkets and off-licences.

Table 3.2: Shares of beer sales by value across on-trade and off-trade (per cent), 2008

Brewer	Per cent
Scottish and Newcastle	30
Molson Coors	20
Inbev	20
Carlsberg	14
Diageo	5
Others (regional and local brewers)	11

Source: Key Note³⁷

- 3.7. As demonstrated by Table 3.3 below, the largest group of direct customers for brewers are pub companies which own pubs (which may be either managed or leased pubs) and are not affiliated to any particular brewer. A pub company which owns tied leased pubs acts as an intermediary, supplying beer at a margin to its pubs at a separately negotiated price; generally at the brewer's wholesale list price (less any discount) or at the pub company's own standard wholesale price list (less any discount).
- 3.8. Independent wholesalers also act as an intermediary, purchasing beer from a number of brewers and selling on to retail customers.
- 3.9. Brewers also sell beer directly to their own tied or free of tie lessees and directly to independent free houses.³⁸ Free of tie lessees and free house pubs do not generally receive the size of discounts from brewers that are offered to other larger purchasers such as pub companies and wholesalers, as they do not buy the same kinds of annual volumes.

³⁷ Key Note report: 'Brewers and the Beer Market', 2008.

³⁸ We note that a small proportion of free houses may still be tied for beer under a 'loan tie' arrangement with a national brewer, as set out in paragraph 5.50 below.

Supply of beer – retail level

Ownership of retail outlets

3.10. Table 3.3 sets out the total number of pubs in the UK according to the different type of ownership model, in 2009.

Table 3.3: Number of pubs in the UK by type of ownership (2009)

Ownership type	Number	Per cent
Non-brewing pub companies		
- leased	23000	41.6
- managed	6250	11.3
- total	31259	56.5
Free houses	17000	30.7
Brewing pub companies		
- leased	6750	12.2
- managed	2350	4.2
- total	9100	16.4
Total	55350	100.0

Source: Key Note³⁹

3.11. Approximately 54 per cent of pubs in the UK are leased pubs owned either by a brewing or non-brewing pub company. Around 15 per cent of pubs in the UK are operated as managed pubs by either a brewing or non-brewing pub company, and 31 per cent of pubs in the UK are free houses.

³⁹ Key Note Market Report: Public Houses 2009 (Publican data).

3.12. A small proportion of leased pubs are not tied to their pub company in relation to the purchase of beer and/or other drinks and therefore operate on a 'free of tie' basis.⁴⁰

Competition between pubs

3.13. Table 3.4 below sets out the sizes of the estates of the largest pub companies (both brewing and non-brewing companies) in the UK.

⁴⁰ A number of pub companies lease a very small proportion of their estate on a free of tie basis. Other companies, for example Wellington Pub Company, own estates which are leased entirely on a free of tie basis.

Table 3.4: number of pubs in the UK owned by pub company (2004 and 2009)

Pub company	Number of pubs 2004 (per cent of all pubs)	Number of pubs 2009 (per cent of all pubs)	Pub type
Punch Taverns	8300 (14)	8425 (15)	Leased and managed
Enterprise Inns	8575 (14)	7765 (14)	Leased
Mitchells & Butlers	2000 (3)	2050 (4)	Managed
JD Wetherspoons	650 (1)	715 (1)	Managed
Wellington Pub Company	850 (1)	850 (2)	Leased
Avebury Taverns	750 (1)	n/a	Leased
Spirit	2025 (3)	n/a	Managed
London and Edinburgh Inns	825 (1)	n/a	Leased
County Estate Management	1400 (2)	1195 (2)	Leased
Greene King	2075 (3)	2585 (5)	Leased
Marston's	2125 (4)	2250 (4)	Leased
S&N UK Limited	1500 (3)	2200 (4)	Leased
Total pubs (UK)	60000	55,300	

Source: Key Note⁴¹

3.14. The largest leased pub estates in the UK are owned by Enterprise Inns plc ('Enterprise Inns') and Punch Taverns plc ('Punch Taverns') (both non-brewing pub companies), each owning over 7,500 pubs, or 14-15 per cent of the total number of pubs in the UK in 2009. The largest brewer-owned leased pub estates are operated by Marston's Pub Company plc ('Marston's'), Greene King plc ('Greene King') and

⁴¹ Key Note reports: 'Public Houses', 2005 and 2009.

Scottish & Newcastle UK Limited (S&N UK Limited), which each own around 4-5 per cent of pubs in the UK in 2009.

3.15. The largest managed pub operator is Mitchells and Butlers plc which owns approximately four per cent of the pubs in the UK. JD Wetherspoon plc owns approximately one per cent of pubs in the UK in 2009.

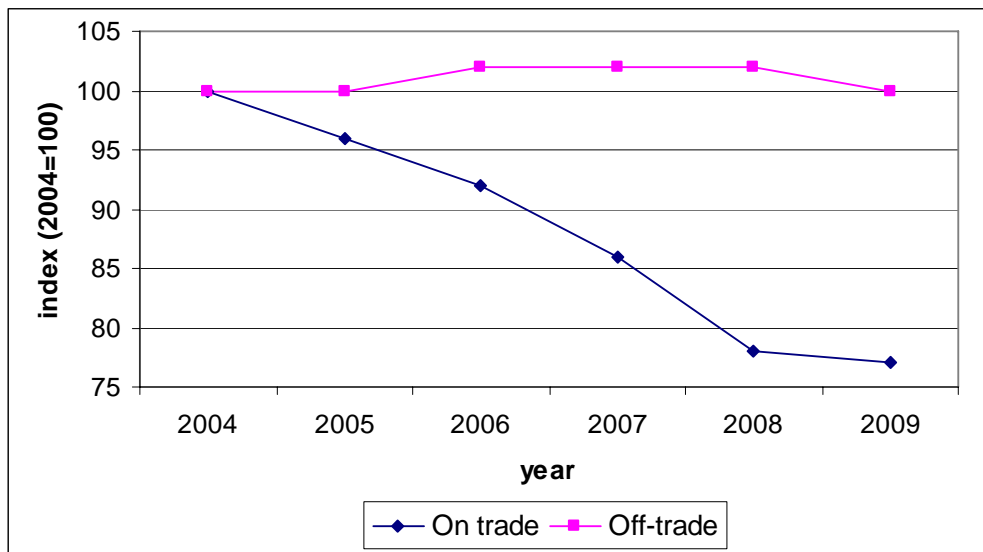
3.16. Pubs compete on the basis of a number of different factors which together form the overall 'experience' offered to customers. It has previously been found that factors such as the food offering, amenity and the convenience of the location of a particular pub rank highest among the most important factors from a consumer's view point in terms of determining choice of pub. Conversely, the range of drinks on offer and the price of drinks have previously been found to be of less importance to customers.⁴²

Sales trends since 2004

3.17. Since 2004, there has been a continuing decline in the volume of beer sales to the on-trade, which follows a period of declining sales over the last two decades. BBPA statistics show that on-trade sales of beer have fallen significantly year on year since 2004, while sales to the off-trade have been relatively constant over the same period, albeit with modest declines in 2008. These trends are illustrated in Graph 3.5 below.

⁴² As set out in a MORI survey, which was reproduced at Table 9 in Annexe E of our 2000 report on the Supply of Beer.

Graph 3.5: On-trade beer volumes (2004-2009)



Source: BBPA statistical handbook, 2009

3.18. Falling on-trade beer sales have coincided with increasing numbers of pub closures. According to the ALMR figures,⁴³ the net number of pub closures in the UK (the number of total pub closures, less the total number of pub openings) reached 1866 in 2008⁴⁴, an increase from 1409 in 2007 and 316 in 2006.

3.19. A number of parties commented on the range of pressures facing pubs, including the current economic climate, the impact of the smoking ban, competition from supermarkets, increases in duty, social and demographic changes and a trend towards drinking alcohol at home.⁴⁵

⁴³ ALMR evidence submitted to the BEC report on 'Pub Companies', May 2009: Volume II, Evidence 94, Appendix 1 (based on CGA pub opening and closing data).

⁴⁴ The figure presented for 2008 is our estimate, based on ALMR data to September 2008.

⁴⁵ See, for example, 'Pub Companies and Tied Tenants' FSB Policy Paper; pub company submissions to the OFT and the ALMR submission to the OFT.

3.20. An ongoing trend within the pub sector generally has been the growth of food sales within pubs. The value of food sales within pubs increased by around 33 per cent between 2003 and 2008, and now accounts for around 30 per cent of total pub turnover by value.⁴⁶ Over the same period the proportion of pubs' turnover that is accounted for by sales of alcoholic drinks has fallen from 55 to 48 per cent.⁴⁷

Beer prices

3.21. Between 1998 and 2008, the retail price of a pint of beer has increased by 38 per cent. Over the same period, the standard retail price index (RPI all goods) has increased by 32 per cent, whilst the RPI all services index has increased by 50 per cent.⁴⁸

3.22. We were told by a number of parties responding to OFT information requests that increases in retail on-trade prices have been driven by increases in duties on alcohol, utility and raw material costs, increases in business rates and Sky TV subscriptions, the costs of implementing legislative changes (such as the Licensing Act 2003 and the Health Act 2006), and above inflation increases in the minimum wage.

3.23. As we noted in our 2000 report on the Supply of Beer, it is more likely to be appropriate to compare retail price increases for beer to service sector inflation than to RPI all goods, as there is a significant service element in relation to the running of a pub.

⁴⁶ Mintel report: 'Pub Visiting', September 2008.

⁴⁷ Mintel report: 'Pub Visiting', September 2008.

⁴⁸ Source: Office of National Statistics ('ONS') data.

- 3.24. According to the 'Producer Price Index',⁴⁹ wholesale beer prices charged by brewers increased by 28 per cent between 1998 and 2008.
- 3.25. Between 1998 and 2008, off-trade prices fell by around 5 per cent. Although we note that the BEC report referred to the widening gap between off-trade and on-trade beer prices,⁵⁰ we do not consider the off-trade to represent a suitable benchmark for comparison with retail price increases in the on-trade, given the differences between the two retail channels, and in particular, the different costs of on- and off-trade operators. At paragraph 6.1 of the super-complaint, CAMRA notes that:

'The fact that the price of alcohol in pubs is substantially higher than the price of alcohol purchased in the off-trade reflects the provision of services beyond simply the supply of beer.'

The operation of tied lease agreements

- 3.26. Pub companies which own leased pubs operate different versions of the tied lease agreement and some companies offer a number of different types of tenancy or lease agreements. Different pub companies will tie different combinations of products, although lessees are generally tied in relation to the purchase of beer and cider, and are often tied to other products such as 'minerals' and flavoured alcoholic beverages. In some cases, lessees are able to choose whether to be released from the tie in respect of certain non-beer products.

⁴⁹ Source: ONS Producer Price Index MM22 June 2009. The Producer Price Index measures brewer prices and indicates changes in the prices that brewers charge for goods destined for the UK market (net of VAT and after discounts). These prices are an average across the on- and off-trade.

⁵⁰ At page 62 of the BEC report on 'Pub Companies', May 2009.

3.27. Although the precise nature of the obligations of the pub company and lessee will vary between agreements, there are two main types of tied agreement:

- short-term tenancies – agreements which are typically of a duration of three to five years, normally with an opportunity to renew the agreement, where the pub company will generally carry out repairs (or structural repairs at least) and the tenancy will not be assignable, and
- longer-term lease agreements – agreements which are typically for a duration of 10 to 25 years, pursuant to which a lessee would be required to carry out full repairs and decoration of the premises and the lease would generally be assignable. A lease agreement will therefore allow a lessee to build up goodwill in a property and achieve a return on their investment. This also provides an exit route for a lessee, who is able to assign the lease.⁵¹

3.28. Under the tied model, pub companies derive income from two sources:

- profit made on the wholesale price charged to lessees for tied products (also known as the 'wet rent'). For non-brewing pub companies this equates to the difference between the discounted wholesale price they pay to brewers, and the higher prices they charge to lessees, and
- the property rent charged to lessees, which is determined at the beginning of the agreement and is subject to review at fixed intervals (also known as the 'dry rent').⁵²

⁵¹ BBPA submission to the OFT.

⁵² BBPA submission to the OFT.

4. BARRIERS TO ENTRY AT THE BREWING LEVEL

Issues raised in the super-complaint

- 4.1. CAMRA is concerned that small brewers,⁵³ and other brewers seeking to gain access to wholesale and distribution markets for beer are unable to sell directly to tied leased or managed pubs, which together represent a large proportion of pubs in the UK (as shown in Table 3.4, above). The nature of the exclusive purchasing obligation within the tied lease agreement means that tied pubs are unable to purchase tied products from other suppliers, or, therefore, to negotiate different terms of supply with those suppliers.
- 4.2. In particular, paragraph 1.3 of the super-complaint states that the operation of tied lease agreements and other exclusive purchasing obligations means that suppliers are:
- 'denied independent access to tied pubs and this prevents, restricts or distorts competition by establishing a substantial barrier to market entry'.
- 4.3. In addition to the existence of tied lease agreements, CAMRA refers to a number of difficulties that such brewers experience in accessing the market, including:
- pub companies' requirements for minimum order quantities from brewers
 - the requirement to deliver to a centralised distribution network
 - demands for unrealistic discounts on wholesale prices, and

⁵³ CAMRA defines 'small brewers' at paragraph 11.1 of its super-complaint as brewers producing fewer than 200,000 hls of beer per year.

- the absence of a 'thriving' network of independent wholesalers, which is an additional means of distribution for small brewers.

4.4. The super-complaint refers to SIBA's Direct Delivery Scheme (DDS) which was developed as a way of facilitating supplies by small brewers to multiple retailers (that is, retailers owning a number of retail outlets, including pub chains and supermarkets). The DDS processes orders on behalf of small brewers, and is a single point of contact for multiple retailers and acts as a one-stop buying point that enables retailers to buy from over 350 small brewers which participate in the scheme. Small brewers who receive orders under the scheme deliver directly to a local outlet owned by a participating retailer.

4.5. CAMRA states that, while the DDS has had some success in improving market access for small brewers, it is not currently the solution to the difficulties faced by those brewers. CAMRA suggests that the success of the DDS can easily be limited by pub companies, either by:

- limiting the number of pubs within their estate which are allowed to participate in the scheme, or
- by adopting discriminatory pricing in respect of the terms on which small brewers' brands are supplied by the pub company to its tied pubs.

OFT assessment of issues raised in the super-complaint

4.6. In order to inform our response to the super-complaint, we sent information requests to pub companies which tie over 500 pubs in the UK regarding their distribution arrangements and the range of brewers supplying to their estate.

4.7. As part of our information gathering process, we have considered:

- the issues raised in the super-complaint regarding access to

downstream wholesale and distribution markets for the on-trade (in particular, the supply of beer to pubs), and

- market trends and factors affecting small brewers' sales in recent years.

Access to wholesaling and distribution

Economies of scale in brewing and distribution

- 4.8. Successful market entry or expansion in relation to the supply of beer to pubs by brewers is dependent on securing on-trade retail outlets for the supply of beer.
- 4.9. As noted in section 3 above, brewers supply to free houses directly, or through the distribution networks of independent wholesalers (many of which are regionally focused). Non-brewing pub companies generally outsource their distribution requirements to the national brewers (or their distribution arms). The national brewers operate centralised distribution networks and suppliers to these networks are required to deliver to central or regional depots, for onward distribution throughout the network.
- 4.10. As a result of their size, small brewers face difficulties in accessing the centralised distribution networks of tied and managed pub estates, because of the distance that they are required to travel to regional depots.
- 4.11. In addition, small brewers are generally unable to match the discounts offered by national brewers to pub companies because they do not benefit from the production and logistical economies of scale of larger brewers.
- 4.12. Some lessee groups told us that the price at which pub companies sell brands of small brewers' beer to their lessees means that the lessee is not able to sell the beer at a profit. On the other hand, we were told by some pub companies that they are prepared to accept

