



The Independent Family Brewers of Britain

**Review of the competition rules applicable to vertical agreements
(Block Exemption Regulation)**

**Submission to European Commission
Directorate-General for Competition**

Organisation: Independent Family Brewers of Britain (IFBB)

Contact: Paul Wells, Chairman

Contact telephone number: 00 44 1234 272766

Contact email address: paul.wells@charleswells.co.uk

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Section 1

Executive Summary

The Independent Family Brewers of Britain represent a relatively small but distinctive part of the UK beer market. Our members are companies owning regional breweries and pub estates and the majority are private, family run, businesses. We rely largely on the 'beer tie' to operate as both brewers and pub retailers.

The tie allows IFBB members to plan brewing plant capital expenditure over future years, secure in the knowledge that there are guaranteed outlets for their beers; the majority of which are Britain's best cask conditioned beers. Brewing is a highly capital intensive business and brewing, packaging and supplying beer on a large scale requires substantial capital. The tie system, therefore, plays a vital role by enabling smaller brewers to compete with the much larger enterprises.

Our response to the Commission's consultation therefore focuses on the tie. There have been changes in the marketplace over the ten years since the Block Exemption was adopted in 1999 but none have altered the grounds for the Commission's decision allowing continuation of the tie.

At the time of the last review of the Block Exemption in 1999, we had 38 members. This has now reduced, due to competitive pressures and consolidation in the industry, to 27. The number of pubs owned by our members has reduced from 5,334 to 4,227¹ and over 75% remain, as before, brewery tied tenancies. The remaining 25% are managed, with just a small number of leases. All of these pubs operate under the tie system.

There are 3 key reasons for the continuation of the tie within the Block Exemption:

1. It is in the best interests of the tenant

With the security of the tie, the brewers buy, insure and maintain the properties operated by their tenants. This provides a very low entry cost for tenants setting up in business, creating new employment opportunities for entrepreneurs. When sales increase or decrease, the system causes the financial impact to be shared between the pub and the brewery, thus lowering the tenant's risk.

As the businesses are co-dependent, IFBB members provide extensive support services to tenants which are not available to licensees operating in the free house market. This is particularly helpful in a difficult economic climate. Not surprisingly then, IFBB members have an extremely low turnover of tenants compared to the industry as a whole.

¹ IFBB annual members survey, August 2009

2. It is in the best interests of the consumer

The tie benefits the consumer by enabling a wider choice of locally brewed beer brands, particularly specialist cask beers, than would be available if family brewers ceased to exist. They also enjoy well-invested pub premises which compete vigorously with other on-trade² outlets in their local markets.

3. It is in the best interests of our local communities and economies

The tie benefits geographically diverse local communities and their economies by guaranteeing jobs at the brewery, in its pubs and with suppliers to the business. IFBB members are major employers in many fairly small towns. Employment at the breweries is important for those involved directly and for suppliers of ingredients and services. Each pub provides employment, often in small communities, and in rural areas many pubs are given a lifeline to remain open because IFBB members take a long term view about viability and will support licensees as they grow the business.

Tourism is a vital part of the economy and a visit to some historic pubs is high of the list of things to do for visitors to the UK. The IFBB members strongly support this by maintaining and preserving many of the most historic pubs in the country, for the benefit of visitors and local residents alike.

² On-trade means licensed for consumption of alcohol on the premises – a definition of a ‘pub’

Section 2

The Independent Family Brewers of Britain (IFBB)

2.1 Introduction

Brought together in 1993 to defend the tie, the IFBB in 2009 consists of 27 brewers who represent a distinct and unique sector of the UK brewing industry – the family owned and operated brewing company.

Our pubs are at the heart of the communities we serve. We produce distinctive, regionally brewed cask beers ('real ale') and support regional and local suppliers through the use of locally sourced raw materials and services.

While our breweries have been family owned and run for many generations, our businesses are dynamic and innovative, constantly developing new products and brands and spending millions each year on pub developments. We share a common goal to "maintain the traditions of cask brewing in Britain, and to continue to support and promote this healthy, profitable and vibrant sector of the industry".

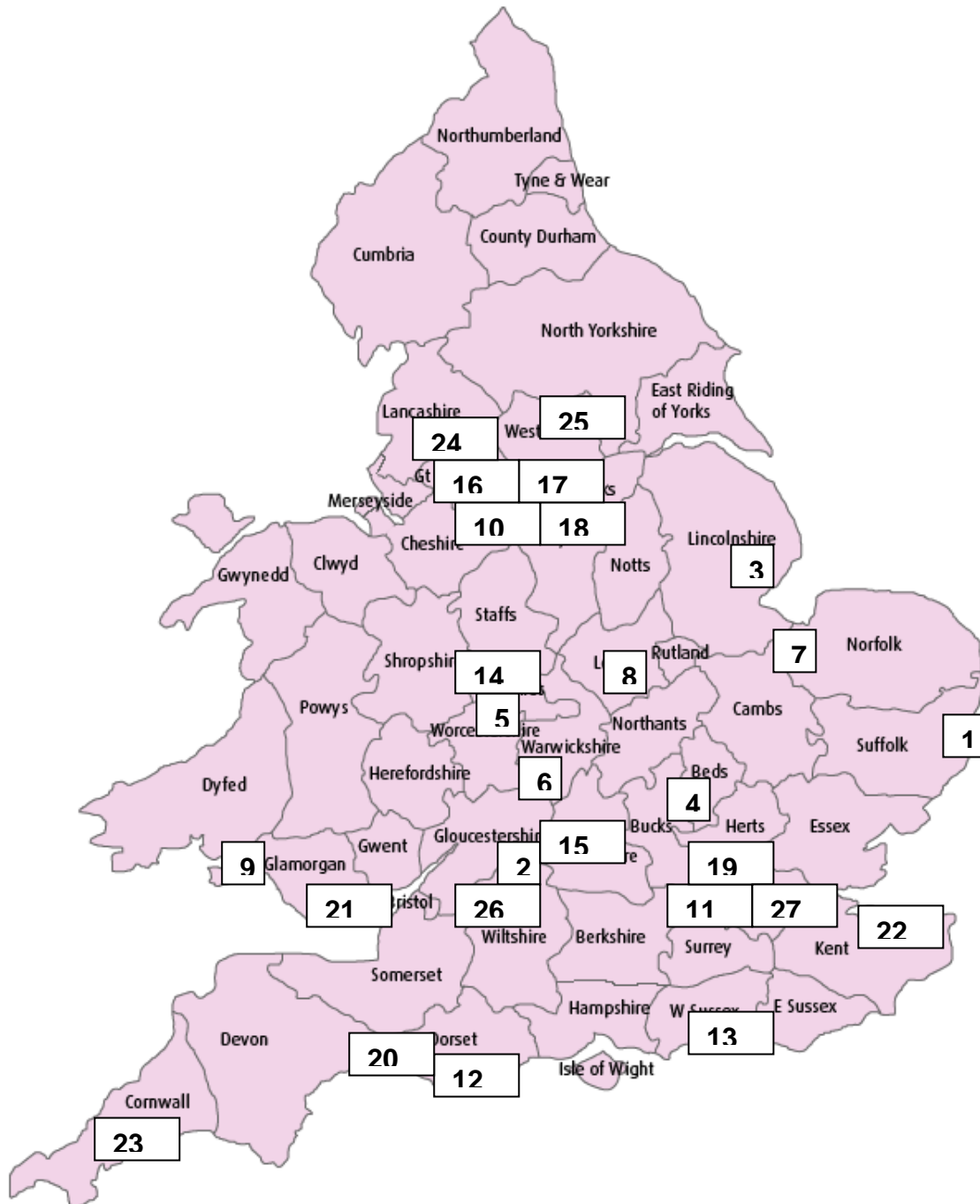
The name of each family brewery is still prominently displayed on (and in) each IFBB member's pub indicating the main brand of cask beers sold in the pub. Each of those names embodies a long brewing tradition.

2.2 Members

Member companies are distributed throughout the regions of England and Wales:

<i>Member name</i>	<i>Location</i>	<i>Map reference</i>
Adnams	Southwold	1
Arkells	Swindon	2
Batemans	Wainfleet	3
Charles Wells	Bedford	4
Daniel Batham	Dudley	5
Donnington Brewery	Stow-on-the Wold	6
Elgoods	Wisbech	7
Everards	Leicester	8
Felinfoel	Llanelli	9
Frederic Robinson	Stockport	10
Fullers	London	11
Hall & Woodhouse	Blandford St Mary	12
Harveys	Lewes	13
Holdens	Dudley	14
Hook Norton	Hook Norton	15
Hydes	Manchester	16
Joseph Holt	Manchester	17
JW Lees	Middleton	18
McMullens	Hertford	19

Palmers	Bridport	20
SA Brain	Cardiff	21
Shepherd Neame	Faversham	22
St Austell	St Austell	23
Thwaites	Blackburn	24
Timothy Taylor	Keighley	25
Wadworth	Devizes	26
Youngs	London	27



Section 3

Market Data

3.1 Beer

The total volume of beer (lager, ale and stout) sold in the UK is 47,965,250³ hectolitres, and IFBB members have a 5.9% share of that total.

3.2 Pubs

There are around 54,000 pubs in the UK. IFBB members own 4,227 of these giving the IFBB members a market share of the pub market of just under 8%.

There are 150,000⁴ on-licences in the UK as a whole. The IFBB share therefore of the total on-licence market is 2.8%.

Around 75% of our members' pubs are operated as traditional tied brewery tenancies, with the balance as managed operations, i.e. directly owned and operated by the member brewer.

3.3 Employment

IFBB members directly employ around 19,000⁵ people in brewing and pub estate management, and if we assume that each pub - tenanted or managed - employs an average of seven people, a further 29,500 are employed.

3.4 Breweries

Our members' breweries range in size from producing 5,000 hectolitres up to 800,000 hectolitres, and each operates one brewery.

Distribution of beers, ciders, wines, spirits and minerals to the pub estates is undertaken by most members using directly employed staff. All members sell not only to their own pubs but also to free-of-tie ('free trade') accounts and to non pub customers.

An extensive range of beers brewed elsewhere is also usually available. Nearly all members offer national and international brands of beers, especially lager beers which they tend not to brew. This range offers good opportunities for inter state trading in the EU and many members have forged partnerships with imported lager brands from other EU countries.

³ British Beer & Pub Association (BBPA) Statistics Handbook 2009

⁴ BBPA Statistics Handbook 2009

⁵ IFBB annual members survey, August 2009

Examples of such partnerships amongst IFBB members are:

Adnams	Mythos	(Greece)
Daniel Thwaites	Warsteiner	(Germany)
Hall & Woodhouse	Hofbrau	(Germany)
Shepherd Neame	Oranjeboom	(Netherlands)
Wells & Youngs	Erdinger	(Germany)

3.5 Scope of Article 81(1)

Agreements which are not capable of appreciably affecting trade between Member States or capable of appreciably restricting competition by object or effect are not within the scope of Article 81(1). Therefore, on the basis of the market data above and the other information given in this submission, we conclude that the agreements containing a tie entered into between IFBB members and their tenants, in principle, fall outside the provisions of Article 81(1).

Because we are confident that the tie is in the interests of tenants, consumers and the wider public, as well as our member companies, this submission explains some of the reasons for that view, rather than relying on 'de minimis' and other legal exemptions.

Section 4

The Brewery tied pub system

4.1. Basis of the tie

A distinctive feature of the British system, as compared with most of the other countries of Europe, is that most product ties stem from ownership of the pubs rather than loan finance agreements.

The traditional pub usually has one of three forms of ownership, giving rise to different bases for the tie:

- 1. Freehold** – where the owner licensee buys the pub outright and is therefore free to buy all products from any source. Often the owner licensee will take loan finance from a supplying brewer in return for a product tie (tie by loan)
- 2. Long (assignable) lease** – where a premium is paid for the lease. These leases may operate on a tied or free-of-tie basis, dependent on the landlord / lease owner
- 3. Traditional brewery tied (non-assignable) tenancy** – a shorter term tenancy agreement tending to be for a 3 to 6 year term, with a full or partial drinks tie, as offered by our members

The property tie originated when brewers started to buy their own pubs to guarantee an outlet for their own beers. This meant (in the days before mass distribution) that brewers could ensure the delivery of their cask beers to their own pubs and thus guarantee beer quality without there being concern around the short shelf life of the product. Cask conditioned beers have a secondary fermentation in the barrel so it is essential to use them within, ideally, three days from starting to serve from the barrel.

With the tie agreement, the licensee tenant rents premises from the brewer and is supplied by that brewer with a range of products. The brewer has a marketing outlet, and the tenant the opportunity to run his or her own business.

Traditionally, the vast majority of pubs in the UK have been operated on short-term tenancy agreements with rents calculated on the trading potential of the pub rather than on a commercial market rent. In the late 1980's national brewing companies (not IFBB members) began to offer longer-term leases, with a right to assign, and therefore build a goodwill premium.

The Beer Orders of 1990 stimulated the break-up of the national brewers into separate brewing companies (now all owned by overseas global brewing companies) and large pub owning companies. Institutional investors favoured the latter, as the long leases (with upward-only rent reviews) allowed steady profit growth from property income for these investors. With property values escalating in the last two decades, pub companies were bought and sold routinely and consolidation produced today's two large pub companies.

The recession has meant that values of freehold pubs and long leases have fallen, which has caused difficulties for individuals who have invested large amounts of capital in a pub business in recent years. By comparison, the tied brewery tenancy provides not only a low cost entry for a licensee starting a small business, but also offers a low cost/low risk exit as neither the freehold nor the lease need to be sold to another investor. A tied brewery tenancy is a less risky financial option (and requires less capital) than either buying a freehold or taking on a lease premium.

4.2. How does it work?

The Tie has the effect of creating a dry rent and a wet rent payable to the brewery by the tenant licensee.

- The dry rent is **fixed** (subject to rent reviews, which are covered within the tenancy agreement) and is the element for renting the building from the brewery. The rent is determined by the pub’s past beer sales volume and on predicted Fair Maintainable Trade. The latter is the level of trade agreed to be achievable at the pub, if that pub is run by an average competent operator
- The wet rent is **variable**, since it is a percentage of the prices paid to the brewer for stock i.e. beer and other products. This wet rent then varies in line with the pub’s beer sales and the tenant pays rent only on what he sells. This offers the tenant some protection during a downturn because, if sales reduce, so will this element of rent. If the tie were to be abolished, then this protection would disappear and the fixed cost to the tenant would increase significantly

4.3. Financial comparisons

The IFBB has commissioned an international accounting firm to carry out financial comparisons of operating a pub as a brewery tenant or a free-of-tie operator over a period of five years.

These financial comparisons have been made using a number of assumptions which are discussed in detail in Appendix 1.

Under the assumptions as specified, the current earnings of a brewery tie would be slightly lower than the equivalent free-of-tie house in Year 1; however as time progresses, the brewery tie pub becomes an increasingly attractive proposition.

The table below summarises the averaged ‘earnings’ position of three notional brewery tied pubs, and their free-of-tie equivalents:

Earnings comparison	Year 1	Year 2	Year 3	Year 4	Year 5
Brewery tied tenancy	37,019	37,033	36,572	36,621	36,688
Free-of-tie operator	38,315	37,040	35,799	34,593	33,422

The table on the previous page is calculated on weighted averages of notional wet led, food led and mixed turnover pubs (see Appendix 1 for more detail).

The analysis is strictly earnings based and does not therefore cover other factors such as:

- the risk-return profile of the respective operating models, in that a free-of-tie operator is exposed to movements in the market place (or in property valuations) impacting upon his business to a far greater extent than is the brewery tied tenant;
- the barriers to entry and exit faced by a free-of-tie operator, both in terms of raising the initial capital to purchase the pub, and also in incurring the time and expense connected with exiting the trade;
- the cost of repaying the capital incurred by the free-of-tie operator (although the above earnings numbers include a cost for repayment of interest on a mortgage, no assumptions have been made about repayment of principal debt);

which all reduce the operating risk of the brewery tie model compared to the free-of-tie house. Therefore, on a risk-return basis over the 5 years, we believe the brewery tenancy offers a far more attractive model for many aspiring pub licensees.

Section 5

Benefits of the system to the brewery tenant

5.1. Entry into the trade

In principle, the traditional brewery tied tenancy system operates as follows (although there may be some small variances between member brewers):

- the brewer owns and insures the pub, and pays for repairs, improvements and alterations, and
- the tenant will buy the inventory (tables, chairs etc) and stock at value, this being his only capital investment.

A traditional brewery tied tenancy (inventory and stock) can be acquired for as little as £5,000 and would rarely cost more than £50,000, depending on the size of the inventory and ingoing stock value of the pub in question. This offers an excellent opportunity for those with relatively limited capital to run their own business.

For newcomers and for experienced licensees, the brewery provides extensive support in order to ensure the success of the pub operation. The mutual benefit to be gained from a successful pub is at the centre of this support and licensees will be able to look to their brewery for a range of benefits. The value of this support is typically around £8,000 per pub in the first year depending on the family brewer in question. Because these are not available to free house pub operators and any other on-trade outlet, they constitute a unique (and critical) aspect of taking a brewery tenancy. The majority of new licensees need this level of support in their first 12 to 18 months – without it many would cease to trade very quickly.

All this contrasts with the free-of-tie leaseholder, who normally pays a large capital sum to acquire the lease and is then obliged to keep the building in good repair and fully insured, both at his own cost. He will receive little or no support from a brewery.

5.2. Support services

The brewer provides a full support package to tenants, headed by access to a Business Development Manager (BDM) to advise on how to operate the pub and help deliver business growth. Within IFBB members' tied estates, the BDM manages an average of just 34⁶ pubs, which is considerably fewer than most other pub companies which can be as high as 55 pubs. Taking into account other 'head office' staff who visit the outlet to bring help and advice, the ratio is even more favourable, at approximately 1 to 20 pubs.

⁶ IFBB annual members survey, August 2009

As with any individual business, the brewery and the tenant will agree a business plan and invest, for example in capital expenditure, training or marketing. The brewery brings long experience of owning and operating the property, essentially providing retail knowledge and the intellectual property of decades' worth of successful pub operations. This invaluable insight helps ensure that the tenant makes progress in growing his own business. Free house operators do not have access to this type or level of business support.

This combination of support services, with expert time devoted to helping the tenant, illustrates the ways in which the brewer, as landlord, provides special commercial or financial advantage to the tenant.

5.3. Special Commercial and Financial Advantages (SCOFA)

Each IFBB member provides a range of services and support free of charge, or at reduced cost, to its tenants. Often these supports will be offered via their Business Development Manager, or accessible via a central helpdesk at the brewery.

A free house operator is unlikely to benefit from such services and support without incurring cost, and also potentially has to choose from a range of suppliers, thereby expending time and effort. Moreover, these suppliers or consultants may have little previous knowledge of the pub itself, whereas the brewery would have extensive knowledge.

An example of the value of such SCOFA benefits is shown below, and represents the benefit to a tenant of having a brewery tied tenancy with a typical IFBB member during their first year.

<i>Benefit</i>	<i>Value</i>
Induction training Course – 2 people	£1,000
Other training	£200
British Institute of Innkeeping (BII) Membership	£200
Cask Marque accreditation	£140
On site cellar training	£125
Business Development Manager Contact and assistance Assumption that each new licensee will receive a minimum of 20 visits in the 1 st year covering business planning, cellar inspections, business reviews etc and extra analysis work carried out offsite	£2,100
PR Advice/Assistance Entries to national and local awards, help and advice with entries to Good Beer Guide, advice on websites plus internal sales tools	£200

Business Support Manager	£250
Three 2 hour visits to each new licensee plus off site house specific assistance covering EPOS tills, budgeting, cash flow, analysis of accounts and stock results, and comparisons between accounts and benchmarks	
Retail Eyes (mystery shopper) visits x 2	£200
Marketing Support	£500
Retail Eyes follow up, re-launches and re-developments, arranging promotions – house specific	
Wines advice	£125
Visit from Wine Manager, production and delivery of new wine list	
Kerb Appeal	£1,700
Assumption of new signage / kerb appeal approximately every 10 years	
Project / Design advice	£150
Commercial Services / Help Desk	£200
Based on licensing advice, agreement advice, change day assistance and facilitating repairs etc	
Buildings Insurance	£600
Based on average across a typical estate	
Centralised energy advice and consultancy	£150
Business rate (local taxation) reviews	£100
Carried out by property consultants	
Gaming machine consultancy	£100
Total cash benefit	£8,040

In addition to these specific support services, the brewery regularly alerts its tenants to issues such as new legislation which require their attention. This may lead to providing free follow-up advice given by experts on how to meet obligations cost-effectively. These benefits are substantial but not included in the quantified list.

As indicated earlier, the brewery maintains and insures the pub building. Because those costs vary considerably and may total sums far in excess of those listed, similarly, they have not been quantified above but are among the special advantages.

5.4. Rental benefit

A traditional brewery tied tenancy offers lower fixed rents than commercial property transactions. Rent has traditionally been calculated on beer volume and Fair Maintainable Trade figures as opposed to a full commercial rent based on the value of the property, its location and total square footage of the building.

The variable 'wet' rent paid to the brewer for stock, i.e. beer and other products varies according to trading conditions and offers the tenant some protection during a downturn because it reduces if sales reduce.

If the tie were to be abolished, the protection of the variable 'wet' rent would disappear and the fixed cost to the tenant would increase significantly.

5.5. Survey of tenants experiences of running a brewery tied pub

Seven IFBB members have participated in a survey of their tied tenants, led by independent industry experts. A total of 719 surveys have been completed, representing just fewer than 24% of the total tied brewery tenancies across the IFBB members' estates.

The survey results were collated on a member-by-member basis, and have been amalgamated to form a benchmark for the IFBB members. The survey results have been shared with each participating member, on both an individual brewery and collective IFBB member basis, but individual surveys have not been shared with the members, allowing their licensees to remain anonymous.

Appendix 2 sets out the results. They illustrate both the range of benefits available to tenants and their high levels of satisfaction with the way that the system is operating. This underlines that the system is mutually beneficial.

Section 6

Benefits of the tie to the family brewer

The family brewers provide a vital part of the UK's brewing heritage, and the abolition of the tie would see this tradition lost. Many regional brewers have already closed and without the tie there would undoubtedly be further closures.

The tie gives the brewers the opportunity to:

- Have an assured outlet for the beer they produce. In a highly competitive market, faced with giant multinational breweries, it is vital to have a guaranteed route to market, to maintain volumes, economies of scale, profit and ultimately – jobs
- Sell a certain volume of beer via tied pubs, aiding production planning of a perishable product. Long term, secure volume safeguards brewery jobs and regional diversity
- Manage the delivery of beer in an efficient way, in good condition and at low cost
- Make a single delivery of a range of products, thereby improving distribution efficiency
- Develop and promote new beers, giving the consumer more choice and variation
- Plan capital expenditure, in order to achieve better efficiencies and economies of scale, thus remaining competitive
- Enter the pub market, by taking on pubs and operating the tie. The recent growth in the number of micro brewers has highlighted this trend
- Compete with national brewers. With the tie, brewers can expand to new geographic areas and secure a portion of that local market to build a following, thus building their brands

The UK has a worldwide reputation for interesting pubs and cask beers. The tie has played a crucial role in preserving this tradition over generations. With the exception of the UK and Germany, there are very few private and small family-owned brewers in EU countries. Their consumers are the poorer for it, in terms of pub choice and beer choice.

Section 7

Benefits of the tie to the consumer

7.1 Choice and competition

The tie operates in the best interests of the consumer by maintaining both product and pub choice.

Brewers make available to their tenants a wide range of products, including those of the major European brewers. For example, Charles Wells Ltd makes available a list of 25 lagers from 12 different countries, as well as a wide and varied range of British cask and keg ales, stout and ciders.

For IFBB members, abolition of the tie or significant changes to it would result in a considerable reduction of the 419⁷ brands which they produce, as the market forces of competing with larger producers would inevitably require concentration on fewer products.

The tie offers consumers more choice of pubs. It preserves competition at local level by allowing pubs to survive the ups and downs of successive licensees. There would be further pub closures if, without the tie, this was left to pure market forces. Many rural community pubs are kept open by IFBB members long after they have become economically unviable in the short term, as brewers can take a longer term view of the wholesale income, not only the fixed rent.

The tie also allows IFBB members to introduce new brands to the market place through their tied houses, without massive advertising costs, thus encouraging innovation and product development.

For many IFBB companies, the tied pubs are their principal form of marketing to consumers as they cannot afford investment in advertising in addition to ongoing pub and brewery re-investment. By using the pub as the 'brand', brewers connect the building with the beer in the consumer's mind.

The Tie therefore:

- Preserves regional diversity in brewing
- Preserves cask ale as a beer category
- Preserves choice of beers nationally
- Preserves pubs and therefore competition between on-trade outlets

⁷ IFBB annual members survey, August 2009

7.2 Retail Pricing

Data from market research analysts Nielsen for the year to December 2008 shows that the average price of a pint of beer is the same in a tenanted pub as a free-trade pub. Although in both prices are very slightly higher (£0.10 per pint) than in managed pubs, these managed pubs will very often be able to benefit from the efficiencies and economies of scale generated by significantly larger outlets.

Moreover, managed pubs are the smallest segment (16%⁸ of the UK pub market) and may exhibit specific characteristics that also explain pricing differences. The data is shown in the table below:

	£ per pint
UK MANAGED PUBS	2.56
LEASED/TENANTED PUBS	2.66
INDEPENDENT PUBS	2.66

Table 1: Price of a pint, by tenure type, 2008⁹ (Nielsen)

Data from CGA Strategy, market intelligence specialists for the industry, shows some trends from 2004-2009.

OPTName	2004 Q4	2005 Q4	2006 Q4	2007 Q4	2008 Q4	2009P06
Independent Pub	£2.00	£2.03	£2.08	£2.15	£2.23	£2.31
Managed Pub	£1.93	£2.01	£2.08	£2.16	£2.22	£2.24
Non Managed Pub	£2.02	£2.06	£2.11	£2.17	£2.25	£2.29
Difference b/w tenanted and independent	£0.02	£0.04	£0.03	£0.03	£0.02	-£0.02

Table 2: Price of a pint, by tenure type, 2004-2009¹⁰.

These two data sets show that historically and in 2008 there has been no significant difference, if any, in price per pint between tenanted and independent pubs and not even any significant difference between these and managed pubs.

Some commentators have recently inferred bigger prices differences, but they are not comparing like-for-like. They compare large managed house chains, which tend to exhibit more aggressive pricing to smaller tenanted pubs.

⁸ BBPA Statistics Handbook 2009

⁹ Nielsen, MAT to December 2008

¹⁰ CGA Strategy

Section 8

Economic impact of the removal of the tie

The British beer market is unique in the world for the range of beer products and the quality of the outlets for on-trade consumption. This springs from the level of competition between outlets – in the case of IFBB members, backed up by brewery investment in their estates.

This is in contrast to ‘free’ markets without any tie arrangements where exclusive supply agreements are attached to loan finance rather than ownership, thereby lacking any mutual commitment to the success of the retail enterprise.

Within the EU, only in Germany, Belgium and the UK is the beer market supplied by other than a small number of dominant companies, so that independent wholesalers supplying retail outlets have little choice of source of supply. Consumers therefore have a restricted choice and it is the norm for only a few beers to be available and retailers find it hard to differentiate themselves.

In the UK, the introduction of progressive beer duty has, with some reservations, allowed a flourishing micro brewing sector, which will be stimulated by their ability to tie for beer if they buy pubs. To strengthen their route to market and foster capital investment, the tie will be vital for continued success.

For the UK pub market, the ability to maintain choice and regional diversity in brewing depends on brewers – of varying sizes – being able to exploit the economies that the tied house system offers. Without this resource to counterbalance the dominant companies’ advantages – economies of scale from producing in very large plants and large marketing budgets – the small and medium sized brewers will quickly be driven to concentrate on running pub estates, to the detriment of the brewing market as a whole.

In summary, we believe that the market impact of the removal of the tie would be the closure of IFBB member breweries, the rapid decline in regional and local beer brands – especially cask conditioned beers – the creation of a smaller number of large brands and a reduction in investment in retail outlets. Overall a prestigious and world renowned British industry would be further reduced and ultimately the consumer would be worse off.

Section 9

Conclusion

IFBB members' tenancy agreements containing the tie are not capable of appreciably affecting trade between Member States or capable of appreciably restricting competition by object or effect. On the contrary, as we have shown, they enable smaller brewers to maintain vigorous competition to the benefit of consumers.

Therefore, these agreements fall outside the scope of Article 81(1). Nevertheless, IFBB members are pleased to have this opportunity to present the facts and to dispel false allegations. We are proud of the distinctive contribution which we make to the UK brewing industry through our products and traditions, which are fundamental to the reputation of British brewing.

Brought together originally in 1993 to defend the tie, IFBB members meet periodically to discuss industry issues. However, they compete with each other, as well as with more dominant enterprises, and all their business relationships are conducted independently. There is no commercial agreement or network of agreements between our members.

The principal reason for maintaining the tie is the benefit to consumers. It provides more choice of beers and pubs for consumers and more competition in the pub trade by enabling small producers to compete with the giant national brewery and pub companies.

As we have shown, the tie works because of the mutual benefit between landlord and tenant. Their goals are aligned and commercial success is the shared vision. The mechanisms upon which that mutuality rest are the lower fixed rents and counterbalancing wet rents.

There is a differential in pricing between wholesale prices in tied and free-of-tie pubs, and this has become more pronounced in recent years. However discounts to tied pubs have also increased and there is no valid evidence of differential retail prices between tied and non tied pubs.

A comparison of the financial models for our tenancies and free-of-tie pubs shows that multiple valuable benefits accrue to our tied tenants by way of special commercial and financial advantages. The lower cost of entry and exit and the value of these advantages are also well illustrated by the evidence from tenants themselves. Moreover, the cost of property maintenance (borne by the landlord in the brewery tenancy) and the cost of business support are increasing.

Pub closures in the recession have attracted publicity. The greatest difficulties are faced by those who invested shortly before the recession in long leases with full commercial rents and a product tie. The IFBB members have very few pubs operated on this arrangement. In the recession, it is apparent that a minority of these leaseholders are in economic hardship, often having paid substantial sums to buy their leases.

Blame for such closures is sometimes attributed to the tie system. In fact, they face the same difficulties as other small businesses purchased for high prices before the recession. They should not be taken to be representative of the business model which the tie allows. On the contrary, the shared risk and reward approach contained in the traditional brewery tenancy is of greatest benefit to licensee tenants.

In this submission, we have brought together some of the extensive evidence demonstrating that the tie system benefits consumers, tenants and local communities, as well as the brewers who contribute so much to the character of the traditional British pub. It is a system which helps to achieve the goals of EU competition policy and it is in the public interest for it to continue.

APPENDIX 1

APP1.1 Financial comparison performed

The IFBB engaged an international firm of accountants to carry out financial comparison of brewery tied pubs and equivalent free-of-tie operators using tenancy pubs from our members' estates as a basis for such comparison.

A sample group of ten of our member breweries were asked to stratify their pub estates into a turnover size and composition matrix, the results of which are shown below:

	<£3k turnover per week	£3k-£5k turnover per week	£5k-£10k turnover per week	>£10k turnover per week	Total
Food turnover <10% of total	14.1	14.6	7.4	1.0	37.2
Food turnover 10%- 50% of total	2.8	12.5	24.7	5.7	45.8
Food turnover >50% of total	0.7	3.2	9.6	3.6	17.1
Total	17.6	30.4	41.7	10.3	100.0

From the three model categories (wet led pubs with turnover between £3,000 and £10,000, food led pub with a turnover in excess of £5,000 and mixed turnover pubs with a turnover between £3,000 and £10,000) sample financial information was obtained from 78 individual pubs across seven of our member breweries.

APP1.2 Creating a notional brewery tied pub profit and loss account

Using this sample data to derive overall averages and trends, the following earnings assumptions were made to arrive at a profit and loss account for a notional brewery tied pub in each of the three categories:

	Wet led	Food led	Mixed
Weekly turnover	£3,500	£12,000	£8,500
Proportion of turnover			
Wet	96.5%	43.3%	74.3%
Dry	3.5%	56.7%	25.7%
Composition of beer barrelage			
Standard lager	42.3%	35.4%	36.8%
Premium lager	10.3%	11.5%	15.4%
Cask / keg ales	30.2%	39.2%	28.6%
Cider / stout / other	17.2%	13.9%	19.2%
Beer %age of wet turnover	70.0%	50.0%	60.0%
Machine income % of turnover	2.4%	0.5%	0.8%
Gross margins			
Wet	48.5%	52.2%	51.2%
Dry	44.3%	57.5%	53.7%
Cost %ages of turnover			
Premises costs	12.7%	11.6%	10.4%
Admin and professional fees	4.4%	4.2%	4.3%
Entertainment and promotions	5.5%	0.9%	2.4%
Staff wages %age of turnover	11.7%	25.0%	16.3%

Rent has been assumed to be calculated as 40% of the pub's profit before rent.

APP1.3 Creating an equivalent free-of-tie profit and loss account

Using our industry experience, and following discussions with free-of-tie landlords, we have assumed that the following broad differences exist between the profit and loss account of a brewery tied and an equivalent free-of-tie pub:

- **Purchasing of beer** – a free-of-tie operator will be able to purchase barrels of beer at the following discount (compared to the price charged to the brewery tenant):

Standard lager	£143.40
Premium lager	£145.25
Cask / keg ales	£116.18
Stout / cider / other	£151.72

- **Purchasing of other goods** –non-beer drinks (wines, spirits, minerals) can be purchased by the free-of-tie operator at a discount of 10% compared to the equivalent brewery tied pub. No discount has been assumed for food purchasing. Machine income is assumed to be twice that of the equivalent brewery tied pub, as our member breweries have indicated that they share machine income equally with their tenants
- **Rent** – no rent is to be paid by the free-of-tie operator
- **Brewery services** – our member breweries offer a significant amount of ‘head office’ support to landlords, which if purchased on the open market would result in the free-of-tie operator incurring an element of additional cost. We have included a figure of £8,000 plus 1% of the implied property value, per annum as an additional cost to the free-of-tie operator
- **Interest payments** –the free-of-tie operator will purchase the pub (through a 100% loan to value mortgage) and will incur annual interest costs of 6.5% of this loan value. The value of the pub has been derived using industry standard valuation techniques. The implied valuations used in our assumptions are as follows:

Food led pub:	£900,000
Mixed turnover pub:	£850,000
Wet led pub:	£350,000

- **Other costs** – all other costs of the two different pub types have been assumed to be the same

We have stated the earnings of both operating models before both depreciation and taxation.

As this analysis focuses on earnings only, it does not take into consideration factors such as:

- Capital repayments on monies borrowed by the free-of-tie operator to purchase the pub, which will need to be made from the operator's post-earnings cash flows'
- The relative barriers to entry / exit faced by the free-of-tie operator, and the tied-tenant (in that a free-of-tie operator will need to be able to raise sufficient capital to purchase the pub, which may well include funding a significant deposit without mortgage finance to enter the trade, and will then also incur the time and cost associated with an eventual sale of the pub, whereas the tied-tenant is able to enter and exit the business with a much lower degree of financial and time commitments)
- The relative risk / reward profile of the two operating models, in that a free-of-tie operator is exposed to market fluctuations (both industry related and property price related) to a far greater extent than is the tied-tenant

All of which will have an impact above and beyond the strictly "earnings" numbers presented hereafter in this appendix.

The result of these assumptions has been to generate “Year 1” profit and loss accounts for the two types of pub, in each of the three categories, as follows:

Food led house	Brewery tied £	Free-of-tie £
Income		
Wet	270,192	270,192
Dry	353,808	353,808
Total income	624,000	624,000
Gross profit		
Wet	141,040	169,372
Dry	203,440	203,440
Machine	3,120	6,240
Total gross profit	347,600	379,052
Brewery services (within rent)	-	(17,000)
Staff wages	(156,000)	(156,000)
Rent	(34,957)	-
Premises costs	(72,384)	(72,384)
Admin and professional fees	(26,208)	(26,208)
Entertainment and promotions	(5,616)	(5,616)
Interest	-	(58,500)
EBTD	52,435	43,344
KPIs		
<i>Wet gross profit %</i>	<i>52.2</i>	<i>62.7</i>
<i>Dry gross profit %</i>	<i>57.5</i>	<i>57.5</i>
<i>EBTD %</i>	<i>8.4</i>	<i>6.9</i>
<i>Beer volumes:</i>		
<i>Standard lager barrels</i>	<i>55</i>	<i>55</i>
<i>Premium lager barrels</i>	<i>16</i>	<i>16</i>
<i>Cask / keg ale barrels</i>	<i>71</i>	<i>71</i>
<i>Cider / Stout / other barrels</i>	<i>23</i>	<i>23</i>

Implied pub value

£900,000

Mixed house	Brewery tied	Free-of-tie
	£	£
Income		
Wet	328,406	328,406
Dry	113,594	113,594
Total income	442,000	442,000
Gross profit		
Wet	168,144	207,387
Dry	61,000	61,000
Machine	3,536	7,072
Total gross profit	232,680	275,459
Brewery services (within rent)	-	(16,500)
Staff wages	(72,046)	(72,046)
Rent	(34,021)	-
Premises costs	(45,968)	(45,968)
Admin and professional fees	(19,006)	(19,006)
Entertainment and promotions	(10,608)	(10,608)
Interest	-	(55,250)
EBTD	51,031	56,081
KPIs		
<i>Wet gross profit %</i>	<i>51</i>	<i>63</i>
<i>Dry gross profit %</i>	<i>54</i>	<i>54</i>
<i>EBTD %</i>	<i>11.5</i>	<i>12.7</i>
<i>Beer volumes:</i>		
<i>Standard lager barrels</i>	<i>85</i>	<i>85</i>
<i>Premium lager barrels</i>	<i>31</i>	<i>31</i>
<i>Cask / keg ale barrels</i>	<i>77</i>	<i>77</i>
<i>Cider / Stout / other barrels</i>	<i>47</i>	<i>47</i>

Implied pub value

£850,000

Wet led house	Brewery tied	Free-of-tie
	£	£
Income		
Wet	175,630	175,630
Dry	6,370	6,370
Total income	182,000	182,000
Gross profit		
Wet	85,181	109,554
Dry	2,822	2,822
Machine	4,368	8,736
Total gross profit	92,370	121,112
Brewery services (within rent)	-	(11,500)
Staff wages	(21,327)	(21,327)
Rent	(11,929)	-
Premises costs	(23,158)	(23,158)
Admin and professional fees	(8,052)	(8,052)
Entertainment and promotions	(10,010)	(10,010)
Interest	-	(22,750)
EBTD	17,894	24,315
KPIs		
<i>Wet gross profit %</i>	<i>48.5</i>	<i>62.4</i>
<i>Dry gross profit %</i>	<i>44.3</i>	<i>44.3</i>
<i>EBTD %</i>	<i>9.8</i>	<i>13.4</i>
<i>Beer volumes:</i>		
<i>Standard lager barrels</i>	<i>64</i>	<i>64</i>
<i>Premium lager barrels</i>	<i>14</i>	<i>14</i>
<i>Cask / keg ale barrels</i>	<i>54</i>	<i>54</i>
<i>Cider / Stout / other barrels</i>	<i>28</i>	<i>28</i>

Implied pub value

£350,000

APP1.4 Economic assumptions

To compare the differences in these notional pubs' earnings over a period of time, we have used the following assumptions to generate five year profit and loss accounts for each of the six derived pubs listed above:

- **Revenue inflation** –turnover will increase at a rate of 2% per annum (subject to the level of beer decline mentioned below)
- **Beer volume decline** –beer volumes will decline at a rate of 2.5% per annum. There is consequently a slight decrease in beer turnover for each of our modelled pubs, while all other turnover lines are increasing
- **Staff cost inflation** –staffing costs will increase at 2% per annum
- **Other cost inflation** –other cost lines (and machine income) will increase at 1% per annum
- **Rent uplift** – as the majority of our member breweries contract with their tenants on three year leases, in year three, there will be a one time uplift to rent of 2%
- **Interest rate increase** – as the current level of base interest rate is at an all time low, we have assumed that over the next few years there will be a gradual increase in rates back up towards a longer term 'normal' level. Consequently, the base level of interest rates will increase by 0.125% per annum

The impact of the above assumptions on the six pubs derived above is as follows:

Earnings comparison - Food led pub					
	Year 1	Year 2	Year 3	Year 4	Year 5
Brewery tied tenancy	52,435	53,396	53,696	54,736	55,816
Free-of-tie operator	43,344	42,793	42,297	41,859	41,476
Earnings comparison - Mixed pub					
	Year 1	Year 2	Year 3	Year 4	Year 5
Brewery tied tenancy	51,031	50,880	50,067	49,953	49,858
Free-of-tie operator	56,081	54,210	52,381	50,594	48,848
Earnings comparison - Wet led pub					
	Year 1	Year 2	Year 3	Year 4	Year 5
Brewery tied tenancy	17,894	17,338	16,545	15,992	15,439
Free-of-tie operator	24,315	22,878	21,458	20,053	18,664

Under the assumptions as specified, the current earnings of a food led pub under a brewery tie would be higher than as a free-of-tie house. Conversely we note that current earnings for wet led and mixed turnover pubs would be higher as a free-of-tie operator, although over time our scenario analysis suggests that the difference in earnings diminishes and the brewery tie becomes an increasingly attractive alternative.

We note that the traditional 'wet led' pub is a declining sector.

APP1.5 Average impact of brewery tie

We have taken the above three categories of pubs and applied an average weighting to each of their respective earnings results to generate an overall comparison of the brewery tied pub to an equivalent free-of-tie pub.

The five year impact of this analysis is as follows:

Earnings comparison					
	Year 1	Year 2	Year 3	Year 4	Year 5
Brewery tied tenancy	37,019	37,033	36,572	36,621	36,688
Free-of-tie operator	38,315	37,040	35,799	34,593	33,422

In Year 1 the free-of-tie operator has marginally higher earnings, the two models generate equal earnings in Year 2 and in Years 3 – 5 the brewery tied is a more beneficial operating model.

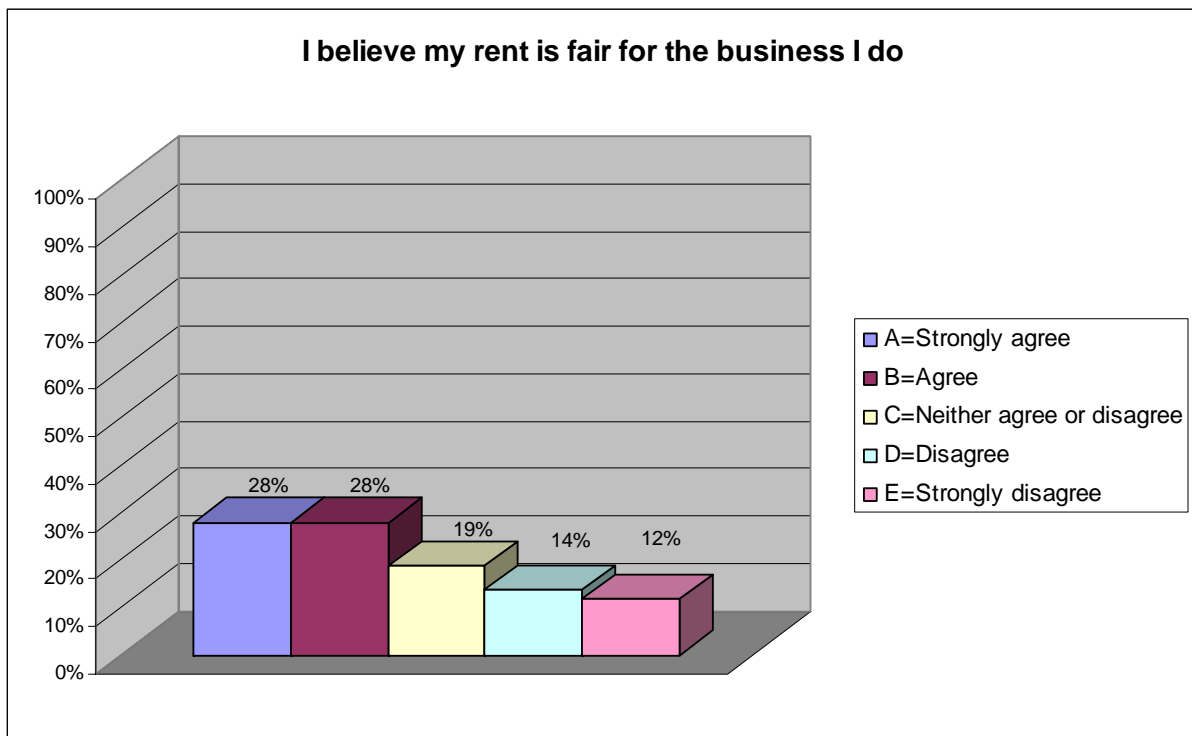
APPENDIX 2

APP2.1 Survey of tied tenants experiences

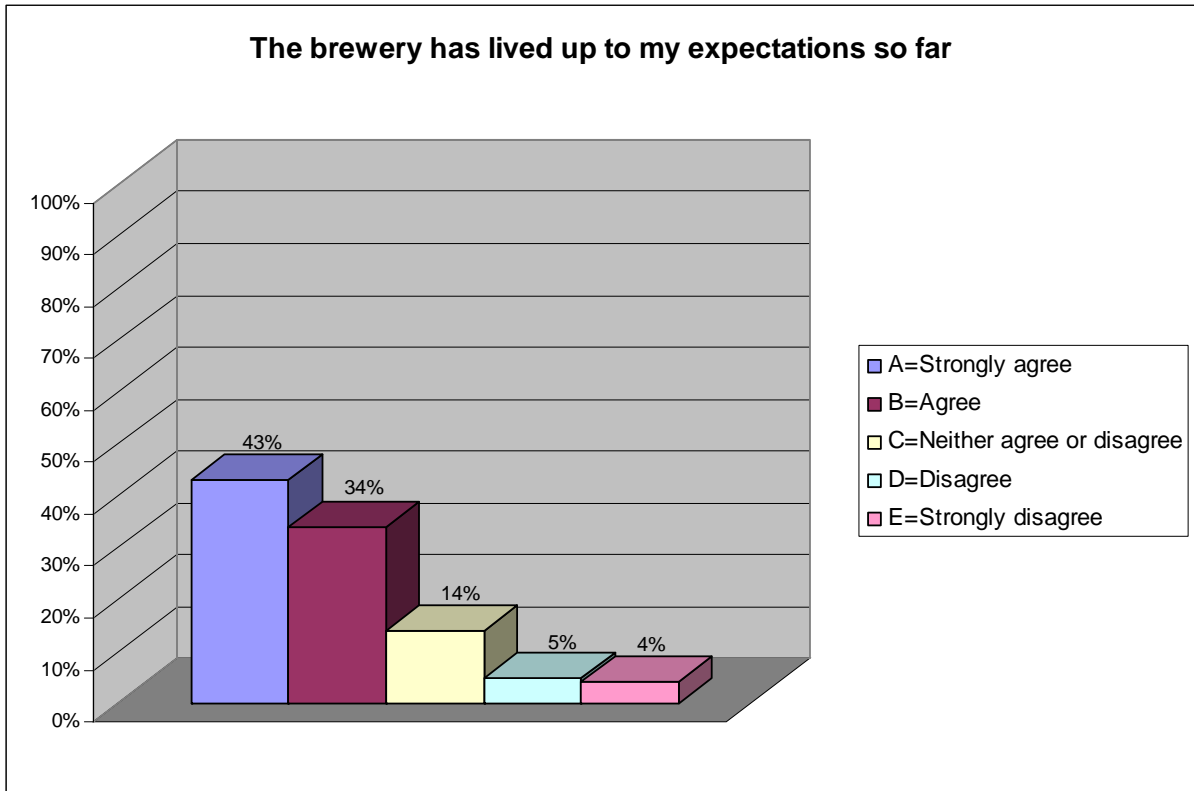
The surveys covered a range of questions, the vast majority of which were common across all members. Each tenant was asked to score the relevant question from A to E, where:

- A = Strongly Agree with the statement
- B = Agree
- C = Neither Agree nor Disagree
- D = Disagree
- E = Strongly Disagree

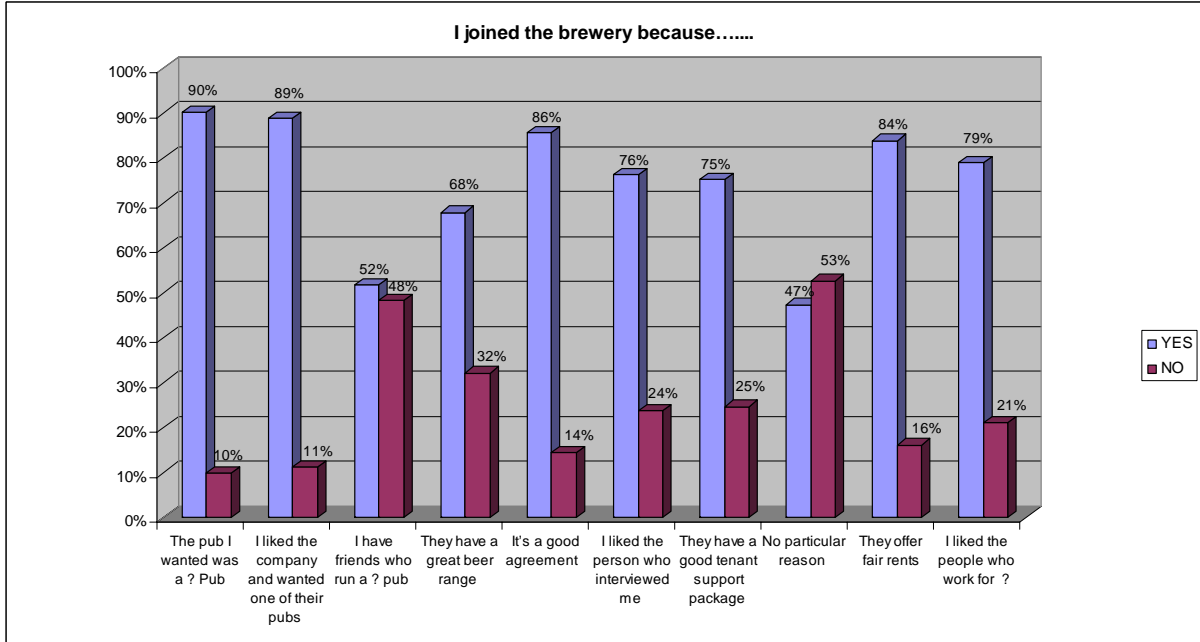
The results have been produced into graphical format



56% of tenants believe their rent is fair for the business they do, compared to 26% who disagree. Given the nature of this question, it is felt this is a positive result in light of the current economic situation and the negativity surrounding tied tenancies

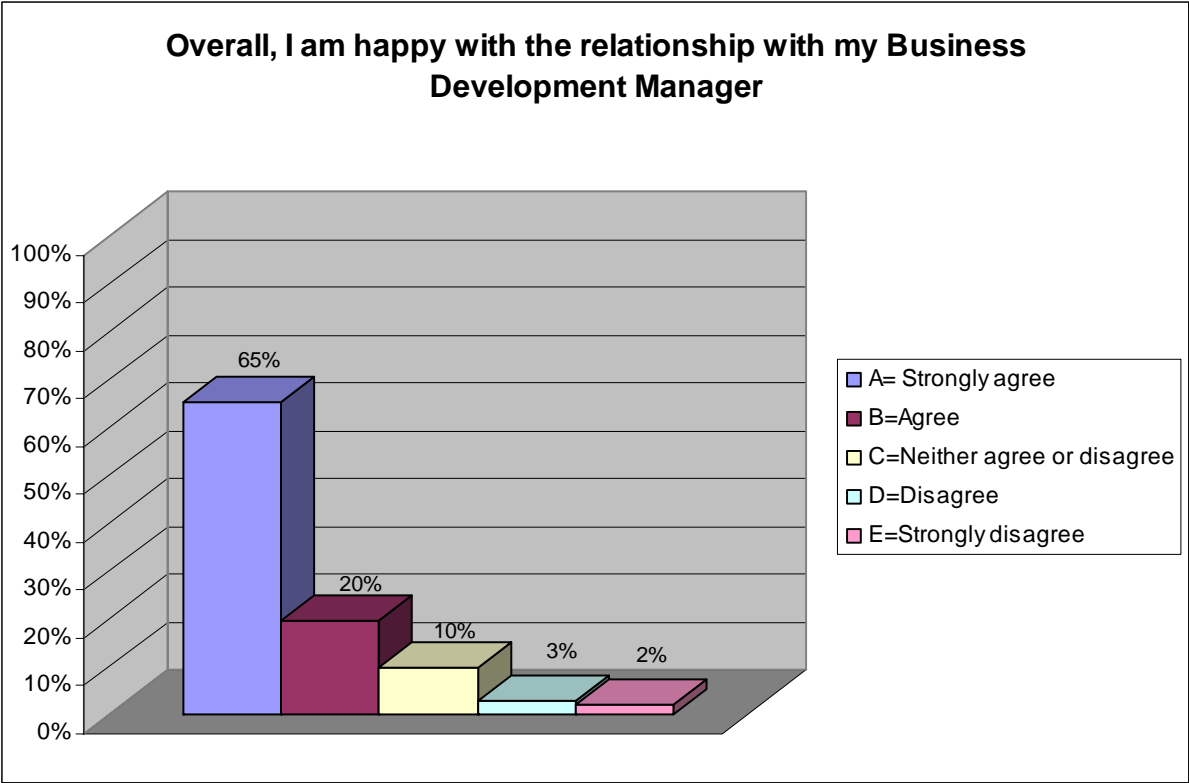


77% of tenants agree, with only 9% disagreeing, that their brewery has lived up to their expectations

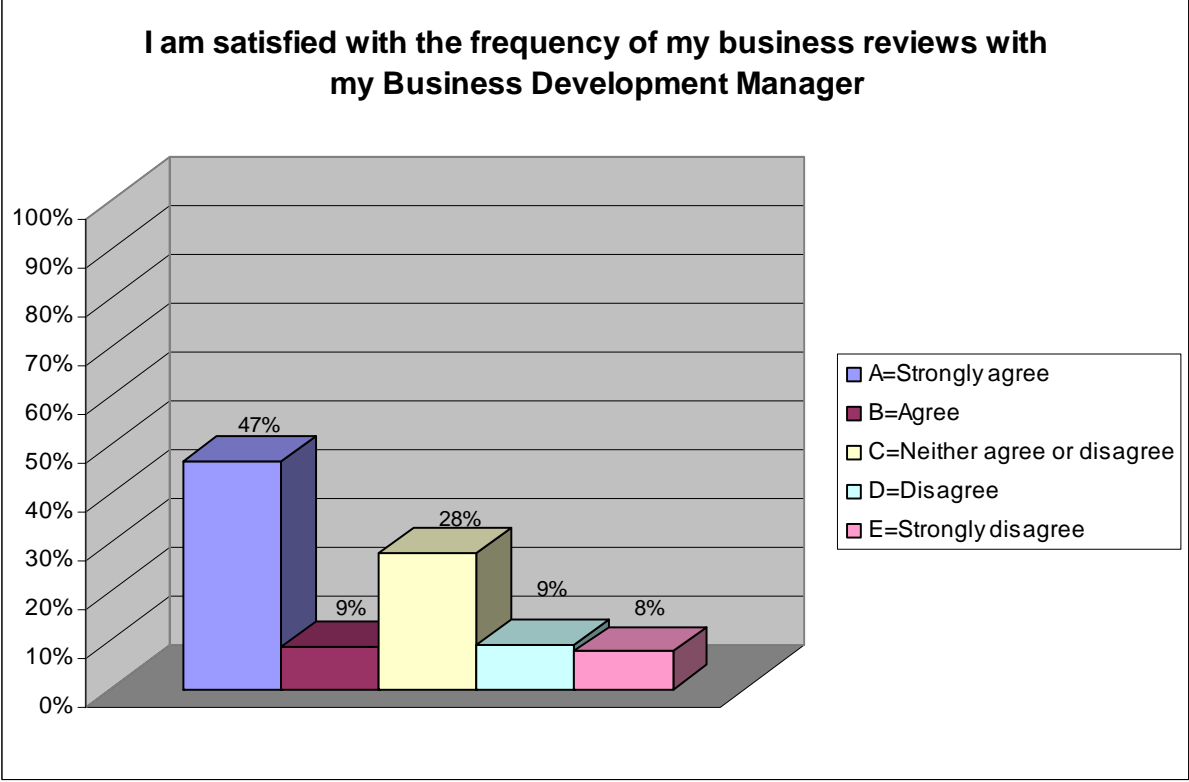


90% of tenants joined the brewery in question because the pub they wanted belonged to that brewery. However in addition to this:

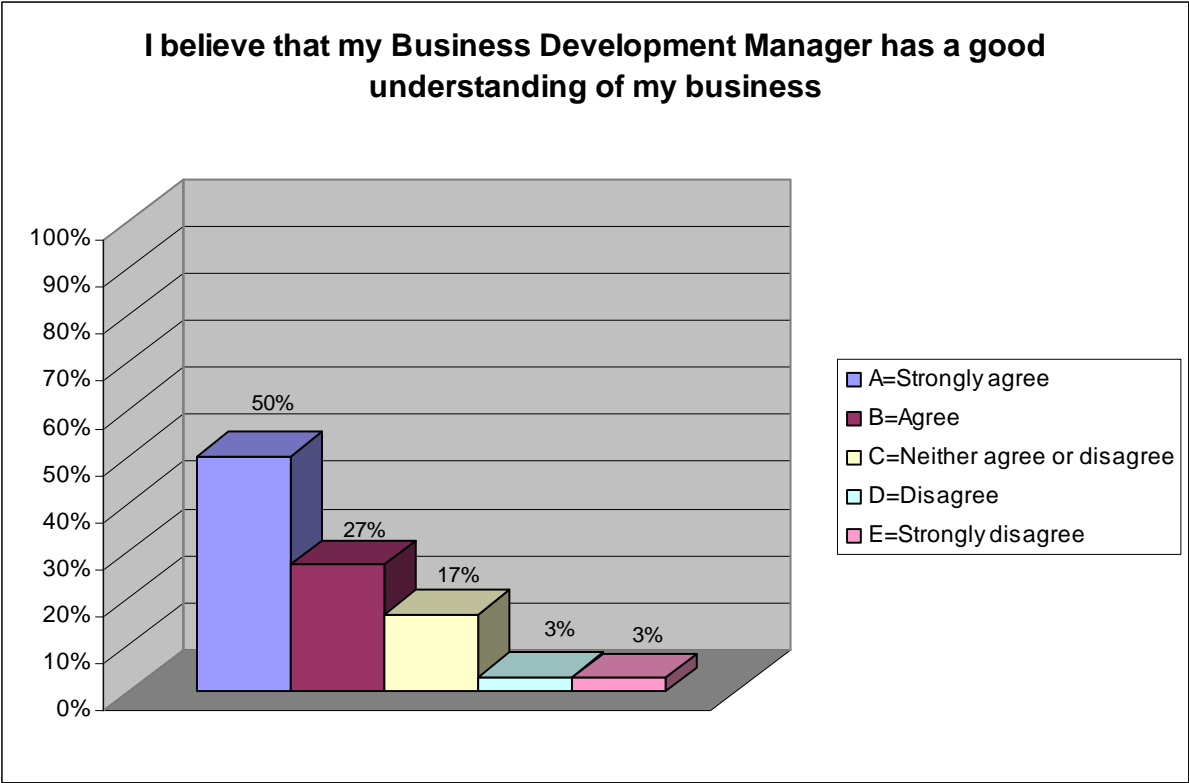
- 89% liked the company and wanted one of their pubs
- 86% thought the tenancy agreement was a good agreement
- 84% believed the brewery offered fair rents
- 79% liked the people at the brewery
- 76% liked the person who interviewed them
- 75% thought the tenancy support package was a good package



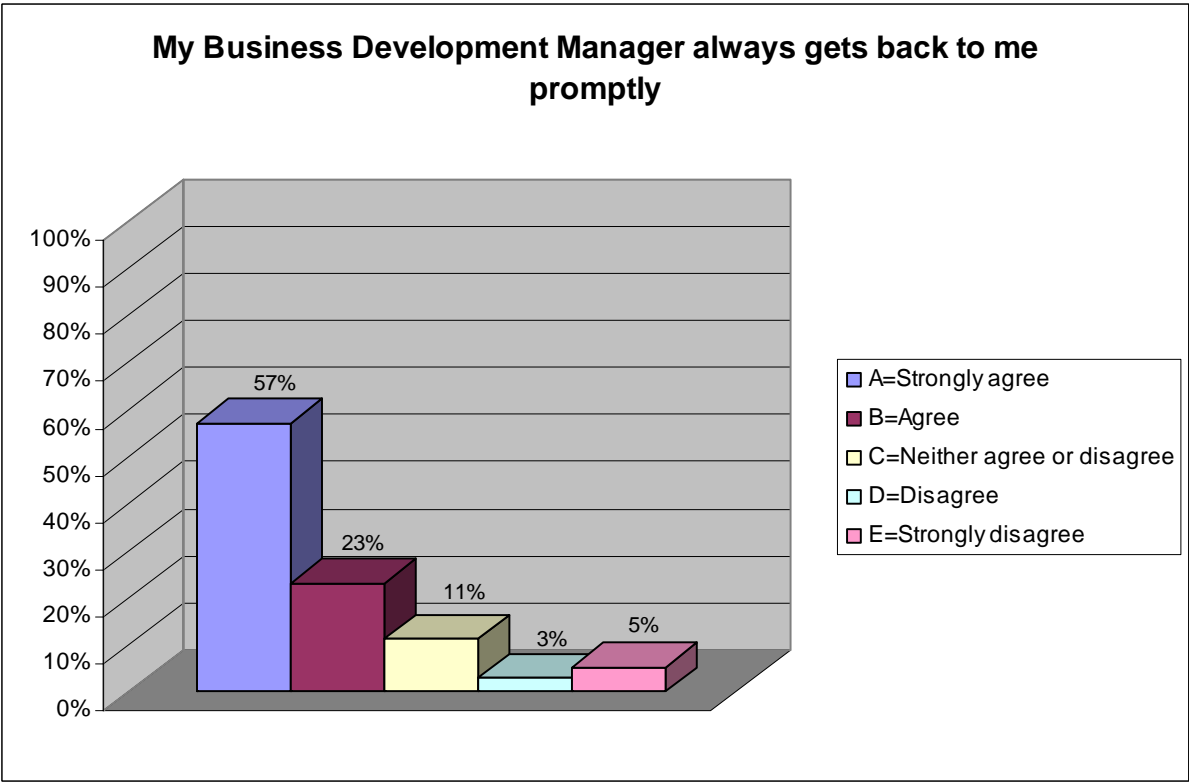
85% of tenants are happy with the relationship they have with their BDM (or equivalent), with only 5% disagreeing



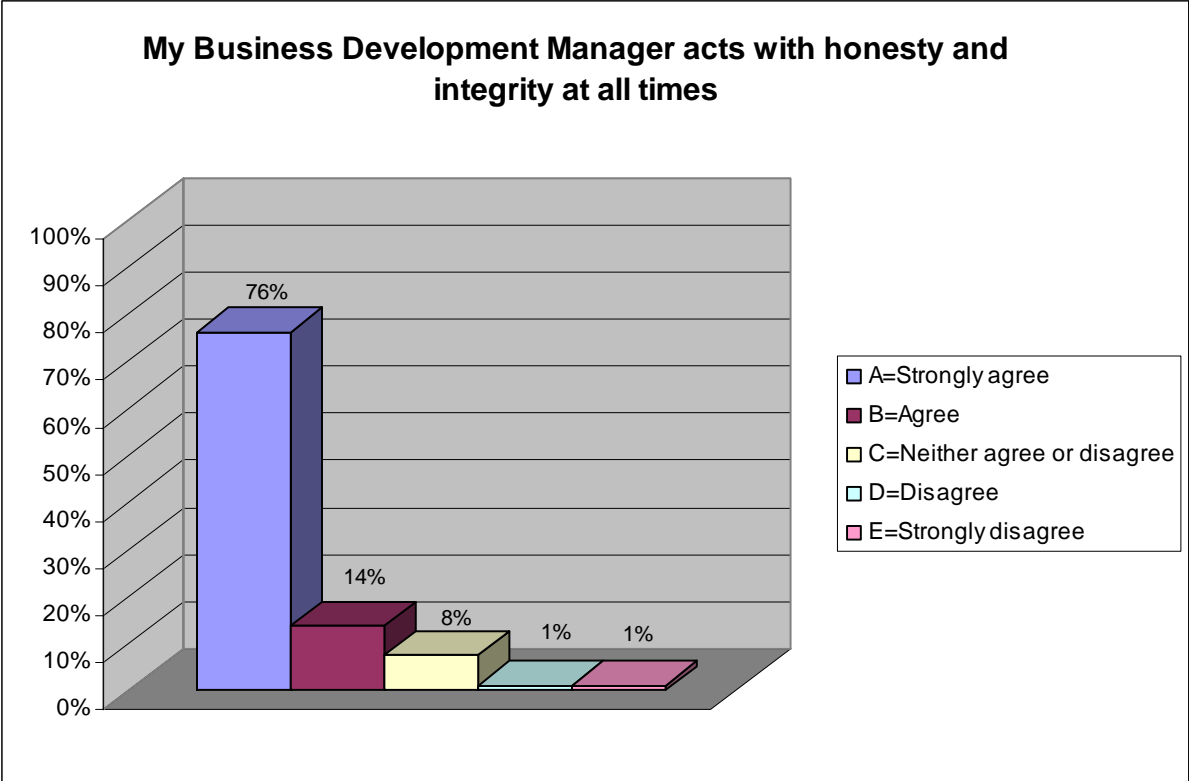
Overall, tenants are satisfied with the frequency of their business reviews



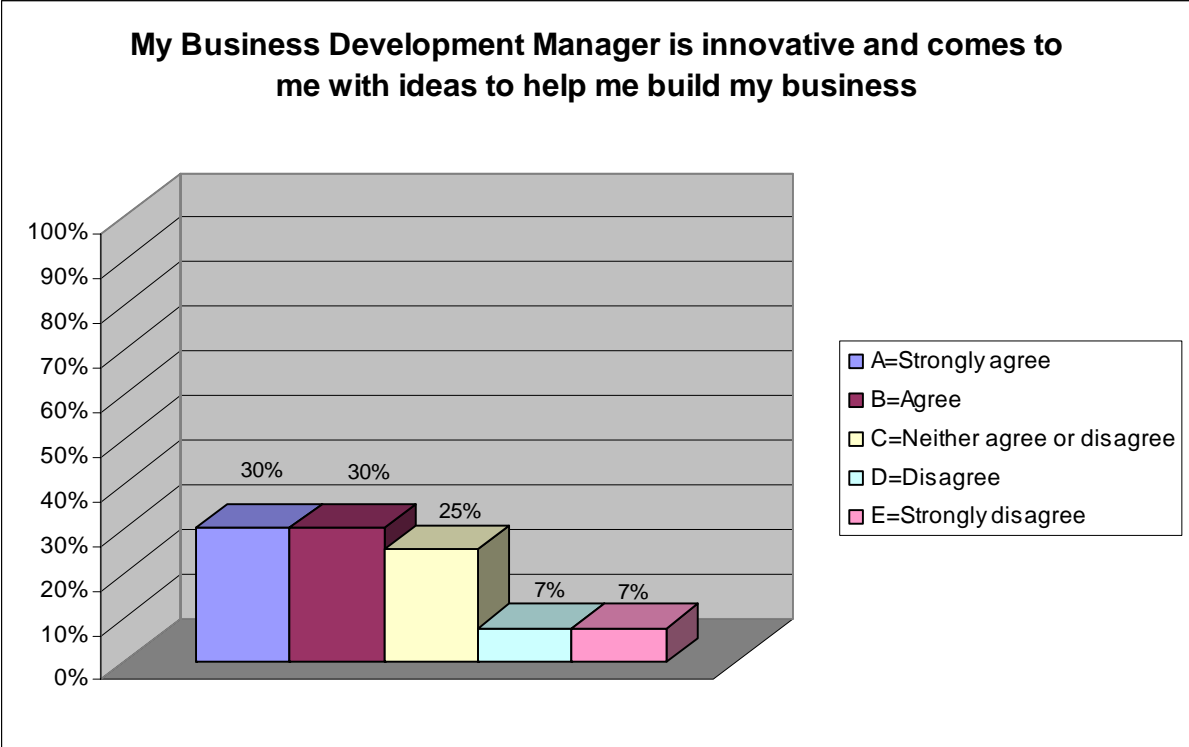
77% believe their BDM has a good understanding of their business, with only 6% disagreement



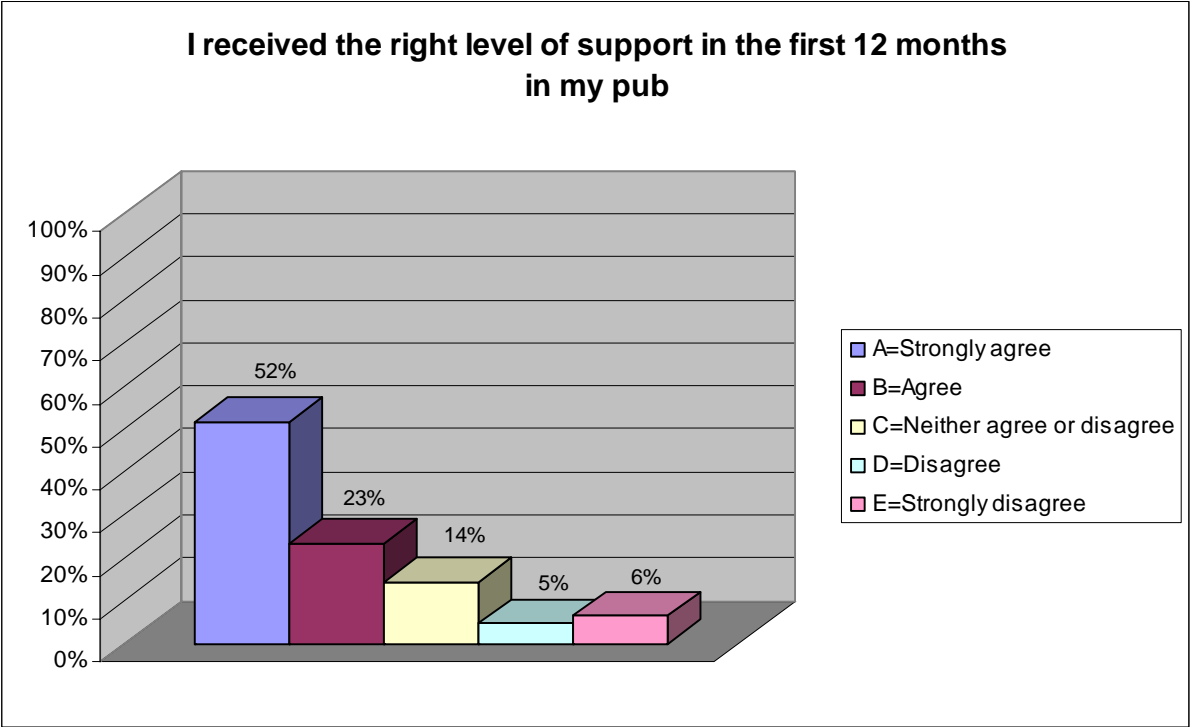
80% feel that their BDM comes back to them promptly



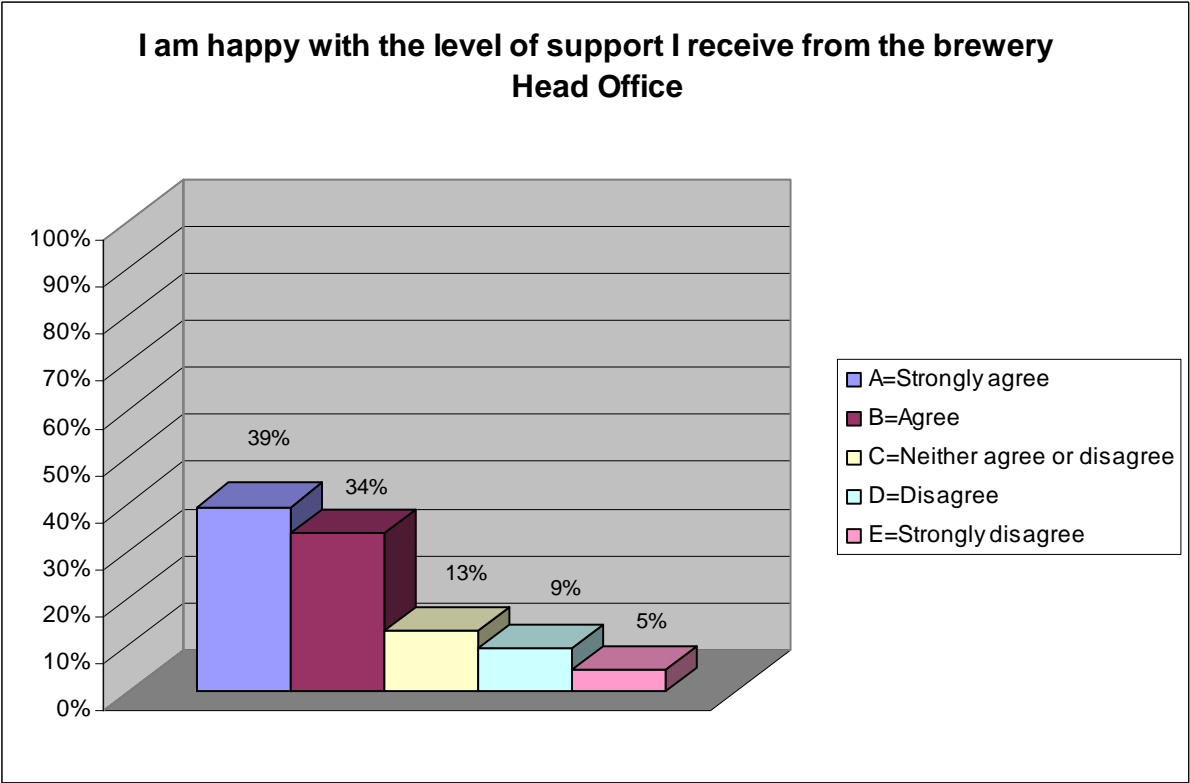
90% of tenants agree that their BDM acts with honesty and integrity



60% of tenants agree that their BDM helps them with ideas to benefit their business

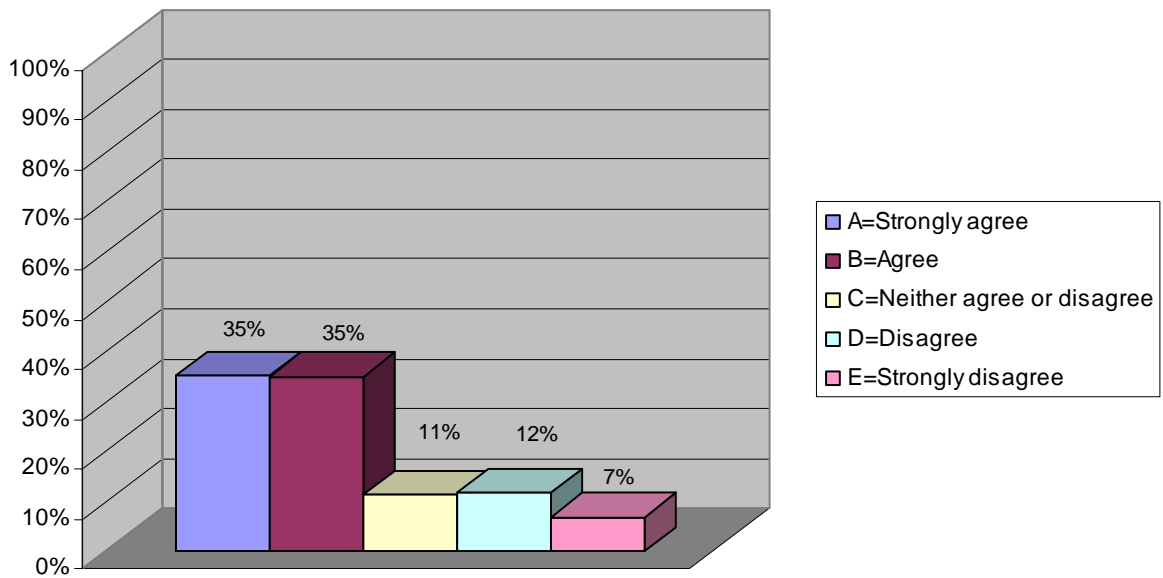


Three quarters of tenants agree that they received the right level of support in the first 12 months in their pub



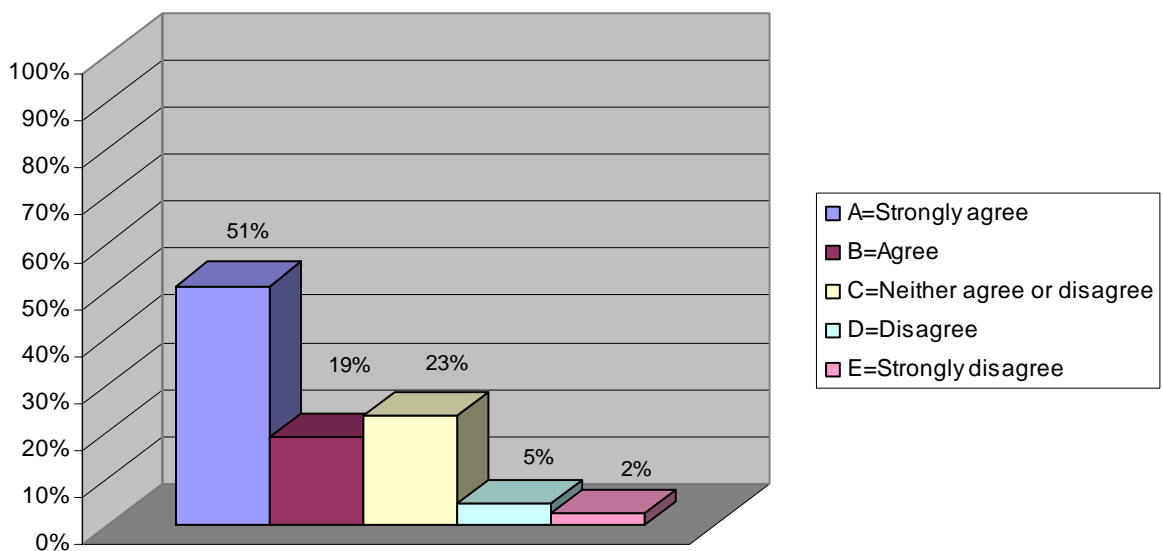
73% of tenants are happy with the support they receive from their brewery

The brewery Head Office always responds to me promptly



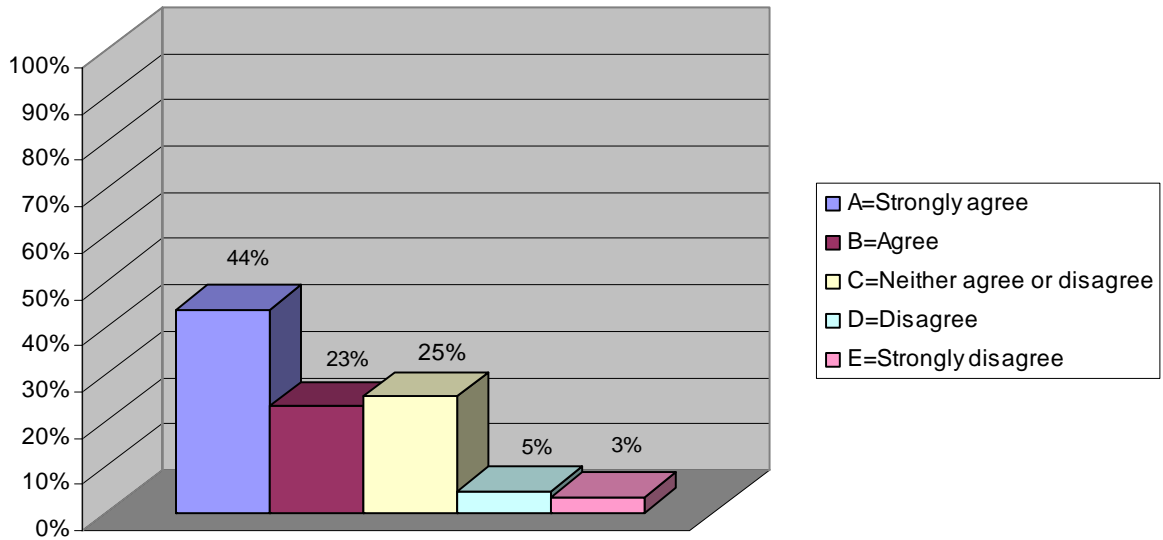
70 % believe they receive a prompt response from the brewery / Head Office

I am happy with the level of service I receive from the brewery Training Department



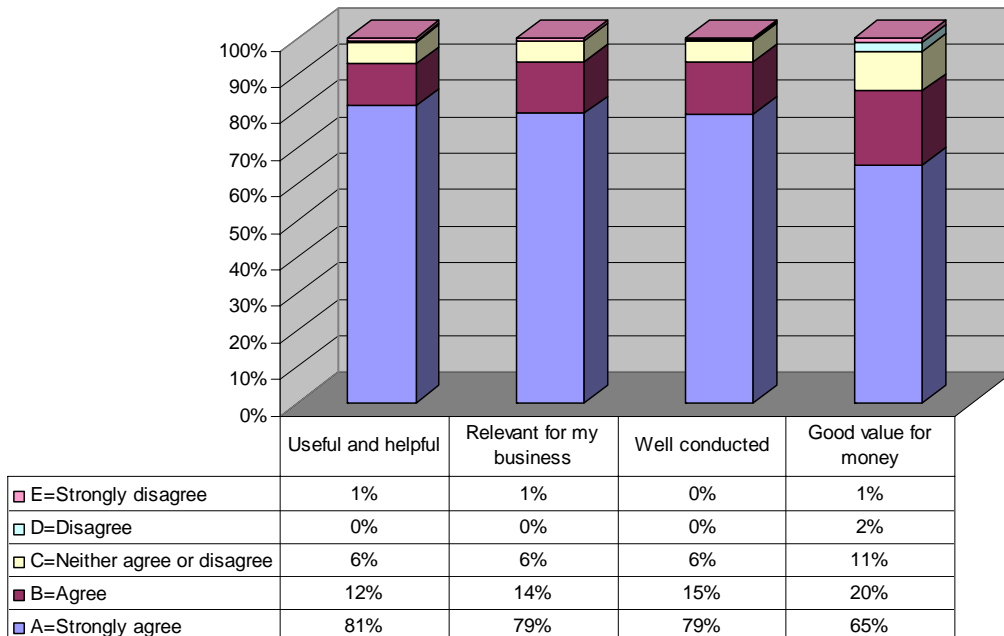
70% are happy with the service they receive from their Brewery's training department

In terms of the support available from my brewery, I am happy with the selection of training courses available to me

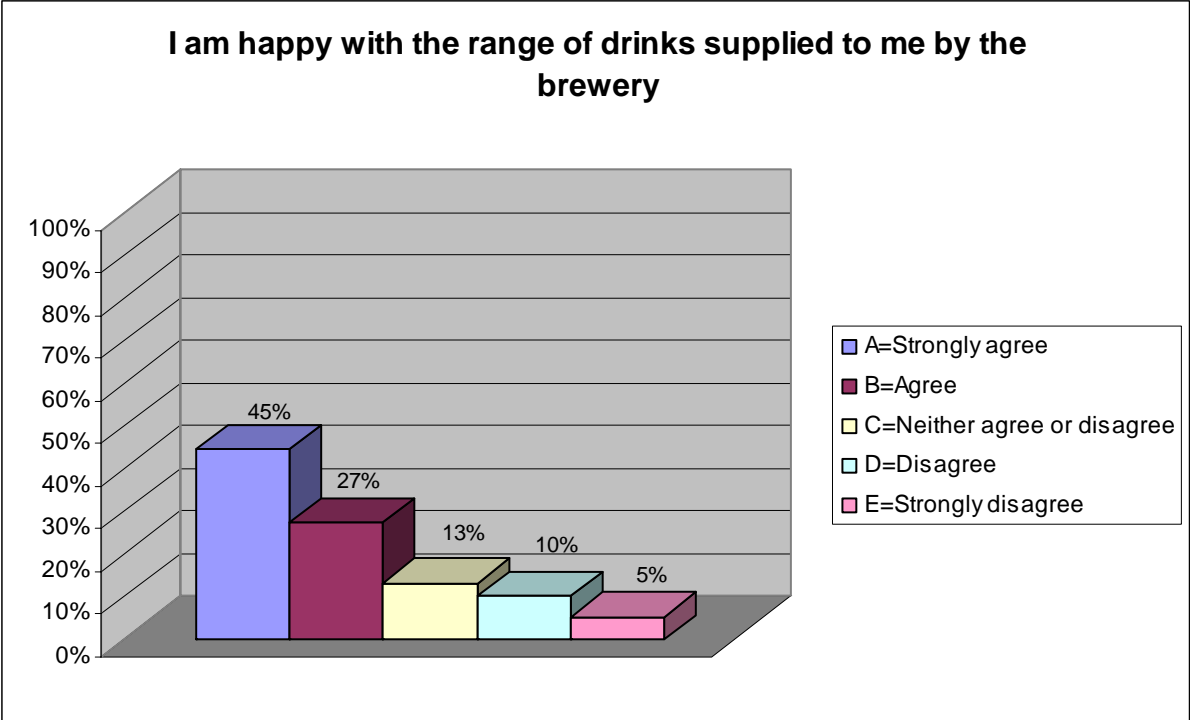


Generally, tenants are happy with the selection of courses that are available to them

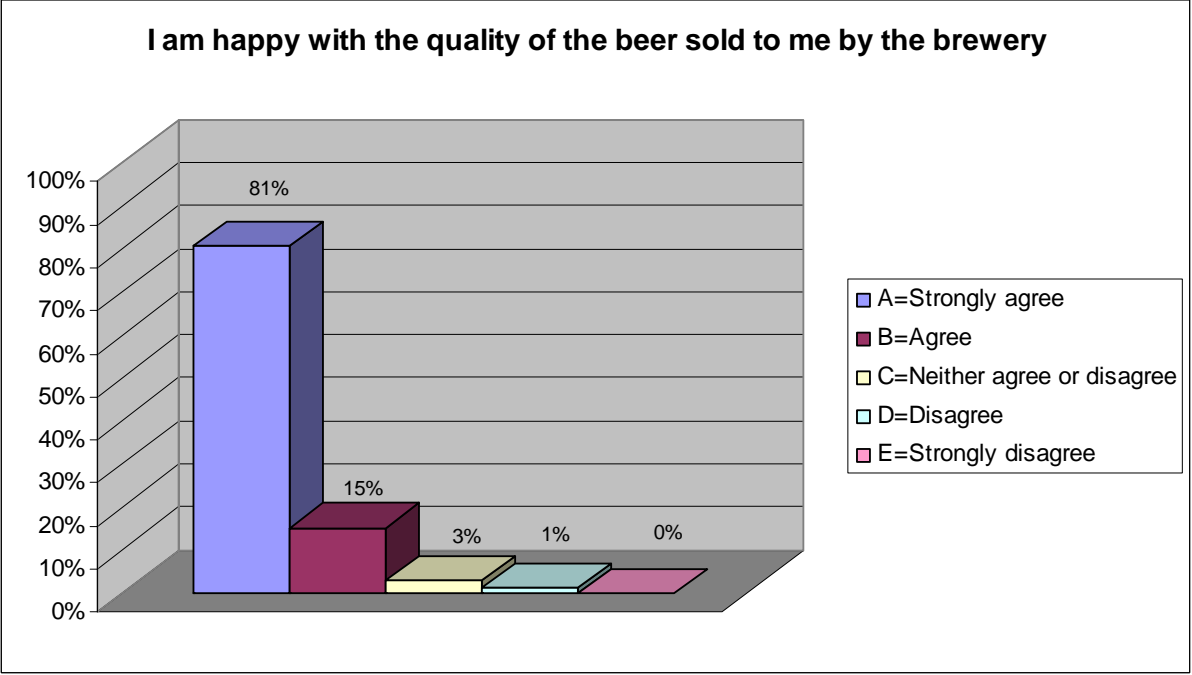
The training courses I have been on have been



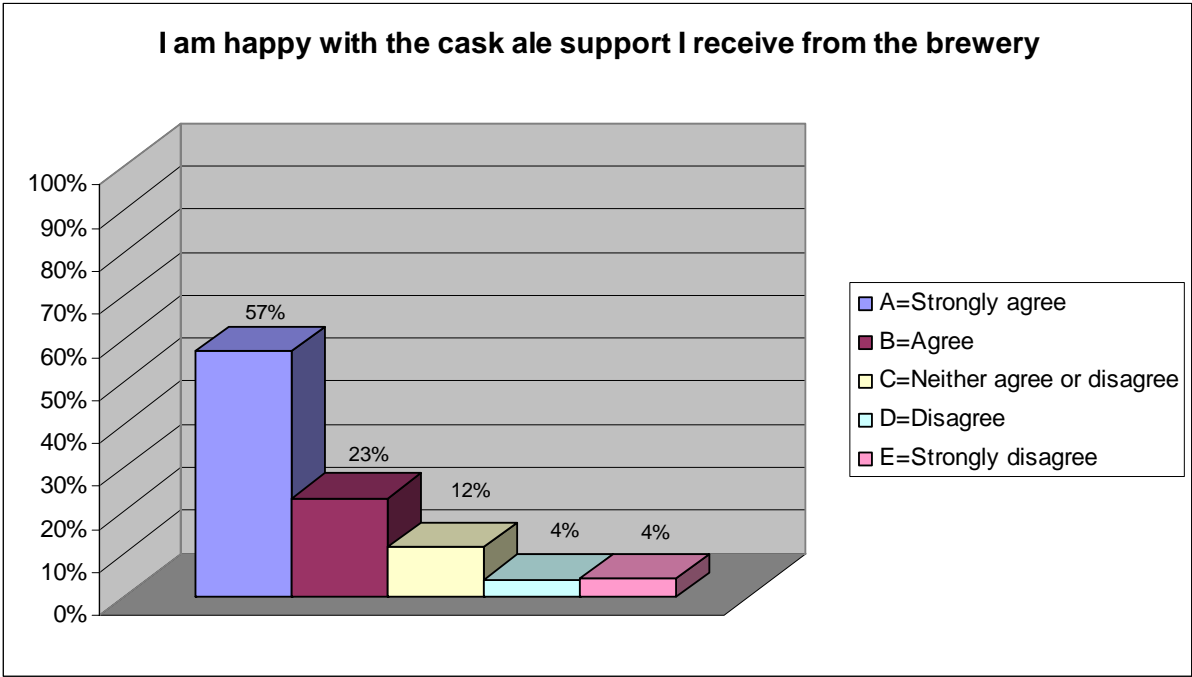
These courses are well received, being useful, relevant, well conducted and good value for money. There was minimal disagreement on these questions amongst tenants.



72% of tenants are happy with the range of drinks they are able to sell to their customers



96% are happy with the quality of the beer they sell – with only 1% disagreeing



Overall, 80% of tenants are happy with the cask ale support that they receive