

Response to Law Commission's consultation

Business tenancies: the right to renew



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Executive summary

Introduction

We, the Office of Rail and Road (ORR), make this submission in the light of the findings of our market study into the provision of railway station catering services – for which our [final report](#) was published in June 2024. Lease protection under the Landlord and Tenants Act 1954 ('the 1954 Act') played an important role in our findings.

Our submission

Our market study assessed the state of competition in station catering, and the extent to which passengers and taxpayers are getting value for money from this market. The evidence that we gathered from our review suggests the impact of the provisions of the 1954 Act appear likely to be negative from a passenger and taxpayer perspective.

Our study recommended that landlords of railway stations should contract out of lease protection for all future leases and that landlords should take every opportunity to move away from existing protected tenancies. Our study also identified the opportunity for reform posed by the then-forthcoming Law Commission review of the 1954 Act.

In this submission we argue that it would be proportionate and beneficial to expressly exclude tenancies of premises within railway stations from Part II of the 1954 Act as one of the named exceptions under section 43. The Law Commission might consider the case for further proportionate exemptions in other circumstances where similar market characteristics to station catering exist.

If tenancies of premises within railway stations stay within the scope of the 1954 Act, our view is that a reduced level of lease protection should apply either by moving away from a default right to renew position or by lessening the burden of statutory processes for opposing renewal and contracting out.

1. Introduction and purpose of this submission

Introduction

- 1.1 We are the independent economic and safety regulator for Britain's railways and we regulate performance and efficiency on England's strategic road network. We are also a designated national competition authority, with powers held concurrently with the Competition and Markets Authority (CMA), to apply competition law in markets relating to the supply of services relating to railways.
- 1.2 We have a statutory duty to promote competition for the benefit of users of the railway, ensure that markets function effectively, and protect the public interest in the sectors we oversee.
- 1.3 We are grateful for the opportunity to respond to the Law Commission's consultation on the right to renew business tenancies. Our response draws on recent insights from our work, specifically our 2024 market study ('our market study') into retail businesses who sold ready-to-eat food and drink from railway stations ('station catering').
- 1.4 Our submission focuses on the implications of the 1954 Act for our own sector. While we of course recognise the broader scope of the Law Commission's consultation, we have limited our response to those issues on which the findings of our market study enable us to comment. Where possible and relevant, our submission briefly considers the wider applicability of our study's findings.

Our market study

- 1.5 Our market study concluded in June 2024 with the publication of our [final report](#).
- 1.6 Over the course of our market study, we requested corporate and financial data from businesses who specialise in station catering and from landlords who run railway stations. We talked to station managers and retailers about their first-hand experience.
- 1.7 The evidence collected over the course of our market study gave us a comprehensive picture of how businesses operate in railway stations, and the key issues that they face including those caused by the application of the 1954 Act. Our review, in line with our jurisdiction, covered stations in Great Britain (GB), thereby encompassing stations in Scotland where the 1954 Act does not apply.

This breadth enabled us to carry out a limited comparison between otherwise similar markets where the 1954 Act did and did not apply.

1.8 Our market study report signalled our intention to engage with the Law Commission's review as follows:

“We will... make our own submission to the Law Commission's consultation. We will aim to focus on, but not be limited to, the following areas of the 1954 Act that we believe merit modernisation and need to be amended so as to better fit to the current commercial needs within railway stations:

- (i) Grounds of termination: we will submit that there is a need to ensure more flexibility and bring the grounds closer to the needs of the modern real estate/environmental needs;*
- (ii) Cost of termination (including statutory compensation): we will submit that the cost of legal proceedings to terminate protected leases, together with statutory compensation where applicable, can be a significant barrier to the redevelopment and/or repurposing of station units. We will submit evidence on the issues caused by the need to factor statutory compensation into any redevelopment proposals;*
- (iii) Terms of lease upon renewal: we will submit that legislation should allow more flexibility to update lease terms on renewal, as and when appropriate, so as to fit the market's current requirements and ensure that protected leases are kept in step with market standards.”*

1.9 We summarise key aspects of our findings, particularly where they relate to protected leases, in [Chapter 3](#) of this submission.

2. The structure of the GB rail industry

- 2.1 The GB mainline railway infrastructure, including track, stations, bridges, and signals, is owned by Network Rail Limited. Network Rail is an executive non-departmental public body, sponsored by the Department for Transport.
- 2.2 Although Network Rail is the owner of all stations, it only operates [20 of the very largest stations](#). The remaining c 2500 stations are operated by Train Operating Companies (TOCs), whose primary function is the operation of passenger trains.
- 2.3 Since privatisation in 1997, the majority of TOCs have been privately owned enterprises that were either awarded the right to operate a franchise or licenced to operate an independent service under their own brand. Additionally, at the time of writing [DfT Operator Limited](#), a public corporation of the Department for Transport, operates a number of rail services that were previously operated by private sector companies but have not been re-awarded to the private sector.
- 2.4 Both TOCs and Network Rail are partly funded by the taxpayer. The overall level of subsidy to the railway significantly increased during and after the Coronavirus pandemic to cover the shortfall caused by the reduction in passenger numbers.
- 2.5 The Government has [announced](#) that it is committed to a programme of rail reform. [The Passenger Railway Services \(Public Ownership\) Act 2024](#) makes provision for almost all passenger railway services to be provided by public sector companies instead of by means of franchise agreements. Whilst there remains a degree of uncertainty around some of the details of the future industry structure, the future seems set to involve, firstly, a move towards greater public ownership of passenger train services, and, secondly, a greater degree of integration between infrastructure management and the operation of passenger services.

3. Business tenancies in railway stations

Introduction

- 3.1 Our reasons for launching our market study are summarised in our published [statement of scope](#). Station catering plays an important role in serving the needs of millions of rail passengers and commuters across the country and is an activity that accounts for the large majority of the commercial property income that is earned at stations.
- 3.2 Of the stations that fell within the scope of our market study, only around 20% have one or more catering outlet and almost half of these stations have only one outlet. Station operators tend to prioritise their primary function, which is to operate passenger trains, over retail, often meaning that where space is at a premium, retail outlets are limited.
- 3.3 Retail premises in stations are, with few exceptions, commercially let by the station operator. At TOC-managed stations the TOC, as the station operator, is the landlord and Network Rail, as the owner, is the superior landlord. Leases for premises in TOC-managed stations are tri-partite in nature.

The role of competition

- 3.4 As in all markets, competition between station catering suppliers can be an important market force driving value for money in terms of the price and quality of goods and services.
- 3.5 As described in Chapter 3 of our market study report, a common feature of many station catering outlets is that, offering what is often a convenience proposition and being located within the enclosed boundaries of a train station, they face relatively little head-to-head competition 'in the market' from other suppliers of similar goods. The best value for money for customers may be reduced. This increases the risk that offerings which are sub-optimal in terms of price and or/quality may be able to survive within stations, insulated from normal market competitive pressures. Because of this, our market study featured a particular focus on the strength of competition 'for the market', whereby suppliers compete to win the right to operate station outlets. Such competition can deliver clear benefits to both passengers and landlords (and hence taxpayers) by incentivising tenants to present the strongest

offer to passengers and/or landlords, thereby increasing the chance that they will win or retain outlet occupancy.

Our market study's findings

Overview

- 3.6 Our market study suggested a lack of effective competition among prospective tenants to occupy existing station outlets. We found that landlords competitively tender premises less than 5% of the time.
- 3.7 Our market study found a number of reasons for this apparent lack of competition. Some of these factors appeared to be transient in nature, including the aftermath of the Coronavirus pandemic. Other factors appeared to be permanent and possibly intractable, such as the limited space available within stations and the specialist knowledge required to compete in an operating environment that is unusual in terms of the very 'peaky' profile of demand at railway stations and the commonly limited access to kitchen and storage space that is typically available to otherwise comparable high street outlets.
- 3.8 But we found that lease protection constituted the single most important barrier to competition to occupy tenancies. We found that 24% of station outlets, accounting for 27% of total rental revenue, are currently covered by protected leases. Our review also found that the lease protection may extend beyond these outlets, since holding a protected lease may confer the lessee with strong advantages, often associated with facilities such as storage space etc, when competing to occupy adjacent outlets.
- 3.9 Most protected leases are held by the largest and longest established players in the market. The largest single holder of protected leases is SSP Ltd, a FTSE250 business with a global turnover of c. £3.4bn offering well known nationwide own brands such as Upper Crust and franchised brands such as Burger King. Our review found that SSP controls 20% to 30% of outlets in stations and accounts for 40% to 50% of passenger expenditure. SSP's share of all outlets is larger than that of the next six largest players combined. Costa Coffee and WH Smith are the next largest players in the station catering market.
- 3.10 Our market study found some, albeit not conclusive, evidence to suggest that lease protection tends to put downwards pressure on rents and hence upward pressure on product/ticket prices and/or taxpayer subsidy. Hard evidence in this area was difficult for us to obtain. Our market study found, firstly, that traditional metrics by which retail asset owners value shopping centres etc, such as rent per

square metre may be distorted by the prevalence of kiosk units. Rail stations and units within them also vary significantly in terms of their footfall and hence revenue earning potential, as shown in [published ORR station usage data](#). However, data that we presented in our market study averaged over a small number of case studies (see Chapter 3 of our market study report) suggested that lease protection places downward pressure on rentals amounting to around 10% of the starting minimum guaranteed rent.

Why our market study found that lease protection is an issue

- 3.11 In the paragraphs below we explain our market study's key findings regarding the impact of the 1954 Act. In doing so we provide further detail than provided in our published report – which we attempted to keep relatively short and whose focus encompassed a wide range of issues beyond those associated with the 1954 Act.
- 3.12 The stakeholders who engaged with our review presented us with arguments and evidence which aligned with their commercial interests, for example:
- The landlords we spoke to consistently argued against lease protection. They told us that lease protection entails a loss of control of their premises and of the ability to take decisions on tenant mix. Landlords also argued that lease protection hands excessive negotiating power to tenants many of whom are very large international businesses, as summarised above.
 - Most of the tenants and prospective tenants who engaged with our review argued that lease protection is harmful on the grounds that it denies them the opportunity to occupy units located in railway stations. Opportunities to bid on the open market come up only very rarely because sitting tenants always exercise the right to renew; railway stations are seen as potentially lucrative and reliable trading locations.
 - Some landlords, and in particular those tenants who are currently net beneficiaries of lease protection, stressed that the protection offered under the 1954 Act can be important to provide small businesses in particular with security of tenure in order to mitigate the lack of certainty and secure a return on investment in fit out costs.
 - We were not, however, provided with a large volume of evidence that made a compelling link between protection under the 1954 Act and levels of investment. Particularly at larger stations, investment in station catering continues to take place in new outlets without the benefit of protection under the Act.

- 3.13 Both landlords and tenants told us that the cost of opposing renewal or renegotiating the terms of a protected lease can, particularly from the perspective of small businesses, be disproportionately high and can consume a significant amount of time. Landlords told us this was a material factor influencing their decision to rarely oppose the renewal of protected leases. This often results in the sitting tenant benefiting from favourable terms.
- 3.14 During our market study we met with, and received written submissions from, several landlords and tenants who are currently and/or prospectively active in our sector. Of the seven possible grounds of opposition to lease renewal that the 1954 Act provides, our review only found evidence of the use of ground (f), whereby repossession is necessary for a landlord to carry out a necessary demolition or work of construction¹. Our interpretation of the evidence made available to us was that, in all but very unusual/exceptional circumstances, in our sector ground (f) provides the only realistic means of opposition.
- 3.15 We did not discuss the other grounds in detail with stakeholders but found evidence of:
- a common perception of a ‘prevailing wind’ acting against landlords in the courts in the case of grounds (a) to (c);
 - limited relevance of ground (d) due to the limited space available within rail stations;
 - infrequent applicability of ground (e) owing to prohibitions on sub-letting; and
 - station operators typically not being in the market to occupy their own retail outlets.
- 3.16 During our market study we were told that demolition or reconstruction is costly from the perspective of rail operators, firstly given the often high costs of construction work in a rail environment (reasons for this can include factors such as listed station buildings) and secondly given the disruption to a normal retail offering that such works will often cause, particularly in environments that are only served by a small number of outlets.
- 3.17 Our market study found that, when redeveloping a retail unit, a landlord such as Network Rail will calculate an Internal Rate of Return (IRR), to be compared with

¹ As the Law Commission will be aware, the full list of grounds is: (a) Repair Obligations; (b) Persistent Rent Delay; (c) Other Breaches; (d) Suitable Alternative Accommodation; (e) Property Reletting; (f) Demolition or Reconstruction; and (g) Owner occupation.

pre-agreed hurdle rates. Whilst the direct costs of redevelopment will typically dominate such a calculation, we were told that the costs of statutory compensation can have a material impact on economic viability.

- 3.18 A response to our market study prepared by an agent which acts on behalf of several station operators included an indicative worked example based on its experience in the sector, showing that a combination of statutory compensation and the direct costs of development could amount to a high multiple of the rateable value of a station property.
- 3.19 The evidence provided to us during our market study showed that a redevelopment undertaken purely to enable a landlord to bring in new tenants will rarely, if ever, make economic sense. Stakeholders described to us situations where landlords held long-running but ultimately unrealisable ambitions to remove tenants that they considered were offering poor value.
- 3.20 We were told that lease protection gives sitting tenants a strong advantage in negotiations with landlords. The value of protection to tenants who hold protected leases was shown by our analysis of contemporaneous internal documents provided to us by landlords. We found that tenants whose request for a renewed tenancy has been opposed by a landlord under ground (f) will carefully consider whether they would have any chance of successfully challenging the landlord's claim.
- 3.21 The impact of the strength of negotiation power afforded to tenants by the 1954 Act is particularly acutely felt in a market that is to a degree dominated by the presence of large well-resourced and long-established businesses that already benefit from a strong negotiating position (and who are well resourced to negotiate leases outside the 1954 Act). We understand that it is not the intention of the 1954 Act to further strengthen the negotiating position of strong businesses in this way.

The applicability of our market study's findings to our submission to the Law Commission

- 3.22 The balance of the evidence made available to us during our market study suggested that the impact of the 1954 Act on rail sector retailing is negative. Competition between tenants is a potentially important means by which value for money could be driven in this sector, but lease protection under the 1954 Act is the single most important factor restricting such competition. Our market study found little evidence of countervailing benefits of lease protection, other than perhaps in the case of the smallest tenants – but in the rail catering sector, the

primary beneficiaries of protection under the 1954 Act are companies of a size who are our view not the intended beneficiaries of its protections.

- 3.23 Our review, covered stations in Great Britain (GB), thereby encompassing stations Scotland, albeit that the 1954 Act does not apply there. This breadth enabled us to carry out a limited comparison between otherwise similar markets where the 1954 Act did and did not apply. Whilst we were not able to carry out any formal analysis, some of our evidence did suggest that ScotRail (a Scottish train operating company, publicly owned by Scottish Rail Holdings on behalf of the Scottish Government) adopts a relatively proactive approach to its station catering offering. Our review did not find any evidence that the Scottish market has suffered through not falling under the 1954 Act.

Market study recommendations with regard to lease protection

- 3.24 Our market study recommended that landlords should contract out of lease protection for all future leases.
- 3.25 We also recommended that landlords should take every opportunity to move away from existing protected tenancies (by way of agreed surrenders, renegotiation, or by opposing renewal as permitted by the 1954 Act where appropriate) to minimise protected tenancies and open up leasing within stations to be more flexible and competitive. Landlords agreed with us and have committed to reducing the number of protected leases where feasible. Our proposals have also had the support of the DfT.
- 3.26 Our recommendations received general support from businesses except those understandably who already hold protected leases.

4. The scope of the 1954 Act

- 4.1 The consultation asks whether the scope of the 1954 Act should be changed.
- 4.2 The balance of the evidence that was made available to us during our market study suggested that the impact on retail in railway stations of arrangements around security of tenure in the 1954 Act appears likely to be negative, for the reasons summarised in the previous chapter of this submission.
- 4.3 We consider that it would be proportionate and beneficial to expressly exclude tenancies of premises within railway stations from Part II of the 1954 Act as one of the named exceptions under section 43. Such a step would in our view be beneficial given that lease protection under the 1954 Act currently acts as the largest single entry barrier in the market for station catering.
- 4.4 This change would in our view be proportionate given the relatively clear demarcation between railway and non-railway properties, and the relatively large size of this market, which per chapter 2 of our market study report, looks set to move towards £1bn pf passenger spend per year by the end of the current five-year rail control period (CP7, which runs to 2029).
- 4.5 The Law Commission may wish to consider whether there are any other markets which share the characteristics of station catering which give rise to significant entry barriers due to lease protection. An example of a key factor that the Law Commission could take into account would be tenant size. The largest tenants often benefit from nationally or globally known brands to an extent that was less common at the time the 1954 Act came into effect, making them less likely to be reliant on a continued presence in a particular location. This makes them relatively less likely to be 'captive' to a specific retail location. Such tenants will also typically benefit from the legal and management resource that may be needed to enter lease negotiations from a position of strength.

5. Models of security of tenure

- 5.1 The consultation asks which model of security of tenure should operate.
- 5.2 As explained in the previous section of this submission, the balance of the evidence that was made available to us during our market study suggested that the impact on retail in railway stations of arrangements around security of tenure in the 1954 Act appears likely to be negative. This leads us to propose that if tenancies of premises within railway stations and other markets with similar characteristics were to stay within the scope of the 1954 Act, that a reduced level of lease protection should apply by moving away from a default right to renew position and by lessening the burden of statutory processes for opposing renewal and contracting out.
- 5.3 Our market study gathered a modest amount of feedback from stakeholders on aspects that would improve the functioning of the 1954 Act, such as simplification of statutory processes and we would be glad to share this detail with the Law Commission in the next phase of its review should it be required.
- 5.4 The stakeholder engagement which formed a key part of our market study provided us with some limited insights with the issues identified by the Law Commission with respect to the potential distortion of terms that were negotiated on the basis of the current 1954 Act. We would be happy to discuss these insights with the Law Commission as helpful. Topics for discussion might include phased changes over periods of around 5-10 years.



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