IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2018] UKUT 0019 (LC)
Case No: RA/12/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – Valuation – hereditament – bulk liquid storage depot and premises – contractors test - Modern Equivalent – stage 1 construction costs – stage 2 adjustments – stage 5 "stand back and look" – Schedule 6, Para 2(1) Local Government Finance Act 1988 – Rateable Value determined at £1,165,000

IN THE MATTER OF AN APPEAL FROM THE VALUATION TRIBUNAL FOR WALES

BETWEEN:

SEMLOGISTICS MILFORD HAVEN LIMITED	**Appellant Ratepayer**
- and -	
STEPHEN WEBB (VALUATION OFFICER)	**Respondent**

Re: Petroplus Tank Storage, Waterston, Milford Haven, Pembrokeshire SA73 1DN

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Hearing dates: 17-20 and 23 October 2017

Before: His Honour Judge Nicholas Huskinson and Paul Francis FRICS

Royal Courts of Justice, Strand, London WC2A 2LL
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Richard Glover QC instructed by Burges Salmon LLP, Solicitors, for the appellant ratepayer
Sarabjit Singh and Isabel McArdle instructed by HMRC Solicitors' Office for the respondent

The following cases are referred to in this Decision:

Dawkins (VO) v Royal Leamington Spa Corporation (1961) 8 RRC 241
Monsanto v Farris (VO) [1998] RA 217
Eastbourne Borough Council v Wealden District Council v Allen (VO) [2001] RA 273
British Car Auctions (t/a Blackbushe Airport Ltd) v Hazell (VO) [2015] RA 108
Imperial College of Science and Technology v Ebdon [1985] 1 EGLR 209 and [1987] 1 EGLR 164
Allen (VO) v English Sports Council [2009] RA 289
Civil Aviation Authority v Assessor for Strathclyde [1990] SLT 378
Foster Yeoman Ltd v Assessor for Highland and Western Isles Valuation Joint Board [2005] RA 189
Colville & Sons Limited v Lanarkshire Assessor [1922] SC 460
Shell UK Exploration and Production Ltd v Grampian Assessor [2000] RA 295
Mersey Docks & Harbour Board v Assessment Committee of Birkenhead [1901] AC 562
Robinson Bros (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee [1937] 2 KB 445
Eton College v Lane (1969) 17 RRC 331
Gilmore v Baker-Carr & Others (1963) 10 RRC 205
Winchester City Council v Handcock [2006] RA 265
United Kingdom Atomic Energy Authority v Highland and Western Islands Joint Board Assessor [2006] RA 153

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DECISION

Introduction

1. This is an appeal from a decision of the Valuation Tribunal for Wales ("VTW") dated 22 December 2015 which determined the rateable value of the land and premises described as "bulk liquid storage depot and premises" at Waterston, Milford Haven, Pembrokeshire SA73 1DR ("the appeal hereditament") in the compiled 2005 rating list at £1,442,000 with effect from 1 April 2005. The appellant ratepayer, SEMLogistics Milford Haven Limited ("SEM") argued in its statement of case for a rateable value of £750,000. Mr Stephen Webb, the respondent Valuation Officer ("the VO"), ascribes a rateable value of £1,458,000 but does not appeal the figure determined by the VTW.

2. Mr Richard Glover QC of counsel appeared for the appellant ratepayer and called Mr Christopher Thomas, who has been Finance Director of SEM for the past seven years, and was previously Finance Manager for the then owners, Petroplus Tank Storage Milford Haven Ltd, commencing work at the appeal hereditament in 1998. He provided a total of four witness statements giving extensive factual and background information relating to the hereditament and the company's activities thereon, and comments upon the reports and opinions of the respondent's witnesses. Mr Paul Needham FRICS, a consultant to Gerald Eve LLP, Chartered Surveyors and Property Consultants of London W1 and a rating valuation specialist particularly in respect of heavy industrial hereditaments in South Wales, gave expert valuation evidence. Expert evidence on the oil storage market, its economics and the UK's and SEM's position within it was given by Mr Richard Kellaway MA FEI, an independent consultant to the oil industry and former Senior Adviser to Global Infrastructure Partners. Mrs Jean Martin B Eng C Eng, Managing Director of Insite Technical Services Ltd, project management and design services to the energy sector, gave expert evidence relating to engineering aspects and the design, layout and construction of a modern equivalent terminal. An expert witness report on dredging was provided by Mr Martin Maloney, a consultant to Anthony D Bates Partnership LLP, but his evidence was considered uncontroversial and he was not therefore called.

3. Mr Sarabjit Singh and Ms Isabel McArdle of counsel appeared for the respondent VO and called Mr Christopher Brown BSc C Eng MI Chem E, Senior Chemical Engineering Associate of PDC (Petroleum Development Consultants) Ltd and former director of Wood McKenzie, London who gave expert engineering and market evidence. Mr Robin Hughes BA (Econ) FRICS Dip Rating IRRV (Hons) a Member of the VOA National Specialists Unit with responsibility for the rating assessments of specialist industrial properties throughout England and Wales gave expert valuation evidence.

Appeal background & relevant facts

Appeal history

4. The appeal hereditament was originally part of a larger site (over 400 acres) owned and operated as a refinery by Gulf Oil Refinery Ltd. In 1997 the refinery closed and was sold in 1998 to Petroplus International BV ("Petroplus") who then, in 1999, started to operate it purely as an oil storage terminal. Part of the site which included one of three deep water berths (berth 1) was subsequently sold for development as a liquefied natural gas (LNG) terminal to Dragon LNG in November 2004, that development being commenced in 2005 and completed in 2009. The remainder of the land, now forming the appeal hereditament, and which is described more fully in paragraph 8 below, was sold by Petroplus to SemGroup Ltd in 2006.

5. SemGroup was an American 'midstream' oil trading company and acquired the appeal hereditament to support its planned expansion into Europe. The plan was to store the Group's own product and contract out any unused storage capacity to third parties. The Welsh operation was subsequently renamed SEMLogistics Milford Haven Limited.

6. On compilation of the 2005 rating list, the appeal hereditament was assessed at £2,550,000 and described as "oil refinery and premises". That valuation included the land and assets that had been sold to Dragon LNG Ltd in November 2004. The list was therefore altered to show the appeal hereditament described as "bulk liquid storage depot and premises" at a rateable value of £1,750,000. Following a proposal made on the ratepayer's behalf on 4 July 2008, the VO referred it as an appeal by the appellant to the VTW. Pursuant to a two-day hearing in January 2015 the VTW determined in a decision dated 22 December 2015 that the rateable value be reduced to £1,442,000 with effect from 1 April 2005. The appellant ratepayer gave notice of appeal to this Tribunal on 13 January 2016.

7. The Antecedent Valuation Date ("AVD") is 1 April 2003 and the material day is 1 April 2005. On that date, the refinery process units and its associated pipework, a number of buildings and general refinery related infrastructure were still on site. Whilst the refinery process units were subsequently removed in 2008 pursuant to a sale to Bosicor Oil Ltd and sent for re-use at a refinery in Pakistan, many of the buildings, roads, electrical supplies, substations and other refinery related infrastructure remained. Accordingly, although the site was assessed as a storage depot for oil storage etc, it was not purpose-built for that sole use having much now redundant infrastructure and considerably more land than was in reality required for the storage operation alone.

8. The appeal hereditament as it stood at the AVD, extended to some 260 acres and contained, in addition to the disused and decommissioned refinery, 79 storage tanks of varying capacities, 53 of which are agreed to have had commercial value, including two (tanks 2 and

11) which were temporarily out of use at the material day. The agreed arithmetical total volume of the 53 tanks was circa 1,356,180 cubic metres (m^3) assessed by external measurement (the method used in the VOA Costs Guide referred to in the evidence). The tanks included open top tanks, those with fixed roofs and those with 'external floating roofs' ("EFRs"). The site included a number of buildings and offices, 13 electricity substations, general infrastructure (set out more fully in the evidence summarised below) and the two remaining berths/jetties: berth 2 capable of accommodating vessels of up to 165,000 deadweight tonnes (DWT) and berth 3 for vessels up to 18,000 DWT.

9. It is agreed between the parties that the nature of the appeal hereditament is such that this is a case where it is necessary to adopt the contractor's basis of valuation for the purpose of arriving at the appropriate rateable value. The Guidance Note issued by the Professional Institutions' Rating Valuation Forum dated 1995 (the relevant such guidance as at the agreed valuation date of 1 April 2003) states at paragraph B 1:

> "The "traditional" explanation of the theory underlying the adoption of the contractor's basis is that the hypothetical tenant, instead of taking the subject property at a rent, has the option of building a precisely similar property for his own occupation, and that his rental bid for the subject property will be related to the annual equivalent of the capital cost of providing the site for and of building such a property"

The Guidance Note provides in relation to the contractor's basis that the recommended approach to such a valuation comprises the five component stages listed below:

> Stage 1 – Estimate the replacement cost of the site works, buildings, rateable structures and rateable plant and machinery.
>
> Stage 2 – Adjust the replacement cost to reflect any deficiencies in the buildings etc.
>
> Stage 3 – Value the land.
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> Stage 4 – Decapitalise the sum of stage 2 and stage 3 by the appropriate interest rate.
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> Stage 5 – Stand back and look at the result of stage 4 and make any further adjustments considered appropriate.

10. It is recognised (and the parties agree) that it is not necessary in all cases where the contractor's basis is being applied to assess the cost of building a precisely similar property. This is because the hypothetical tenant, when deciding how much to bid for the hereditament, will have in mind as a potential alternative their ability to construct for themselves their own property – which they could do to a modern and more convenient standard and layout insofar as the actual hereditament is old and poorly laid out. This potential alternative property which the hypothetical tenant could in theory construct is known as the "modern equivalent" or "modern substitute".

11. An important feature of the present case, as has been explained above, is that the appeal hereditament as at the AVD was not a purpose-built terminal for oil storage, but had instead originally been constructed and operated as a refinery with associated oil and other storage tanks. It was therefore agreed that the modern equivalent was a relevant consideration, but the parties vehemently disagreed as to its scope in this appeal.

Statutory provision

12. Paragraph 2(1) of Schedule 6 to the Local Government Finance Act 1988 provides that:

> "The rateable value of a non-domestic hereditament … shall be taken to be the amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year on these three assumptions:
>
> a) the first assumption is that the tenancy begins on the day by reference to which the determination is to be made;
>
> (b) the second assumption is that immediately before the tenancy begins the hereditament is in a state of reasonable repair, but excluding from this assumption any repairs which a reasonable landlord would consider uneconomic;
>
> (c) the third assumption is that the tenant undertakes to pay all usual tenant's rates and taxes and to bear the cost of the repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command the rent mentioned above"

Issues

13. It follows from the above that the rateable value is to be assessed by reference to the amount at which this hereditament (with its various advantages and disadvantages) might reasonably be expected to let from year to year upon the statutory assumptions. The disadvantages to which the appellant drew attention as being matters which would decrease the notional rent paid by the hypothetical tenant included in particular the following. The unwanted presence of the refinery (a continuing liability); the unsatisfactory layout of the site (laid out not as an oil terminal but as a refinery with the tanks being designed to support the refinery); the unsatisfactory nature of various of the tanks including their age, size and design; the consequential additional running costs of a site constructed originally as a refinery as compared with the costs of running a modern and purpose designed oil terminal; and the excessive dredging requirements at the jetties. The appellant also drew attention to what it said was the unpromising state of the market as at the AVD for oil storage, to the poor prospect for any improvement in this in the near future and to what it said was (in consequence) an overprovision of capacity at the site for oil storage which would result in underutilisation of the tanks. There were also issues regarding the allegedly poor location of the hereditament in comparison with competitors in the market, and the effects that has on trading prospects.

14. The nature of the development which the hypothetical tenant should be taken to have in mind (as the notionally available alternative to renting the appeal hereditament) and the extent to which the concept of the modern equivalent affected the valuation process in the present case was the foundation upon which this dispute rests. There was in consequence disagreement between the parties upon numerous points including in particular:

1) Essentially, he appellant's approach at **stage 1** was to assess the cost of constructing the hereditament; but then, at **stage 2,** to make adjustments to reflect the hereditament's disadvantages (other than over-capacity and underutilisation) by reference to an oil terminal (the modern equivalent) which was in some respects different from and less extensive than that which the respondent contended for. The principal disagreement under this head was the question of the nature of the tanks which were to be assumed to be constructed. The appellant argued for tanks with aluminium domed roofs and internal floating roofs ("ADR/IFR") over the stored fluid, whereas the respondent contended for the continuation of the use of External Floating Roofs ("EFR"s). There were also issues over the extent and nature of the construction of the tank farm which was to be assumed as regards lighting, bunds, underground services, electricity substations and roadways.

2) There was further disagreement at **stage 2** in the valuation process, regarding whether, in addition to any allowance to reflect tank capacity for which the hypothetical tenant would have no use, there should be an adjustment made to reflect what the appellant contended would be underutilisation of the tanks and of the jetties. The appellant contended that the cost of construction of the notional alternative development would not represent its value because certain aspects of it would potentially not be used at all and others would be only lightly used and therefore would carry more limited value into the hands of the hypothetical tenant as compared with other aspects of the development. In particular, it was argued that, having regard to the state of the oil storage market as at the AVD, the prospects were that at most if not all times substantially less than the 1,356,000 m^3 total capacity of tanks would be used, such that the effective capital value of the notional alternative development would be substantially less than the actual construction cost.

3) The maximum rent which the hypothetical tenant would be prepared to pay on the statutory terms for this notional alternative development would reflect value not cost. Accordingly, it was necessary to adjust downwards the cost of constructing the tanks to reflect this underutilisation. A similar argument was advanced in relation to the cost of construction of the two jetties – it being pointed out that the two existing jetties were constructed to serve an oil refinery. It was common ground between the parties that the concept of the modern equivalent justified the assessment of the cost of constructing not two jetties exactly the same as existed, but instead two jetties where the major jetty was of a length and specification less than the existing major jetty. However, the appellant went on to argue that this cost should be discounted to reflect the fact that this notional new jetty would be used on a far less regular basis than the actual jetties were used when the site was used for its original purpose and accordingly the hypothetical tenant would be getting limited value for the large cost of construction.

4) There was disagreement as to what if any adjustment should be made at **stage 5** to reflect the fact that (so the appellant contended) the hypothetical tenant taking the hereditament upon the statutory terms would find that they had a site which:

a) was old and ill laid out and therefore substantially more expensive and less convenient to operate than the notional modern equivalent, and

b) came with an unwanted refinery (or at least the rateable parts of that refinery) which the hypothetical tenant would have to maintain in accordance with the statutory terms, and (in particular) would have to keep inspected and protected from any potential dangers, especially possible explosion from remaining hydrocarbons within the installation.

5) There was also disagreement regarding the state of and prospects for the oil storage market as at the AVD – this being a point of potential relevance upon the underutilisation argument and also upon the extent of any eventual end allowance that should be made at stage 5 so as to reflect any relevant disadvantages in the market.

15. At the commencement of the hearing the appellant's assessment of the appropriate rateable value to be entered into the 2005 rating list was £750,000 although as the proceedings progressed, and various issues were either agreed or adjusted, Mr Needham amended his final valuation to £830,000. Mr Hughes' valuation for the respondent amounted to £1,458,000 and that figure was not amended. However, it was the respondent's position that the VTWs determination at RV £1,442,000 was not excessive and it was content therefore that the assessment should remain in that sum.

16. At an early stage in the proceedings we indicated to the parties that we considered it would greatly assist our analysis in the case if we were presented with an *agreed* document in the form of a "Scott Schedule" that indicated the specific topic headings in issue and the amount which actually turned upon such disagreement. A version had been included in Mr Needham's rebuttal report (p2413) but this was understood to be unagreed and did not in any event show the parties' final positions. A final, more comprehensive version, was in due course provided (page 3799L of the bundles). From this, it was clearly evident to us that the principal points in issue were:

(a) the tanks and tank bases where the difference between the parties in terms of rateable value at stage 4 was £322,921 (based upon the proper application of the modern equivalent concept and upon the underutilisation argument) and the tank bunds where the difference was £29,376 (on the basis of substantially the same points of disagreement);

(b) the jetties where the difference between the parties was £135,984 (the underutilisation argument);

(c) the site infrastructure where the difference was £85,965 (based upon the proper application of the modern equivalent concept and upon claimed allowances);

(d) fire protection where the difference between the parties was £15,577 (again based upon the modern equivalent concept and claimed allowances);

(e) the extent of the end allowances to be made at stage 5 of the valuation.

17. The expert witnesses provided in bundle 21 joint experts' reports, whereby each expert of corresponding expertise (apart from Mr Maloney as he was the sole expert on dredging) prepared a list of issues which had been agreed or which remained in issue, and set out the parties' final positions thereon. This was a useful exercise for which we are grateful. We do not however consider that it is necessary for us, for the purpose of deciding the present appeal, to attempt to resolve each and every one of the remaining points of disagreement as between the experts effectively on a 'line-by-line' basis (see paragraph 20 below).

18. During the course of the hearing it did occur to us that, bearing in mind the site's infrastructure is of considerable age and was designed as a refinery rather than an oil storage terminal, an appropriate method of approaching the valuation upon the contractor's basis in the present case might be to go at stage 1 of the process straight to the valuation of a modern equivalent rather than to the valuation of, in effect, the actual site and rateable plant – with allowances for the differences between costings of the actual site and the modern equivalent being made only at stage 2. We observe that the RICS Guidance Note contemplates this possibility in exceptional cases at paragraph 3.1.3. However, neither Mr Needham nor Mr Hughes approached their valuation on this basis. Also, neither Mr Richard Glover QC for the appellant nor Mr Sarabjit Singh for the respondent suggested that this would be an appropriate course. Accordingly, we have concluded that we should not pursue a valuation involving at stage 1 going to the estimated cost of building a modern equivalent. Instead, the concept of the modern equivalent and the nature of such is of use in assessing whether certain aspects of the actual site should be treated as omitted or constructed in some other manner at stage 1 and in assessing at stage 2 what allowances should be made for obsolescence, whether physical, functional or technical (see paragraph 3.2.2 of the Guidance Note).

19. At the conclusion of the hearing we enquired whether we were invited to inspect the site. The respondent did not invite us to do so. The appellant invited us to consider doing so but left it to our discretion as to whether a site visit would in fact help us in our deliberations. Our provisional view was that a site visit would not assist, bearing in mind the nature of the questions before us (which do not include the consideration of any valuation evidence in the nature of comparables) and the fact the AVD is 1 April 2003. We have kept the question under review during our deliberations, and have finally concluded that we would get no benefit from a site visit, especially bearing in mind the availability of photographs of the site, extensive and detailed plans and of a full description in the evidence before us.

20. We now summarise what we consider to be the principal features of the evidence given to us by the several witnesses. We have had regard to all the evidence whether referred to below or not. At the hearing, it was recognised by both parties that it would not be practicable or proper to invite the Tribunal, once we had decided the relevant matters of principle between the parties, ourselves to work through all of the relevant figures in the respective valuations and to come to a final conclusion as to the rateable value. The difficulty of doing this will be apparent if we mention that Mr Needham's valuation extended to 607 separate lines, each line of which could include an entry in up to 18 columns and Mr Hughes's valuation extended to 324 lines each line of which could include an entry in up to 15 columns. We were invited, once we had decided the points of principle, to issue a preliminary decision upon these points and to invite the parties to submit what would (it is hoped) be an agreed valuation on the basis of such decision. If no such agreement can be reached the parties will have to submit further

representations and we will need then to consider how to proceed and whether any further hearing is required. However, it has been possible for us (as will become evident) to reach a conclusion in respect of some of the figures and percentages, so it is hoped that the valuers will find it possible to fill in any remaining gaps.

The evidence

21. **Mr Thomas** described the history and layout of the site, it originally having been developed for oil refining at this location due to its deep water harbour and the availability of land at Milford Haven on or close to the waterfront. Certain disadvantages for a refinery site at this location in due course emerged and the refinery closed in 1997. The redundant refinery process plant was present on the site, Mr Thomas explained, at dates relevant to the present case – it eventually being removed in 2008. In late 2004 an area of the site and one of the three deep-water berths was transferred to Dragon LNG for development as an import terminal for liquefied natural gas (this piece of land does not form part of the appeal hereditament). Geographically, the location for storage purposes has the advantage of being accessible by large oceangoing ships. However, in market terms, it has the disadvantage of being a long way from the prime Amsterdam/Rotterdam/Antwerp ("ARA") location for oil terminals. Also, access by water is effectively the only method of bringing oil products to or taking them from the site. There is no longer any or any acceptable connection to the mainline pipeline system which takes products underground from Milford Haven to other key terminals and distribution points throughout England and Wales. Further, the highway network by which road tankers might access the site is very poor. Mr Thomas drew attention to various aspects of the site which were inefficient, inconvenient or excessive for an oil terminal use because they had been designed originally for a refinery. By way of example there are 13 electricity substations on the site positioned and equipped for supplying a refinery. As at the AVD far less by way of substations were required (and Mrs Martin in her design of the modern equivalent allows for only three). Further observations were made regarding drainage infrastructure, water treatment, fire protection system, roads and bridges, street and other lighting, air compressors, buildings, and periphery fencing. It was pointed out that the total area of the hereditament, at 260 acres, was precisely twice that which Mrs Martin had calculated as the area needed for housing a modern equivalent.

22. It was also pointed out that when the site was used as a refinery there was a continuous production process from raw materials (crude oil) to numerous refined products and that these distillation products were fungible and flowed through the same lines to tanks which stored the same product type with the new product being loaded on top of the product already stored within the tank. The site was designed with this in mind, however as a storage facility the layout and range of tank sizes is inflexible, inefficient and inconvenient. There is the need to store different products for different customers, and there has to be the opportunity for the same quantity delivered being returned to the customer (whose delivered parcel cannot be mixed with that from another customer and therefore must be stored separately). A storage facility therefore requires suitably sited and appropriately sized tanks for customers' requirements; the ability to redeliver efficiently all the customer's products and therefore the capability completely to empty a tank; and a simple pipeline and pump system allowing for fast product transfers to and from the tanks to the vessels without any risk of cross-contamination.

23. Mr Thomas said that the existing tank sizes and ranges were unsatisfactory especially having regard to the three very large tanks each of about 100,000 m³. He explained that, based upon the main build-bulk and break-bulk business at the terminal, a modern purpose-built terminal would need to have tanks sized at approximately 40,000 m³, 20,000 m³ and 15,000 m³ in order best to meet the requirements of customers. He also said that a modern terminal would install geodesic domes on all tanks with an internal floating roof upon the liquid in the tank beneath the dome (ADR/IFR) as that represented the best option for a terminal operation rather than an external floating roof (EFR) which had various disadvantages. These included the accumulation of rain upon the surface needing draining, the weight of such a roof and the potential damage from its landing on the base when a tank was emptied.

24. It was explained that the various disadvantages of the site, as compared with a modern equivalent oil terminal, gave rise to substantial additional operating expenses. He prepared an analysis of these which was presented in a table at exhibit CT 19 and involved additional expenditure over the following separate headings, namely tank bottom pumping, line flushing, tank transfers, roof water drainage, tank inspections, treatment of line flushes and tank bottoms, EFR maintenance, slow pumping rates, water treatment, site electrics, pump maintenance, pipeline manual line-ups, pipe line maintenance, road and bridge maintenance, fire system maintenance, energy efficiency, air compressors, perimeter fence, and inspection of asbestos (but not including removal). He indicated how he had estimated these figures and the total additional expenditure came to £598,000 per annum. This did not include additional dredging costs. Nor did it include the additional costs attributable to maintenance/safety obligations regarding the refinery plant which would be unused and unwanted by the hypothetical tenant. Mr Thomas agreed that his figures in CT 19 were based in part upon his estimates (using his background and experience within the business) rather than on specific data as many of the historical records going back to the AVD had been lost.

25. Mr Thomas in his exhibit CT 39 produced a table of the unwanted costs of having to maintain and keep safe the refinery. During the course of his evidence he agreed that the figure he had allowed for "third-party maintenance" was not something that should have been included, so in the result the additional annual costs were approximately £162,000 made up from the costs of nitrogen purging (so as to remove the risk of conflagration of any remaining hydrocarbons), storm damage, asbestos inspection, insurance, additional staff time, water sampling and inspection, and testing the fire protection system. Included in CT 39 was a document he had found on SEM's computer system apparently being records from the then occupiers of the site, Petroplus Tankstorage Milford Haven Ltd, showing costs in relation to these headings over the period between 1999 and 2005. Mr Thomas agreed that he did not know who had prepared it, or when, or on what data, or for what purpose. He did however say that, in the light of his personal experience working at SEM since 1998 and with his responsibility as a finance officer and then finance director, the topic headings for expenditure in relation to the refinery were genuine heads of expenditure which did have to be incurred, and that the measure of the expenditure shown on his CT 39 was in his judgement broadly representative of what could reasonably be expected to have been incurred as at the AVD.

26. Mr Thomas then went on to describe the terminal business opportunities available to the operator of the site:

Break-bulk storage: Where a large cargo delivery to the terminal is broken down into smaller loads for onward transmission.

Build-bulk storage: Smaller cargoes being aggregated into larger loads.

"Contango" storage: When the forward (i.e. future) price is higher than at the date the storage contract is entered into. Thus demand for storage is high as traders hedge on the expectation future delivery prices produce a profit after covering the "buy" price and the associated operational costs of storage and shipping.

Arbitrage: Purchase, sale and movement of supplies to take advantage of price variations in different markets internationally.

Mr Thomas explained that the corollary to contango was "backwardation" which is where the forward price structure is lower than the present day, and thus there is no incentive for traders to enter into long term bulk storage contracts. Storage demand is therefore reduced and can become unprofitable where the price is falling. It was agreed that this is the market that was in place at the AVD.

27. As the terminal is located away from the ARA region and the main consumption markets in the UK, Mr Thomas said the ability to take advantage of break-bulk opportunities is limited and mainly involves supplies into Ireland - the preferred locations of break-bulk into the UK being terminals at Avonmouth, Southampton and on the River Thames. The build-bulk activity is mainly in gasoline principally for export to the USA and Africa. Large oil traders have used the terminal to undertake such contango trades when oil prices are favourable, but this market is dependent on the level and structure of the oil price and tends to be short-term. When the changes in the future oil price beyond a limited timeframe are uncertain, this results in a changeable demand for storage at the terminal on a speculative trading basis. As regards arbitrage, such opportunities are dependent on the price for certain oil products in certain regions being different allowing oil traders to transfer the product at a profit. There is a potential market for the terminal in arbitrage between Europe and North America, but such opportunities tend to be temporary and uncertain. There was no significant business opportunity for supply to and from local refineries nor for other crude oil storage. There was however an opportunity for storage as part of compulsory stock obligations pursuant to which member states of the EU are required to hold minimum oil stocks. For Ireland, the National Oil Reserves Agency (NORA) was responsible for maintaining the government's requirements to meet its compulsory stock obligations and this did provide a market opportunity for the terminal, but the storage rates were low and the volume required was limited.

28. Mr Thomas described the extent and nature of the storage contracts in place during the period leading up to the AVD. Most of the contracts were for less than six months and the length of contract was declining (as indicated in exhibit CT 14). He said that the fact that certain tanks were kept open rather than closed or physically removed was not an indication of continuing need for the volume represented by such tanks – this was because there was a substantial cost in taking a tank off-line. He drew attention to exhibit CT 34 showing tank volumes leased as a percentage of available volume and of total site capacity. During the months December 2002 to April 2003 the leased volume was respectively 772,581 m^3, 742,132 m^3, 697,224 m^3, 697,224 m^3 and 515,480 m^3 being in each case much less than the total

available site volume (1,364,851 m³). This was a range of between 43% and 61% of that availability. However, he agreed that during the period from October 2001 to September 2002 the leased volume was in every month more than 800,000 m³ and in four months it exceeded 1,000,000 m³, the peak amount leased being 1,103,463 m³ (83% of available volume) in April 2002. Overall, the exhibit showed the average utilisation percentage between January 2001 and December 2003 at 56%.

29. In order to be able to make available to customers 1,100,000 m³, the highest volumes stored during the period analysed, Mr Thomas said it would be necessary to have a total available volume of no less than 1,200,000 m³. Asked about a planning application made in 2007 for permission to construct new tanks which would have actually increased total tank capacity, he explained that the application was not the result of a perceived need for such an increase. It was for the purpose of giving the operator an option for the future and as a protective measure against possible future tightening of regulations regarding such uses (there having been a recent similar concern locally in relation to LNG storage at the Dragon site).

30. Looking forward, Mr Thomas analysed the market and the outlook as at the AVD, as viewed from his perspective of the operator of the terminal on the appeal site. The conclusions he drew were that, viewed as at April 2003, for the period 2003 to 2005 the maximum forecast demand capacity was 718,000 m³ and that for the period 2006 to 2008 it was 760,000 m³. He did however agree that it would have been wrong to have assumed at the AVD that the then existing backwardated market would last forever.

31. Regarding the jetties and berthing area Mr Thomas said that the utilisation of the berths was higher during the refinery operating period because the plant had a continuous throughput of about 19,000 m³ per day, resulting in regular shipments in of crude oil and shipments out of the processed oils and gases. The product turnover at the storage terminal is lower as an analysis of the berth utilisation during 2002 and 2003 showed. For instance, in 2003 the average berth occupancy levels were berth 2 : 34%, and berth 3 : 12% measured in the actual hours the berths were occupied against the total hours available (berth 1 does not form part of the appeal hereditament). Further, it was the appellant's view that berth 2 was oversized for the terminal operation and what was really required was a capacity to deal with ships between 3000 DWT and 100,000 DWT, whereas the berth could accommodate vessels up to 165,000 DWT.

32. **Mrs Martin** is a chartered mechanical engineer with 25 years' experience in refining, consulting and managing mechanical integrity. She has a detailed knowledge of refinery assets including tank farms and their associated equipment and gave evidence to the following effect.

33. Describing the state of the appeal hereditament and in particular of the storage tanks and their associated equipment as at the AVD, she explained that the site was in effect an inheritance from Gulf Oil. The tanks were all inherited from this former refinery and were constructed for that former use rather than for a terminal operation. The result was that as at the AVD the site comprised many tanks of a wide range of types and sizes, not all of which were useful. Quite apart from the sizes of the tanks being in some respects inappropriate there were

also problems with the design of the actual tanks and the supporting infrastructure. These problems included inflexible pipe routes and pump connections; problems draining individual tanks so as fully to empty them (bottom pumping) which had been less of a requirement when a refinery was being operated at the site; the existence of an oversized drainage system; and the existence of an inappropriate and over complex electrical system that had needed 13 substations.

34. Mrs Martin provided at Appendix 3 of her report a design and specification for a purpose-built terminal with a similar storage capacity to that available at the actual terminal (c. 1,336,000 m^3) using technology, design and materials appropriate as at 1 April 2003. This modern equivalent was designed to meet the operating function of the actual terminal but with a layout and infrastructure devised to overcome so far as practicable its inherited disadvantages and making the best use of available space, all in accordance with the occupier's business needs. Assistance in formulating this exercise was gained from consideration of two modern purpose-built terminals: Alexeia in Estonia built by Puma Energy in the early 2000s and which came on stream in 2002, and Vopak Europoort which was extensively refurbished and developed around the AVD.

35. Mrs Martin explained the potential roof choices when building a storage tank and noted the advantages of an aluminium domed roof above an internal floating roof (ADR/IFR), these geodesic domed roofs being widely used as at the AVD. She adopted the use of such a design in her modern equivalent.

36. In accordance with information gained from Mr Thomas regarding the operator's requirements, Mrs Martin provided for 24 tanks of 42,765 m^3 capacity; 10 tanks of 22,619 m^3 capacity; 4 tanks of 12,723 m^3 capacity; and 4 service tanks with a combined capacity of 33,154 m^3. She explained why these sizes were optimal in terms of the terminal's specific business model and described the specific tank type and layout which she had adopted. She went on to explain the benefits of the adopted pumping and transfer systems and the nature of the bunds which would be necessary, these being of approximately 7,650 m in total length and 2.25 m in height. The overall site size required was about 130 acres, only half that occupied by the actual terminal. The requisite perimeter fencing would be approximately 5.1 km.

37. Mrs Martin explained how there would be far less contaminated water to be dealt with at the modern equivalent and thus a smaller water treatment system would be required. The electrical system would also be simpler and less power hungry than that installed for a refinery resulting in the need for only three substations rather than the 13 that currently exist. There would also be a reduced requirement for air compressor units; the volume of on-site traffic would be much lower on the smaller site, hence requiring a shorter roadway system and less bridges. The existing street lighting could be removed and dispensed with and by judicious moving of eight of the existing site floodlighting towers, sufficient illumination for the whole site and roads would be achieved. Smaller ancillary and office buildings would also be needed.

38. Mrs Martin considered the cost of construction of tanks of the size and specification included by her in the modern equivalent, being tanks with ADR/IFR, as compared with the

cost of construction of tanks as actually existed being EFR tanks and fixed roof tanks. She assembled information in her appendix 10 regarding the costs of constructing tanks with an EFR and she analysed this information to extract the relationship between the cost of the EFR as compared with the total cost of the tank plus the EFR. The information she provided was based on actual quotations supplied by Rhyal Engineering, some of which related to quotations after the AVD, but she adjusted those by an indexation method which she explained at paragraph 8.18 of her first report, so as to give a cost at the AVD. From this she concluded that, on average, the approximate proportion of the cost of a tank with an EFR which is represented by the cost of the EFR itself is 27%.

39. Information was also included regarding the cost of constructing tanks with the ADR/IFR roof system. She analysed costs for roofs of differing diameters and derived a cost for the tank roofs which would be included in her modern equivalent. The combination of her work and his analysis of the VOA's Cost Guide led Mr Needham to the overall conclusion that the cost of the ADR/IFR tanks in the modern equivalent would be likely to be in the region of 12.5% less than the cost of constructing the 53 tanks on the hereditament which he had costed at stage 1.

40. Mrs Martin concluded that the cost of a dome roof tank can therefore be estimated by determining the cost of an EFR tank (for which guidelines for rating purposes are available) and then by removing the cost percentage relating to the EFR itself so as to give the cost of the open top tank and by then adding the cost of an ADR/IFR for the relevant diameter of tank so as to obtain the overall cost for a tank with an ADR/IFR. She concluded that there was a significant cost saving to be made in constructing a tank with an ADR/IFR as compared with an EFR.

41. In cross examination Mrs Martin was challenged as to the reliability of her data and analysis in relation to the assessment of relative costs of tanks with ADR/IFR as compared with tanks with EFR. She did not agree that the data she had used mostly related to estimates rather than completed projects. She said that in general she did not use non-binding offers as part of the data. She was further challenged on the basis that the results of her analysis showed a substantial range of costs for an ADR/IFR and it was suggested to her that, bearing in mind this range, estimates were no better than class 4 estimates as contemplated by the AACE Recommended Practice in relation to the cost estimate classification system. This was not accepted as a valid criticism. She pointed out that the reason for the ranges in her figures was not because of lack of definition of what the project was but was instead because of variable conditions at the sites of the relevant tank installations. Also, the AACE document has been designed for process industries which is stated to include firms involved with the manufacturing and production of chemicals, petrochemicals and hydrocarbon processing. The operation at the terminal is not such an industry but is merely storage of hydrocarbons.

42. Mrs Martin was asked to comment upon the estimated costs of maintaining the unwanted refinery installation on the appeal site. She noted Mr Thomas's estimates regarding this as presented in CT 39. She confirmed the necessity of carrying on safety procedures in relation to the refinery installation especially in respect of nitrogen purging, because it would have been impossible to eliminate all flammable product and even years later this could present a hazard unless dealt with in an appropriate manner (the nitrogen would make the atmosphere inert so as

to remove the risk of explosion). She confirmed her view that it would be very reasonable for a person to spend six hours per day upon keeping the plant safe (as estimated by Mr Thomas).

43. **Mr Kellaway** has extensive experience working in the oil industry generally and especially the oil storage business. He provided an overview of the international oil storage market and the UK's position within it at the AVD, together with commentary on the economics of the UK independent storage market and its key drivers, with specific reference to SEM's facility at Milford Haven including its geographical location and its infrastructure at the material day. He also commented upon Mrs Martin's modern equivalent design.

44. Following a decline in refining in the UK during the 1960s and 1970s due to the oil producing countries (such as the Arab States) creating their own refineries and thus exporting the finished product rather than raw crude, together with new refining capacity being built in Russia, Korea and the Far East in the 1990s and 2000s, UK refineries became increasingly uneconomic and many were closed down – as happened in respect of the appeal hereditament. With oil and oil products (particularly diesel and kerosene) being transhipped via the principal European hub of Amsterdam, Rotterdam and Antwerp and the changing nature of oil product flows into the UK, a market developed for small independent storage companies to grow and develop to satisfy the oil market's storage needs.

45. The development of a futures market (in periods of contango) enabling companies to lock in oil supplies into the future and balance risks from supply shortages and seasonal peaks and troughs in demand, created a new requirement for storage. Examples of seasonally sensitive products include jet fuel which is in more demand in the summer, and kerosene for heating in the winter months. There was also temporary arbitrage between regions due to short term fluctuations in production and consumption factors, such as geopolitical factors and adverse weather conditions.

46. In the UK, the principal demand is for distribution facilities to deliver to the final consumer, most of which is catered for by the major oil companies who have their own storage farms (often shared), but some new independent companies such as Greenergy have also entered this market. Storage of the finished products from the regions mentioned above tends to be concentrated upon ports in the east and south of the UK where access from ARA, Europe in general and the Eastern countries is easier than in Wales and the west coast of England and Scotland. Cargoes need to be of sufficient size to make shipment economic. Particularly large cargoes can be broken down into smaller parcels ("break-bulk") at regional distribution level for transhipment to the point of distribution. Conversely, "build-bulk" can allow the same product to be built into larger parcels for onward distribution. This occurs particularly in the vast terminals of ARA.

47. The appeal hereditament's oil storage capacity is too large to be of interest to those such as major oil companies for storage exclusively of their own stock. It is also inconveniently located geographically for distribution around the UK in that the only realistic transportation method is by sea. Such a terminal has to provide sufficient flexibility to handle a range of liquid products which vary in type dependent upon the time of year. The most likely buyer or

hypothetical tenant would therefore be an independent storage company that rents its space to a series of third party customers. Mr Kellaway was particularly concerned that the three largest tanks of 100,000 m3 were overlarge for the type of clientele and levels of usage that were historically occurring. The business records showed few demands for storage of such large quantities, and as storage is contracted and calculated on tank size and not quantity stored a potential client wanting to store 80,000 m^3 might have to pay for a capacity of 100,000 m^3. Such costings were likely to be uncompetitive.

48. In Mr Kellaway's view the infrastructure at the appeal hereditament was clearly a legacy of its former use and it was inconvenient and costly to have so many different sized tanks. For instance, 11 of the tanks have a capacity of less than 10,000m3 which are too small to effectively store the size of cargoes that the terminal tends to deal with, and using a number of tanks to house one batch of a client's product is, obviously, much more expensive in terms of product handling costs. It was also noted that the size of these tanks is not well suited to products such as jet fuel which needs to be regularly tested prior to batching. Multiple tests over a range of different tanks only goes to further increase handling costs. In an ideal world, there would be only four sizes designed to cope best with the type of market that was being serviced. In his view however, Mr Thomas's stated preferences for three capacities: 15,000, 20,000 and 40,000 m^3 (rounded figures) were reasonable.

49. Mr Kellaway referred to a slide that had been used in a presentation by Wood McKenzie at the 2011 Tankstorage conference in Istanbul. This demonstrates the six principal markets for independent oil and related products storage worldwide at that time (although the situation was said to be the same at both the AVD and the material day). The slide showed a pyramid with the strongest markets at the base, and the weakest (or most difficult to achieve) at the top. It was common ground that the appeal hereditament could only effectively operate at best in only three of those six markets. The strongest and most lucrative market was entitled "Local Supply/Demand Fundamentals" which is basically local distribution to users within the hinterland of the terminal. This is a relatively risk free and high turnover business with rapid throughput, is therefore good in terms of cash flow, and is less seriously affected by fluctuations in the market generally. The appeal hereditament was not suitable for such a market due to its poor location and the fact that, with no suitable road or rail networks serving the facility, the only method for moving stock was by sea. Further, there were two other operating refineries at Milford Haven which had the requisite transport infrastructure, so the chances of achieving any of this business were negligible.

50. The second level, "Regional Transhipment", relates as its name suggests to the storage of cargoes before onward transhipment to another terminal rather than into the hinterland. An example is where the destination terminal's capacity is limited, and to minimise shipping costs on very large cargoes it is economic to "break -bulk" and store stock in the interim in a terminal that is closer to the destination than the original source. Bulk-build, as described by Mr Thomas, also falls into this category. Regional transhipment is probably the principal area that the appeal hereditament serves, but due to its position on "the wrong side" of the UK its market in England in particular is limited whereas, Mr Kellaway said, it is conveniently located (along with Clydebank, Eastham and Belfast, all of which are significantly smaller terminals in terms of capacity) for serving the Irish market, but that is a relatively small market and demand tends to be seasonal. However, in overall terms, he was of the view that Milford Haven was

very much a secondary location and was only used by customers when more convenient locations, such as ARA were not available or were at a premium. In general terms however, it was accepted that contract storage rates at the appeal hereditament were comparable with those at ARA.

51. The next two operations: "Blending" and "Niche Operations" are not markets that SEM Milford Haven serves, but the penultimate category, "Strategic Storage" is. This is where, as described elsewhere in this decision, EU countries have an obligation to store minimum reserves. In Ireland, which is an important market for this hereditament, strategic storage falls under the NORA scheme. Mr Kellaway agreed that most EU countries were permitted to meet their "emergency stockholding" obligations abroad and that there was no need for those emergency stocks to be held near major demand centres or trading hubs such as the ARA. Thus, he accepted that there was nothing to stop SEM holding stocks at Milford Haven for other countries, but it was a fact that overall there was adequate storage capacity in Europe and, in reality, stockholders prefer to be in the ARA area for its ease of access. Indeed, the records show that the only strategic storage contract ever undertaken by the terminal was the NORA one. The result of this analysis of which of the markets Milford Haven could or did compete in was that it is capable only of dealing with limited business streams and realistically only operates in two (strategic storage being virtually non-existent in his view), leaving it particularly exposed in a competitive market – this showing in its history of mixed profitability.

52. Finally, at the top of the pyramid, and thus considered the market with the least overall potential, is "Contango". It was described in the Wood Mackenzie report as the "icing on the cake", and whilst open to the appellant ratepayer this market is in Mr Kellaway's opinion erratic and can be extremely volatile. There must be sufficient margin (the difference between present "buy" price and the future price at which the product is to be sold) to cover traders' costs of storage and product transfer, onward shipment and fees. The inconvenient location of Milford Haven however, and the resultant increase in shipping/transportation costs, was a further disincentive for the appeal hereditament even in a contango market.

53. As to the terminal's capacity, Mr Kellaway agreed with Mr Thomas that, in order for it to meet the peak the demand that was achieved around the AVD, it would need to have a minimum capacity of 1.2 million m3. The market at the AVD was settled into a longer than usual period of backwardation, and although it picked up a little at the end of 2003, it fell back again before rising significantly in 2005. The use of the terminal fell from the peaks enjoyed in early to mid-2002 when storage at one point exceeded 1 million m3 (over 80% of available capacity) to a point at the AVD when only 43% was under contract. This was an indication of the state of the market at that time, and it was also of concern that, as Mr Thomas had explained, a very high percentage of the contracts were short term (less than 6 months in duration). The low level of long term contracts (which were the norm in the storage market) was a risk factor in terms of trading costs and profitability. With it being a buyers' market at the AVD, and there being plenty of storage available in the market generally, clients were far more likely only to require short term contracts. The operator would have to make concerted efforts to seek out business (as demonstrated by Mr Thomas's evidence on the operator's attempts to obtain emergency stockholding contracts), but the take up had been disappointing.

54. Not only was the market difficult for all independent storage operations in 2003 but Mr Kellaway thought the appeal hereditament was in an even worse position for attracting reducing levels of business due to its inconvenient geographical location – particularly in that it could not pick up local storage and distribution business. This left it wide open to the negative impacts of a backwardated market. Added to this was the fact, as demonstrated in Mr Thomas's evidence, that SEM's storage rates particularly around the time when the terminal was at its fullest, were low in comparison with other companies. Whilst he had agreed that to fulfil the peak occupancy figures achieved in 2002 at least 1.2 million m^3 was required, bearing in mind the average levels achieved at other times and particularly into 2003, an overall capacity of around 800,000 m^3 as suggested by Mr Thomas (whose predictions for future trading were optimistic to say the least) would have more than sufficed. In his view, an occupier running at the levels that were in the main being achieved would seriously consider rationalising the tankage to reduce fixed and variable costs. However, he accepted in cross-examination that there was historically a clear and relatively balanced cycle between backwardated and contango markets (although in the previous decade, the balance had been 70% backwardation against 30% contango). At the AVD, Mr Kellaway thought that any reasonable operator would anticipate that within a relatively short space of time, the market would improve but probably not to the levels predicted by Mr Thomas – for instance his expectation of a 45% increase in 2004 of the volumes actually achieved at the AVD was extremely bullish and "more in hope than expectation."

55. Mr Kellaway said that an analysis of the storage contracts from 2002 to 2003 revealed a sorry picture that was far less rosy than Mr Brown had suggested in his evidence. The only crude storage was for contango and did not include ongoing supplies from refineries; most of the storage in 2002 was contango related, that being the reason why many of the contracts were terminated in 2003 as the market moved into backwardation; there remained only limited supplies to Ireland and at the AVD the gasoline storage was empty. It was noted that Mr Brown made no comment on the short-term nature of most of SEM's contracts. Short term contracts (known as the "spot market") tends to be immediate and temporary. The shorter the contract term, the more volatile and less predictable the individual terminal's market is. Long term business forecasting is also more difficult. As to storage rates, Mr Kellaway did not agree with Mr Brown's analyses that indicated rates at Milford Haven were similar to ARA. He did not appear to have added contract lengths, cargo sizes or additional charges and throughput fees into the mix. Mr Kellaway said his own analysis indicated SEM's rates were significantly lower and whilst ARA's fees had increased substantially between 2005 and 2009 (which was accepted to be after the AVD) those at the appeal hereditament had not. This was a further sign albeit proved later, of Mr Thomas's over optimism. It was a fact that at the AVD the actual level of contracted capacity was only 38% which was a significant reduction from the 83% achieved in 2002.

56. **Mr Martin Maloney** gave uncontroversial evidence on dredging. He said he had been instrumental, as a dredging consultant with considerable experience of the requirements in the area of Milford Haven harbour (since 1981), in formulating the Milford Haven Dredging Strategy Forum set up by Milford Haven Port Authority ("MHPA") in 2009 to bring all the marine terminal operators together to co-ordinate all dredging operations within the harbour. He provided a detailed report giving an overview of dredging practices at the various marine facilities in the light of the waterway's geology and sedimentation patterns, the layout and construction of the various jetties and berthing areas, and navigational requirements. Relevant

existing legislation, regulations and operating methods prior and up to the AVD were taken into account. The impending legislative and regulation changes that had been in the pipeline and occurred in 2005 were also considered, particularly as these will have created a situation where previous dredging methods became unacceptable and new, more expensive methodology would have to be used.

57. The two main types of dredging relevant to the SEM site were described as Trailing Suction Hopper Dredger ("TSHD" – the pre-AVD method) and Backhoe Dredger ("Backhoe" – potential post AVD method), the former methodology being considerably cheaper than the latter. We do not propose, as the evidence has proved uncontroversial and is not challenged, to elucidate further in connection with these methodologies.

58. Mr Maloney concluded that the historical seven-year dredging cycle was too infrequent and insufficient to provide and maintain the required keel clearances at the berths, sufficient navigational depths and to comply with the new legislation, regulations and requirements. A five-year cycle would in his view be appropriate, for which an annual cost provision would lie within the range £22,880 for pre-AVD dredging method costs and £57,127 for post AVD dependent upon which method was used.

59. It having been agreed by the parties that a hypothetical tenant could expect to agree an abatement of rent to reflect the expected extra dredging costs, and based upon Mr Maloney's evidence that it could be anticipated there would be a need for the more expensive version post AVD, Mr Needham said a reasonable position to adopt would be to allow for an annualised cost of £40,000 pa.

60. **Mr Christopher Brown** is a chartered chemical engineer with more than 32 years' experience in the oil industry and is a member of the institution of chemical engineers. He gave evidence for the respondent in response to the evidence of Mr Thomas, Mrs Martin (regarding the merits/demerits of the actual site and regarding the modern equivalent) and Mr Kellaway regarding the state of and prospects for the oil storage market as at the AVD.

61. Regarding the evidence of Mr Thomas and Mrs Martin, Mr Brown described the location of the site and pointed out that the only practical access for oil products or crude oil was by sea. At the AVD the actual site had two jetties, Berth 2 being for larger vessels up to 165,000 DWT and berth 3 accommodating smaller vessels up to 12,000 DWT. Their existence was essential for the proper functioning of the terminal, and as Mr Thomas had said there were multiple occasions during 2002 and 2003 when both berths were occupied simultaneously. There would therefore be an equal need for the two jetties in the modern equivalent.

62. Mr Brown said that he had not personally investigated the extent to which various tanks were connected to other tanks and how product could be moved between them and around the site, although he pointed out that the physical separation of the tanks had not prevented them from being used for storage purposes. Nevertheless he acknowledged Mr Thomas's comments regarding the alleged disadvantages of the actual installation on the site at the AVD as compared with a modern equivalent and did not seek to challenge his calculation at exhibit CT

19 of the resulting additional operating costs of just under £600,000 per annum. Whilst he had been unable to verify that assessment, he accepted that it had been calculated by the terminal's own finance director and opined that the terminal management were making flexible use of the tanks of varying capacity to manage cargoes arriving and being dispatched. It was likely that the operator incurred some level of additional operating costs due to the layout, design and connectivity of the site but any calculated additional operating costs would vary with the level of contracted terminal capacity. As to Mrs Martin's suggestion that the estimates in CT 39 might be an underestimate, he said he was sure she had a better understanding of maintenance requirements and costs than he had, but he did not change his evidence upon the point.

63. Asked whether he had any specific comments regarding Mrs Martin's evidence upon certain topics regarding the modern equivalent, Mr Brown did not dispute her figures regarding drainage or her evidence regarding water treatment, and he did not suggest any catchment basins were required. As regards the terminal's fire protection he considered Mrs Martin's design eminently sensible as was her suggestion for site lighting. Neither did he criticise her evidence regarding the site area required or the length and nature of the roads and bunds required.

64. Whilst in his written report he observed that hers was only one of a number of potential design solutions, and that her design would not necessarily facilitate the full range of operations that actually were undertaken around the AVD, he did accept that Mrs Martin's modern equivalent was a very reasonable design; that the range of tanks which she had adopted was sensible (but one of many potential mixes); and that she had identified a sensible location within the site for the positioning of the tanks. Although he observed that the layout could be subtly changed, he acknowledged that it would not be fundamentally different. He suggested that other design solutions were available to enable the full range of operations that were actually conducted, including crude oil storage and berthing two vessels at the same time, but did not seek to suggest that what Mrs Martin had done was not a credible solution.

65. Mr Brown agreed with Mrs Martin that the market was moving slowly towards ADR/IFR tanks and that there were advantages in not having large floating roofs open to the elements. However as at the AVD tanks with EFR were not obsolete and there was little evidence of the installation of ADR/IFRs in the UK at that time. Nevertheless he agreed that so long as ADR/IFRs were not more expensive, there was no reason not to use them and indeed there were sound reasons for doing so.

66. As regards the comparison of the costs of building a tank with ADR/IFR as opposed to EFR, Mr Brown considered that it was far from certain that one approach would always be cheaper than the other. He did not think the data available was sufficient to identify a difference in cost either way and disagreed with Mrs Martin insofar as she said that tanks with ADR/IFR were cheaper than with EFR. However, he did not provide his own estimate of the costs of constructing either type of tank nor did he provide any data upon this topic. He agreed in cross-examination that all of Mrs Martin's evidence did indeed demonstrate that ADR/IFRs were cheaper – certainly so for tanks over 10,000 m^3. He drew attention to the AACE Recommended Practice in relation to the cost estimate classification system and to the range in cost estimates as provided by Mrs Martin. He thought that these cost ranges showed that the

estimates should be treated as class 4 estimates in which little confidence could be placed. In cross-examination he agreed however that some of Mrs Martin's estimates would fall within class 1, 2 or 3 of the AACE document.

67. Regarding the economic and business outlook at the AVD, and in response to Mr Kellaway's evidence, Mr Brown accepted that a substantial amount of the evidence upon which he himself had relied was post AVD, and that at that time the appellant would not have known about what actually occurred. It could only therefore base its forecast on what was known and what its own business experience and expertise in those markets could reasonably predict. He acknowledged that data relating to the operator's performance pre AVD was the best evidence for gauging future performance.

68. Mr Brown accepted that location of the terminal is a critical consideration for customers in deciding which storage facilities to use, but pointed out that SEM was able to capture business – such as contango and emergency stockholding/strategic storage where location was not necessarily a primary concern. Emergency stockholding obligations were not lower in the UK in comparison to other EU countries as had been suggested by Mr Kellaway (due to North Sea oil) because they are calculated in the same way for all member states. Such compulsory stockholding, either for UK consumption or for other EU states was a business opportunity for SEM at the AVD as, equally, was contango storage when the market was in that state. It was notable also, Mr Brown said, that SEM had multiple contracts in 2002 and 2003 when the market was backwardated. As to crude oil storage which was acknowledged to be low in the run up to the AVD, there was no reason why the position would not or could not improve when market positions turned to contango. Thus whist it was accepted that there were, of course, many locational disadvantages, the picture was not as bad as had been painted by the appellant.

69. Mr Brown said he did not agree with Mr Kellaway that the Irish market was small, and it was a fact the level of imports there had increased by 1.8 million m^3 from 2000 to 2005. The actual level of imports of jet fuel/kerosene, gasoline and diesel was 6.2 million m^3 in 2003. Whilst the figures for product imported into Ireland through the SEM site produced by Mr Thomas indicated low levels of business, the fact remains that there was and is a considerable market there.

70. As a general comment upon Mr Thomas' and Mr Kellaway's views on the outlook post AVD, Mr Brown said that even though the market was backwardated at the time, no informed management team would assume that situation would continue forever. A short term view of what the next few months might bring would not be sufficient – there was a need to look farther ahead by which time it could be anticipated that a contango market would return. Nevertheless, Milford Haven was not simply a contango based terminal – there were at least three credible lines of business that were undertaken there, and it was therefore not reliant upon a single income stream. It was a fact that, whatever the predictions might have been, the management chose to keep 1.3 million m^3 in service and available thus maintaining capacity at the level of peak demand that was enjoyed in 2002.

The valuers' evidence

71. **Mr Needham** has over 49 years' experience in valuation matters, and particularly the rating of major industrial and chemical hereditaments. He set out in some detail the background to the contractor's basis of valuation and its five stages and referred particularly to the key cases that have dealt with the relevant principles, including *Dawkins (VO) v Leamington Spa Corporation, Monsanto v Farris (VO)* (in which he had appeared for the ratepayer), *Imperial College of Science & Technology v Ebdon,* and *Eastbourne Borough Council and Wealden District Council v Allen (VO).* He set out his position on the basis of his interpretation of all these valuation and legal principles, his views on matters such as the Rating Guides culminating in his detailed valuation. In his rebuttal report he summarised what he described as the most value significant stages or elements of the valuation process where differences between himself and Mr Hughes remained. There was then produced, on the Tribunal's order, a Joint Report setting out their respective final positions on an item by item basis.

72. **Mr Hughes** has over 31 years' experience covering a range of roles within the VOA including holding the positions of Joint Deputy Head of the Surveying Profession in the organisation and Chief of Staff to the Chief Operating Officer before joining the National Specialists Unit with particular responsibility for industrial hereditaments of the type which is the subject of this appeal. His reports covered the same issues.

73. As we have already stated, it is common ground that the appeal hereditament is to be valued on the contractor's basis and that, therefore, the five-stage test should be applied. To avoid unnecessary and potentially tedious repetition, bearing in mind our task here, it is not necessary, we think, to recite at any length at this point in the decision the valuers' evidence relating to their interpretation of the five stages, or their positions on the case law as these issues of legal and valuation principle and their arguments are covered fully under *"submissions"* below. Instead, we briefly record (where not covered elsewhere) the principal areas where the valuers differ in approach and the results of the positions they take: the stage 1 costs for underground services and bunds; the treatment of and reliance placed upon the modern equivalent and the specific issue relating to tank roofs in connection with allowances at stage 2; the question of whether there should be underutilisation allowances for the tanks and jetties applied at stage 2, and the approach to the two additional allowances the appellant contends for at stage 5 relating to the alleged operational difficulties and the costs of maintaining the redundant refinery plant.

74. As to stage 1 costs, they are all but agreed, but in connection with underground services, Mr Needham disputed Mr Hughes' allowance of £15,000 per acre (which he had said was well established by reference to settled assessments) as there was no VOA Cost Guide specification or cost to support such a figure for a hereditament of this nature. Mr Needham's own assessment, at £6,000 per acre, reflected the fact that the extent of underground works would be much more limited than had been necessary for the oil refinery (as supported by Mrs Martin's specifications in her modern equivalent). He said that £15,000 would have been

appropriate (and indeed he had agreed such a figure on intensively developed steel and chemical works in South Wales) if the works required had been equally intensive.

75. Regarding the cost of tank bunds, Mr Needham said his figure at £46 per linear metre was based upon those applied by the VOA (at the former Murco refinery site) to bunds similarly sized to those specified by Mrs Martin in her modern equivalent. Mr Hughes had provided costings based upon higher bunds and longer runs than would be necessary in the modern equivalent.

76. Turning to stage 2, both valuers use the concept of the modern equivalent and recognise it as a useful yardstick (in the right circumstances) to adopt in assessing the relevant allowances to be made at that stage. Although the experts' joint statement recorded that there was no agreement on the issue of "determination and application of functional and technical allowances" per se, and there was much discussion in their reports about the measurement of physical, functional and technical obsolescence, the principal substantive argument related to the extent of reliance to be placed upon the concept of Mrs Martin's modern equivalent.

77. Mr Needham said the circumstances in this case clearly support the use of the modern equivalent, and whilst he had costed the actual asset at stage 1 in all respects other than the substations, jetties, bunds and underground services, he relied in his assessment of allowances at stage 2 upon Mrs Martin's comprehensive design and costings in all but two of the matters in issue – the claimed allowances for alleged underutilisation of tanks and jetties. Mrs Martin's design, he said, afforded the same functionality as the actual property and would enable the occupier's existing business model to be carried out but in a more 'purpose built' form. It would, as Mrs Martin had said, "overcome as far as is practicable the inherited disadvantages, making best use of available space, current design and technology and an understanding of the occupier's business needs."

78. Mr Hughes said that he had not gone down the same route as Mrs Martin because she had designed what he described as "a completely different hereditament with all rateable elements pared down to the minimum specification." He said the concept of the modern equivalent was "a means of identifying elements of the hereditament for which the modern substitute would not be an 'exactly similar' replacement." It is not an opportunity to design and value a fictional hereditament that is impermissibly far away from the actual hereditament and divorced from what actually exists. It must be a design which follows, and allows to continue, the existing business model. Mrs Martin had, in his view, worked up a notional overall design for the purpose of this appeal rather than one which was based upon the actual requirements of the ratepayer – those comments being made specifically in connection with the disagreement over costs of substations and transformer bays. Mr Hughes' explained in paragraph 6 of his first report:

> "To fulfil its present purpose, the subject hereditament has been adapted from an oil refinery. Consequently adjustments are justified at both stage 2 and stage 5 of the valuation to reflect the fact that the total site area in occupation, and the size and layout of the tankage and the supporting facilities are not optimised for the ratepayer's petrochemical storage business. My approach takes as its starting point the hereditament 'as it is', seeks to identify

its specific deficiencies and adjusts for these. This recognises and quantifies these deficiencies by reference to those different features of a modern equivalent hereditament which would be the hypothetical tenant's "ideal", but leaving the valuation anchored in reality. By not placing at the centre of the exercise this latter non-existent hereditament it avoids venturing too far into speculation, and distinguishes between genuine disadvantage and the actual hereditament simply not being the ideal one."

79. An example of the parties' differences in approach to the modern equivalent can be seen in connection with the electricity substations. Mrs Martin's design provides for three substations, and that is what Mr Needham has costed. Whilst it is agreed that if one were building the hereditament from scratch, three would be sufficient to cope with the operator's demands for an oil storage terminal, Mr Hughes makes the point that, in reality, the appellant uses all twelve (out of thirteen) substations on the existing layout to varying degrees in the conduct of its business. He thus costs all twelve in an approach that "is based upon actual requirements rather than a notional overall design worked up for the purposes of this appeal", making allowances that reflect the actual use of each one. It would not be correct, he says, for the appellant to effectively get nine substations 'free'.

80. As to the issue of tankage and tank roofs, Mr Needham based his assessment of costs on the tankage numbers, sizes and layout as described in Mrs Martin's modern equivalent and the advice that all of them would have ADR/IFR. These would be 12.5% cheaper than the combination of EFR and fixed roof tanks which he had costed at stage 1 (certainly as regards crude oil storage tanks – although it was agreed in the joint report of Mr Brown and Mrs Martin that crude can be stored in ADR/IFR tanks.). Mr Hughes criticised the fact that the data forming the basis of Mrs Martin's costings appeared not to have been derived from the actual construction of tanks, although this was disputed by Mr Needham who pointed out that there is evidence from installations and retrofits in Europe and elsewhere. Mr Hughes said in the light of lack of evidence there were no grounds for applying the discount on a general basis across all the tankage, but he acknowledged that he does not produce any modern equivalent evidence of his own.

81. In respect of the appellant's arguments for underutilisation allowances of 32.5% for tank overcapacity Mr Needham said that he was relying upon Mr Thomas's statement that a realistic estimate of maximum required capacity was 760,000 m^3. Based upon an overall net capacity of 1,215,000 m^3 (the derivation of this figure being explained at paragraphs 168 and 169 below) an allowance of 32.5% produces 820,000 m^3 being effectively valued at the full rate, thus proving he said, how realistic such a proposed allowance for the unused tankage was. Mr Hughes takes as his starting point the actual tanks and makes stage 2 adjustments where it is, he says, demonstrable that the ME provision would be different. He said there is clear evidence that virtually the full capacity was utilised during 2002 and there is no reason why that situation should not arise again. This view was also supported by the fact that Mrs Martin's modern equivalent tank capacities are virtually identical to the existing capacities (although that may have of course been to produce like for like comparison), and from the fact that the appellant made a planning application in 2007 (admittedly long after the AVD) for new tankage to a similar capacity. Mr Needham's further allowance "in the guise of functional obsolescence" was not therefore warranted. Mr Needham countered this by saying that there

had been no criticism of Mr Thomas's forecasts from either Mr Hughes or Mr Brown, and reminded us that they had produced no forecasts of their own.

82. Mr Needham also argues for a 35% allowance at stage 2 for underutilisation of the jetties/berthing on the ground that the company's records indicate it is used only about 56% of the time (those statistics not being challenged by the respondent's experts). Why, he says, would a tenant be prepared to pay rent at effectively a 100% rate for a facility he knows will never be fully utilised? Mr Hughes points out that frequency of use is irrelevant – there is no over-provision and the modern equivalent costings being adopted are for the facilities that are required. No allowance for functional obsolescence is thus appropriate.

83. Turning now to the "stand back and look" (stage 5) final analysis, Mr Needham proposed two additional allowances over and above the two items already agreed. Firstly, he seeks an end allowance of £250,000 relating to the operational disabilities of running and maintaining a site that is a legacy from its former use as an oil refinery, and pointed out that Mr Brown had acknowledged there would be costs but the amount sought was disputed by Mr Hughes. Mr Needham said he relied upon the costs provided in Mr Thomas's table CT 19 at £598,000 but accepted that a significant amount of those costs would relate to non-rateable equipment. Doing the best that he could on the information available he netted the costs down to £390,000 for rateable items to which was to be added £40,000 for excessive dredging costs. Acknowledging that there would be a negotiation process over this aspect that reflected the strength of the parties, he netted the resulting £430,000 to £250,000. Mr Hughes adopted an allowance under this head of 10% simply to reflect layout disadvantages not accounted for under stage 2. This, Mr Needham pointed out, amounted in monetary terms to a reduction in rateable value (on Mr Hughes' basis) of £189,000) and observed that, in overall terms the differences were not great.

84. Finally, Mr Needham calculated that there should be a stage 5 end allowance of £35,000 to reflect the additional costs of maintaining the rateable elements of the redundant refinery plant and equipment in terms of health and safety issues and environmental protection. This figure was based upon Mr Thomas's evidence as corroborated by Mrs Martin's calculations of employing one individual for 6 hours per day to carry out the necessary tasks. Mr Hughes said that he did not agree that so much time would be required, and in any event, the costs were miniscule in the overall scheme of things. Thus, no further allowance should be made.

Respondent's submissions

85. On behalf of the respondent Mr Sarabjit Singh and Ms McArdle submitted that there were six issues for the Tribunal to determine:

(i) Whether there should be a 32.5% 'under-utilisation' allowance in respect of the tanks.

(ii) Whether there should be a 35% 'under-utilisation' allowance in respect of the jetty.

(iii) Whether a 12.5% technical obsolescence allowance should be applied on the basis that a modern equivalent tank would have an ADR/IFR as opposed to an EFR.

(iv) The stage 1 costs of underground services and bund walls.

(v) The effect the modern equivalent put forward by Mrs Martin should have on certain stage 1 and stage 2 allowances.

(vi) The appropriate end allowance for layout and other disadvantages.

86. In summary upon issue (i) they raised the following points. They claimed that a 32.5% under-utilisation allowance in respect of the tanks could not be permissible because it was not an allowance in respect of "functional obsolescence" and was thus not a feature which could be relevant to the assessment at stage 2 of the adjusted replacement cost (ARC), which is what the contractor's basis requires to be assessed at that stage. Quite apart from the foregoing, Mr Needham's claimed under-utilisation allowance was wholly devoid of merit upon the facts having regard to the appellant's business model and tank requirements and the prospects for the oil storage market at the AVD – and if there was some disadvantage for the appeal hereditament in the market at the AVD this was because of its location for which a separate 6.5% allowance had been agreed between the parties. Further, while an under-utilisation allowance might in theory be possible at stage 5 by way of some end allowance, this would be most unusual and would be unjustified on the facts of the present case. In more detail their arguments were presented as follows.

87. Counsel drew attention to the concept of "functional obsolescence" as recognised in The Joint Professional Institutions' Rating Valuation Forum which stated in its 1995 Guidance Note on the contractor's basis of valuation (which applied to the 2005 list) that:

> "'functional obsolescence' covers the problems which may be present **in the design of the property** which could be deficient by comparison with current requirements, e.g. excessive ceiling heights, inappropriate layout, inadequate load bearing of floors, inferior heating and ventilation etc…" (emphasis added by counsel)

88. There was nothing in the case of *Monsanto v Farris* [1998] RA 217 to justify a conclusion that functional obsolescence can include under-utilisation as contemplated by Mr Needham. In *Monsanto* the Tribunal was contemplating overcapacity arising from the design of the property. There was a reduction in the usefulness or desirability of the property because of an outdated design feature. In the present case Mr Needham's claimed 32.5% allowance is based upon Mr Thomas's forecast at the AVD of the spare capacity there would be in the tanks if they were filled to accommodate the average level of demand in 2001-03. This has nothing at all to do with the design of the tanks being outdated. The argument for this claimed 32.5% allowance at stage 2 is not assisted by reference to *British Car Auctions (t/a Blackbushe Airport Limited) v Hazell* [2015] RA 108 either, because none of the allowances made there were stated (expressly or impliedly) to be the under-utilisation of an asset. The respondent is unaware of any case or authority which supports the argument that under-utilisation is an appropriate form of functional obsolescence. Therefore the claimed allowance for under-utilisation cannot be an appropriate stage 2 allowance.

89. The appellant, it was submitted, is not entitled to contend that, even if the claimed allowance was not a functional obsolescence adjustment, it could nonetheless still somehow be accommodated within stages 2 and 3. The appellant would be wrong if it was to suggest that the outcome at stage 3 should reflect the open market capital value of the hereditament and that this would allow under-utilisation to be reflected therein. On the contractor's basis the hypothetical tenant is deemed to give consideration to the possibility of building a new hereditament – there is no place for arguing that the hypothetical tenant may buy a new hereditament. What needs to be considered is the adjusted replacement cost (ARC) as recognised by the Lands Tribunal and by the Court of Appeal in *Imperial College of Science and Technology v Ebdon* [1985] 1 EGLR 209 and [1987] 1 EGLR 164. Counsel referred to a passage in the decision of the Lands Tribunal in that case (at page 224) namely that stage 2 "is not a conversion of cost into value but an attempt to arrive at a cost which is more closely related to the actual buildings". They also referred to a passage in the judgement in the Court of Appeal namely that stage 2 is to "adjust th[e] cost to take account of the actual state of the buildings". It was submitted that this approach had been adopted in two further cases, namely *Eastbourne BC v Allen (VO)* [2001] RA 273 and *Allen (VO) v English Sports Council* [2009] RA 289 and that there was nothing in the *Monsanto* case to justify a contrary conclusion.

90. Accordingly, if Mr Needham's claimed allowance for underutilisation was not a functional obsolescence allowance (which it was not) there was no scope to shoehorn it into stage 2 on the spurious basis that the outcome at the end of stage 3 should reflect the open market capital value of the hereditament. Quite apart from the foregoing, which showed that as a matter of principle this claimed under-utilisation allowance could not be brought within stages 2 or 3, it was necessary to look at the merits of the claimed allowance on the facts.

91. Our attention was drawn to Mr Thomas's evidence that to meet the business' peak demand in 2001 to 2003, namely 1.1 million m³ of leased capacity, a total capacity of 1,200,000 m³ would be needed. Mrs Martin has designed a modern equivalent to meet the operating function of the current terminal and on an understanding of the occupier's business needs and has included 1,336,000 m³ of capacity. Mr Thomas and Mr Kellaway agreed that it would be assumed that the backwardated market would not last forever. A capacity of about 1,300,000 m³ would have enabled the terminal to meet peak demand and offer storage in a contango market and (in Mr Brown's opinion) put the terminal in a good position to offer emergency stockholding. Accordingly, at the AVD the terminal would have needed broadly all of the tank capacity to service peak demand. It is clearly wrong for Mr Needham to give no value at all to between 30 and 40% of that capacity as that implies the business model could have operated just as effectively with only about 820,000 m³ capacity.

92. In so far as it was of any relevance, counsel made submissions upon the evidence regarding the market outlook at the AVD and submitted that it was better than Mr Needham had allowed for. There were opportunities for the terminal to provide storage for emergency or strategic stockholding for European Union countries (in particular regarding their obligation to hold certain minimum stocks). There were opportunities for Irish imports of gasoline, jet/kerosene and diesel with consequent break-bulk opportunities. Also, it was notable (as set out in Mr Thomas's fourth witness statement) that while the terminal suffered loss in 2002 it made a profit in 2003 and the two years thereafter – therefore the terminal made a profit in a heavily backwardated market.

93. In any event (and quite apart from the foregoing) the appellant's anxieties regarding the outlook for the oil storage business at the terminal at the AVD are centred upon the difficulties of the Milford Haven location as compared with the prime locations at Amsterdam/Rotterdam/Antwerp. However, the disadvantages of the terminal's location are already reflected in the agreed stage 5 allowance of 6.5%. There would be double counting if some further allowance were made to reflect the allegedly unpromising market for business at the appeal site at the AVD because this has in effect been allowed for in the 6.5% allowance.

94. Counsel submitted that if there was any merit in the claimed under-utilisation allowance (which they said there was not) this would need to be considered at stage 5 rather than stage 2. It was recognised that in very unusual cases an underutilisation allowance can be made at stage 5, for instance *Civil Aviation Authority v Assessor for Strathclyde* [1990] SLT 378 which was a case concerning a non-profit-making airport which served the public function rather than a private commercial one. A profit -related stage 5 allowance was made in *Foster Yeoman Ltd v Assessor for Highland and Western Isles Valuation Joint Board* [2005] RA 189 which was a case concerning a highly unusual hereditament being the UK's only coastal super quarry which had not been commercially successful and was expected at the AVD to run at a significant loss for at least 10 years. The only other case where a commercial enterprise had a profit-related end allowance applied was *Colville & Sons Limited v Lanarkshire Assessor* [1922] SC 460 where the hereditament (a steel bar-iron and sheet works) was in a region where the industry in question was suffering from an almost complete collapse of trade which was anticipated to continue for many years to come. These highly unusual circumstances justified an end allowance based on non-profitability. However, the Court of Session stressed that this was not a case where there was simply a temporary depression in trade – it was stated that such temporary depression should not lead to deductions for the year when they occur.

95. In the present appeal there is nothing in the evidence suggesting anything like such highly unusual circumstances as found in those cases. At its highest, the evidence in the present case shows a temporary depression in trade due to backwardation, which is precisely the type of matter which should not lead to an end allowance.

96. Upon issue (ii) regarding the jetty, Mr Singh and Ms McArdle submitted that the arguments against an underutilisation allowance, which they had made in relation to the tanks, were equally applicable here. They pointed out that in any event the claimed allowance had no merit. At the AVD the business depended upon receiving products via the jetty; there were times when both berths were simultaneously occupied; the handling of the appropriate range of vessels would not have been possible if the operator did not have access to both berths throughout. The business model depended on the jetty being used whenever necessary to load and unload cargoes and the jetty was functional for that purpose whether it was occupied 10% of the time or all the time.

97. Upon issue (iii) regarding whether a 12.5% allowance should be applied on the basis that, in the modern equivalent, the tanks would have an ADR/IFR as opposed to an EFR, counsel argued that as regards Mr Needham's contention that this 12.5% should be applied as a stage 2 allowance on the grounds of technical obsolescence, this cannot be justified. Tanks with EFR were not obsolescent within the meaning of the 1995 Guidance Note because they were still

widely used in the industry – the UK (per Mrs Martin) being slow to adopt new technology in this regard.

98. In any event it was not accepted that the evidence demonstrated it would be any cheaper to construct a tank with ADR/IFR as opposed to EFR. Attention was drawn to Mr Brown's criticisms of the data relied upon by Mrs Martin, which was not sufficient in quantity or consistency to show with any confidence that one type of roof was cheaper than the other. The differences in the data show that several variables seriously affect what an ADR/IFR or an EFR would cost at any given time depending (inter alia) on design, location, material and labour costs and commodity prices. Accordingly, there was no sound basis for finding there would be any cost saving as at the AVD in building tanks with ADR/IFR. The appropriate way to cost the construction of the tanks would be to adopt the tank costings given in the Cost Guide for tanks with EFR. In the hypothetical negotiations at the AVD between the hypothetical tenant and the hypothetical landlord the tenant would have consulted this Cost Guide to get a broad view on tank costs and would not have undertaken the elaborate, time-consuming and expensive exercise that Mrs Martin has undertaken.

99. Upon issue (iv) concerning the stage 1 costs of the underground services and bund walls, counsel recognised that there were minor issues between the parties regarding those costs. The Tribunal was asked to adopt the £15,000 per acre for underground services supported by Mr Hughes which it was said was well established by reference to settled assessments for other oil storage hereditaments. Mr Needham had provided no adequate justification to depart from it. Similarly, as regards the bund walls the Tribunal was invited to adopt Mr Hughes's approach which was to apply the Cost Guide costs so as to ensure consistency.

100. Upon issue (v) concerning the effect of the modern equivalent put forward by Mrs Martin, counsel pointed out that the Tribunal is (anyhow at this stage) only required to determine a point of principle rather than any precise figures regarding the various matters in dispute which may be affected by the proper approach to the modern equivalent analysis. The matters concerned are bunds, catchment basins, drainage, transformer bays/substations, fire protection, roads, underground services, site fencing, site lighting and site.

101. Mr Hughes's approach was that the actual items on the appeal site should be costed and then a deduction should be applied to reflect the fact that they suffer superfluity in comparison to a modern equivalent. Mr Needham's approach is that in effect only items in Mrs Martin's modern equivalent should be costed. It was submitted that the appellant's approach went impermissibly far away from the actual hereditament (rebus sic stantibus) and involved costing an ideal modern equivalent which was far removed from the actual hereditament, thereby leading to excessive artificiality. It was submitted that such an approach was disallowed in *Shell UK Exploration and Production Ltd v Grampian Assessor* [2000] RA 295.

102. It was submitted that what Mr Needham was doing was placing a modern equivalent right at the centre of his valuation exercise which has led to his valuation straying very far from reality and involving the valuing of the rent that would be paid for the ideal modern property rather than the actual property. Reference by way of example was made to the fact that

although there were 12 functional substations on the actual site (some use of each of which was in fact made by the operator at the AVD), the modern equivalent designed by Mrs Martin only involved three substations. In those circumstances it would be wrong merely to cost three substations. It would be wrong to adopt an approach whereby the hypothetical tenant pays nothing to the hypothetical landlord for facilities he would actually get and use simply because he could at his own expense provide a modern equivalent. The hypothetical landlord would not agree to this.

103. Also, as accepted by Mrs Martin (and as stated by Mr Brown) there are several potential sensible modern equivalent designs. It was submitted that the reference to a modern equivalent should merely be to reflect broad differences from the actual hereditament rather than being tied down to one design (as per Mr Needham's approach). Further, the reference to a modern equivalent should be applied on a broad basis rather than by pursuing an expensive and time-consuming exercise leading to a modern equivalent designed in considerable detail. The hypothetical tenant would not perform such an exercise for the purpose of the hypothetical negotiations but would, as stated, adopt a broad approach. It was pointed out that in the *Blackbushe* case the Tribunal did not cost an entire modern equivalent hereditament.

104. Upon issue (vi) and the question of the appropriate end allowance for layout and other disadvantages at stage 5, the allowances of 6.5% for location and 5% for temporary disruption caused by the Dragon LNG works were agreed. The following arguments were advanced in respect of Mr Needham's two substantial end allowances, one being for £250,000 based on exhibit CT 19 (additional costs of operating the appeal hereditament compared to a modern equivalent) and a further £35,000 based on exhibit CT 39 (costs of maintenance of refinery equipment).

105. Document CT 19 was produced by Mr Thomas and reflected solely his opinion of what the additional costs of operating the appeal hereditament were compared with an ideal modern equivalent. This was pure speculation. Proper data supporting his analysis was not presented to the Tribunal and the material merely constituted his entirely uncorroborated estimates and assumptions. Also, no attempt has been made to distinguish between costs relating to rateable and non-rateable items – this is important because most of the operational issues appear to be around the inheritance of items such as pipework which are not rateable. CT 19 is a completely unreliable document on which to base an end allowance.

106. The document relied upon to produce CT 39 was based upon data from an unknown source. Mr Thomas admitted that he did not know who prepared it, or when, or for what purpose and on what information. It was a completely unreliable document on which to base an end allowance. In any event there is nothing in any of the assumptions in paragraph 2(1) of Schedule 6 which suggests that an obligation to maintain/repair the refinery equipment would pass to the hypothetical tenant pursuant to the statutory terms of the hypothetical tenancy. Further, in so far as the hypothetical tenant took on some kind of maintenance obligation in respect of the refinery equipment, this would be limited merely to the rateable elements of the equipment.

107. In any event, in the overall scheme of things, the additional costs relied upon by the appellant are relatively minor, as analysed by Mr Brown. They would be hardly likely to feature at all in negotiations between the hypothetical landlord and tenant, even less to lead to any significant reduction in rent. The hypothetical landlord would be unlikely to make such large reductions as argued for by Mr Needham in respect of operational disadvantages/costs without being able to consider the profitability of the terminal – the landlord would be highly unlikely to make a large reduction if the terminal presented a good business opportunity with significant profits likely to be made. However in the present case the appellant has not put full business accounts into evidence – but there is some evidence from Mr Thomas's fourth statement indicating that the terminal was consistently profitable even in backwardation. Also, Mr Needham's approach involves the risk of double counting.

108. Counsel commended to the Tribunal Mr Hughes' approach of allowing a 10% end allowance (or 16.5% including the allowance for location) which it was submitted was a realistic reflection of the deduction the hypothetical negotiating parties would make at stage 5 to reflect the overall disadvantages of the hereditament.

Appellant's submissions

109. In closing on behalf of the appellant, Mr Richard Glover QC did not expressly agree that there were six outstanding issues for the Tribunal to determine as set forth in the respondent's written closing submissions (which had of course previously been served on him and the Tribunal). However, his submissions dealt with these six issues and he did not suggest that any of them were not in dispute between the parties. He commenced with submissions upon the relevant principles of valuation upon the contractor's basis and the scope within that basis for consideration of a modern equivalent and for the making of allowances for under-utilisation.

110. It was common ground that the valuation method which most lends itself to the assessment of the rateable value of the appeal hereditament is the contractor's basis. However, it was submitted that Mr Hughes on behalf of the respondent had used that method in a limited and circumscribed manner, thereby falling into error. This was particularly so regarding the limited extent to which he allowed the valuation to be influenced by the consideration of a modern equivalent (specifically in respect of that described by Mrs Martin) and regarding the limited extent of his recognition of the possibility of allowances being made, either at stage 2 or stage 5 of the valuation process, for underutilisation of the tanks and the jetty.

111. As regards under-utilisation Mr Glover contended that the respondent's approach involved a conclusion:

> (a) that the contractor's basis is so muscle-bound that it is unable to make allowance for under-utilisation at stage 2; and
>
> (b) that no allowance can be made at stage 5 for under-utilisation unless either (i) the hereditament is not used commercially, or (ii) the industry/business for which it is used was suffering near collapse.

112. In submitting that this was wrong, Mr Glover invited the Tribunal to bear in mind the simple example which he had given in his opening skeleton argument and Mr Brown's answer in cross-examination in respect of it. The example was:

> *"Suppose that a prospective operator of a tank farm which has the capacity of 100 units expects that he will have almost constant use for 50 units, that he may have occasional use for a further 30 units and that he will have no use for the remaining 20 units. In those circumstances, the last 20 units will have no value to him; and the first 50 will have greater value than the 30 units for which he expects to have only occasional use".*

Mr. Brown accepted that, in the example, the 30 units are of less value to the operator than the 50 units.

113. We were reminded by Mr Glover of what he described as two very basic propositions. The first is that the assessment of rateable value is a question of fact: "namely, what is the rent which a tenant might reasonably be expected to give for premises, subject to the deductions mentioned in the statute, as a tenant from year to year" – per Lord Halsbury in *Mersey Docks & Harbour Board v Assessment Committee of Birkenhead* [1901] AC 562. The second is that, in answering that question of fact, "…it is the duty of the valuer to take into consideration every intrinsic quality and every intrinsic circumstance which tends to push the rental value either up or down" per Scott LJ in *Robinson Bros (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee* [1937] 2 KB 445. There is no excuse for leaving out of account a factor which is value-significant. There is certainly no excuse for saying that there is some rule of law that requires one to leave out of account a factor which is value-significant. Mr Glover pointed out that it was accepted by Mr Hughes that part of the tank capacity at the appeal hereditament was of no value to the occupier and Mr Hughes had himself excluded this from his valuation (paragraph 164 of his first report). This exclusion equated to the 20 units in Mr Glover's example, but Mr Hughes nowhere made any allowance for under-utilisation and thus (once again returning to the example) made no distinction between the 30 units and the 50 units.

114. Mr Glover said that the respondent's argument that there was no room for an under-utilisation allowance at stage 2 involves the following propositions:

(a) that the aim of the capital stages of the contractor's basis is not capital value;

(b) that the only features for which allowance can be made at stage 2 are for age, functional obsolescence and technical obsolescence;

(c) that there are prescribed definitions for those features – and those definitions exclude under-utilisation.

He submitted that each of these propositions was wrong.

115. Mr Hughes' approach to the contractor's basis, it was suggested, was peculiarly rigid and doctrinaire involving the slavish application of rules, whether to do so assisted or inhibited the attempt to answer the question of fact as to what is the rent which a tenant might reasonably be

expected to give for the premises. Mr Glover pointed out that the five stages of the valuation are not hermetically sealed from one another. One valuer may conclude that the evidence enables them more readily to adjust for a feature (such as superfluity or location) at stage 5 and another may prefer to do so at stage 2. He referred to *Eton College v Lane* (1969) 17 RRC 331 in support of this. He referred to paragraph 2.3 of the latest (April 2017) RICS Guidance which reminds the valuer to take care to adopt an integrated approach and not be diverted into regarding each stage in isolation – and also to have regard to every intrinsic quality and every intrinsic circumstance that will affect value.

116. There was concern that that it appeared to be (wrongly) submitted by the respondent that the goal at the end of stage 3 was to assess not market value or capital value but something else, namely adjusted replacement cost ("ARC"). Mr Glover said that this conclusion could not properly be drawn from the Lands Tribunal or Court of Appeal decisions in *Imperial College of Science and Technology.* He referred to the classic statement regarding the contractor's basis in *Dawkins v Royal Leamington Spa Corporation and Warwickshire County Council* (1961) 8 RRC 241 which had been endorsed in numerous later cases. He relied upon the passage in the decision of the Lands Tribunal in *Dawkins* that:

> "Every valuation must hang, as it were, on a peg of factual evidence … The peg which supports the contractor's basis is the cost of construction which, if not known, can be estimated without difficulty. **But cost is not necessarily market value, and the next step in the exercise is to estimate by how much the cost should be discounted to allow for … factors which explain the difference between cost and value**. Then the site has to be valued and the decision taken upon the rate of interest to be applied to the effective capital value." (Mr Glover's emphasis).

117. There was nothing in *Imperial College of Science and Technology* either at first instance or in the Court of Appeal to suggest that this was wrong and Mr Glover also pointed out that Glidewell LJ had noted that the Lands Tribunal had followed the five "now generally adopted" stages identified in *Gilmore v Baker-Carr & Others* (1963) 10 RRC 205, a case which specifically spoke of the capital stages seeking market value. The respondent in the present case was wrong in seeking to rely upon *Monsanto v Farris* [1998] RA 217 as constituting any authority for suggesting that the goal at the end of stage 3 was anything other than market value of the hereditament and he referred to various passages in that decision including in particular at pages 140 – 141 and 177-180 and 199-201. The respondent, Mr Glover said, could draw no assistance from the other cases they referred to upon this point namely *Eastbourne BC* at paragraph 126 ("At the end of stage 3 the valuer should have reached the figure that represents the capital value of the subject hereditament…") and *Allen (VO) v English Sports Council* ("… The contractor's basis seeks to determine the annual value of the occupier's occupation of the hereditament by reference to the effective capital value of the buildings upon it").

118. Mr Glover submitted that there was nothing in the Non-Domestic Rating (Miscellaneous Provisions) (No 2) Regulations 1989 inconsistent with the proposition that the outcome of the capital stages ought to be market value. These regulations prescribe the appropriate rate to be used in contractor's basis valuations which is "the percentage rate applicable in relation to the notional cost of constructing or providing the hereditament". This wording is consistent with

the practical reality of the contractor's basis, namely by applying the decapitalisation rate to the capital value of the hereditament (the cost of providing it by acquisition).

119. Accordingly, the goal at the end of stage 3 is to assess the market value of the hereditament. When assessing this market value there is scope (if the facts justify this) for recognising that some of the assets upon the land may have less value than others (see the example referred to in paragraph 112 above). This will allow at stage 2 (if the facts so justify) an allowance being made for under-utilisation because this can affect capital value. There is nothing contrary to this proposition in the RICS Guidance – this urges that all intrinsic qualities and characteristics should be reflected in the valuation. The Guidance is not intended to be prescriptive as to what is contained in stage 2 allowances. The fact that the Guidance makes reference to certain categories of "obsolescence" cannot be taken as indicating that other features that affect value are to be left out of account.

120. Separately from the foregoing an allowance can be made (once again if such facts justify this) for underutilisation at stage 5. Mr Glover contended that the respondent was wrongly approaching this topic on the basis that the decided cases only include examples of underutilisation allowances where circumstances x, y or z apply, and was then arguing that therefore no underutilisation allowance is permissible unless one or more of circumstances x, y or z exist. He pointed out that whether an under-utilisation allowance should be made turns upon the facts, rather than upon any point of law, see for example *Mersey Docks & Harbour Board* and also *Robinson Bros (Brewers) Ltd*. Mr Hughes had wrongly started from the proposition that the cases precluded him from asking whether an under-utilisation allowance was appropriate – what he should have done was to ask himself whether, on the facts, an under-utilisation allowance was appropriate.

121. Mr Glover drew attention to *British Car Auctions (T/A Blackbushe Airport Limited)* and to the fact that in that case the valuation officer had costed the full length of the runway (but not the full width) and had then considered that an allowance was warranted to reflect the comparatively minor use of the runway made by jet aircraft and that the substantial majority of flights could operate from a shorter runway. A 50% allowance at stage 2 was made to reflect the occasional use by jet aircraft of the existing section of runway excluded from the modern equivalent particularly in adverse weather conditions.

122. If the evidence justifies an under-utilisation allowance, one should be made and it can conveniently be made at stage 2. The same analysis also underpins the use of a modern equivalent at stage 2. A modern equivalent is a useful tool for the valuer because the capital value of the hereditament will not exceed the age depreciated cost of a modern equivalent terminal, which provides the same functionality as the actual but would cost less to construct.

123. Having made those submissions regarding the relevant valuation principles, Mr Glover sought to categorise the issues before the Tribunal. He set out a table of the matters in issue at page 21 of his submissions. He explained that on the stage 2 and 3 issues the allowances that Mr Needham makes are, with two exceptions, related to Mrs Martin's modern equivalent design. The two exceptions are the underutilisation allowances in respect of tank capacity and

the berths/jetties. Accordingly, leaving aside these two claimed underutilisation allowances, the issues between the parties depend upon the appropriateness of adopting Mrs Martin's modern equivalent in relation to the item in issue. As regards three of those items (bunds, underground services and tank roofs) there was a further dispute relating to the appropriate unit cost to apply to the modern equivalent asset.

124. Mr Glover rejected Mr Hughes's suggestion that Mrs Martin's modern equivalent goes impermissibly far away from the actual hereditament and involves costing some proposed ideal modern equivalent. He commended Mrs Martin's design as workable, pragmatic and reasonable and reminded us that Mr Brown, for the respondent, agreed. It was clearly appropriate in the present case to have regard at stage 2 to a modern equivalent because the existing site has a diffuse and complicated layout; it has a range of tank sizes inefficient for operation as an oil terminal; it has tanks of a design (EFR rather than ADR/IFR) which would not be adopted in a modern equivalent and it has excessive support infrastructure (roads, electrics, water treatment etc) which would not be built as part of the modern equivalent for an oil terminal. Mr Glover referred to *Winchester City Council v Handcock* [2006] RA 265 where the Tribunal stated:

> "… that hereditament must be valued rebus sic stantibus. Of course, that does not mean that the notional modern simple substitute cannot depart from the actual physical circumstances of the hereditament – it would not be a modern simple substitute if it did not do so. So there is no offence to the doctrine of rebus sic stantibus in contemplating for valuation purposes a "modern substitute" building that is different, possibly very different, from the hereditament to be valued. But the substitute must bear a sufficient relationship to the hereditament in question to be a useful method of valuing that particular hereditament and not some other quite different hereditament".

125. Mr Glover submitted that Mrs Martin's modern equivalent is not only a useful method of valuing the deficiencies (i.e. in the existing site) addressed by it, but also is the most accurate and reliable method available to the Tribunal for measuring these deficiencies. He reminded us that Mr Brown either positively agreed with or did not challenge the content of Mrs Martin's modern equivalent design in respect of numerous separate topics and that Mr Brown had said Mrs Martin's modern equivalent was a very reasonable design with operational benefits over the actual site. It is true that there may be various possible designs for a modern equivalent of which Mrs Martin's is one, but this is no reason for rejecting a reference to her modern equivalent.

126. In these circumstances the thoughtful valuer would ask him or herself why the allowances should be any smaller than were indicated by a comparison with Mrs Martin's design.

127. An example of the proper operation of Mrs Martin's modern equivalent could be seen by reference to the electricity substations. Their purpose is to play a role in supplying electricity to the operation. It is common ground between the appellant's witnesses and Mr Brown that the electrical system design as per Mrs Martin's modern equivalent (involving three substations) would be sufficient to meet all the needs of the terminal operator. Accordingly, Mr Needham is

correct to cost that system with its three substations. The hypothetical tenant would be paying rent for the provision of electrical services that they require. Mr Hughes's approach appears to insist that the hypothetical tenant should pay more because the refinery happened to have 13 substations and the operator at the AVD was making some use of most of them. The hypothetical tenant would not agree to do this.

128. Accordingly, in each case where Mr Needham makes an allowance by reference to Mrs Martin's modern equivalent such allowance is soundly based.

129. Turning to whether the modern equivalent should have tanks with ADR/IFR or with EFR, Mr Glover submitted that the position of the industry experts was clear. Mrs Martin advocated the use of ADR/IFR and Mr Brown said he would use them as long as they were cheaper. Mr Glover referred to the advantages of the ADR/IFR tanks as emerged in the evidence. He submitted it would be wrong only to adopt ADR/IFR as part of the modern equivalent if it could be said that EFR tank roofs showed "technical obsolescence". It is sufficient to justify the adoption of ADR/IFR roofs as part of a modern equivalent if that option is more valuable and has lower operating and maintenance costs (as the evidence suggests). In any event, paragraph 3.22 of the 2017 RICS Guidance makes reference to technological obsolescence as arising (inter-alia) where current technology has changed so that an alternative use has been adopted and where there are technological deficiencies. Upon the evidence, and in particular having regard to the list of ADR tanks constructed by Vacono (as referred to by Mrs Martin) it can properly be said that ADR/IFR tanks have taken over from EFR as the roof of choice in storage terminals.

130. Concerning the cost in the modern equivalent of the tank roofs in the ADR/IFR design, Mr Glover drew attention to the fact that the starting point for costs in a rating valuation was the VOA Cost Guide, but this did not contain any costing for ADR/IFR tank roofs. Mr Glover referred to the evidence presented by Mrs Martin in relation to the cost of ADR/IFR tanks as compared with the lack of evidence presented by the respondent. He agreed that the data presented by the appellant may be imperfect, but it is the only evidence to assist the Tribunal on this topic. All that the respondent and Mr Brown have done is to criticise the appellant's evidence rather than produce any evidence of their own. He submitted that Mr Brown's reference to the AACE document was clearly mistaken and reminded us that, after much argument to the contrary, Mr Brown had in fact agreed in cross-examination that ADR/IFR tank roofs appeared in all of Mrs Martin's references to be cheaper than EFRs in tanks of over 10,000 m^3 (which all of those in the modern equivalent would be). In the result, Mr Glover commended to the Tribunal the allowance of 12.5% for the tanks which Mr Needham had adopted on the basis of Mrs Martin's exercise of identifying costs at the AVD for ADR/IFR tank roofs of the relevant diameters.

131. Continuing with the question of costs of items in Mrs Martin's modern equivalent, Mr Glover made submissions in respect of bunds and underground services. Regarding bunds Mr Brown and Mrs Martin have agreed that a purpose-built terminal with the same tank capacity as the actual would have bunds 7,650 m in length and at a height of 2.25 m. There is therefore no justification for Mr Hughes costing bunds that are 3 m high and 9,339 m long. Further there is no justification for adopting a higher rate per linear metre than £46 which is what was

adopted at the Murco refinery just down the Haven. In respect of the underground services, both valuers had agreed that an oil storage terminal was not a major industrial complex and that therefore £30,850 per acre would be excessive. Mr Glover submitted that Mr Hughes's figure of £15,000 per acre was effectively a guess, whereas Mr Needham had adopted a more diligent approach by reference to Mrs Martin's analysis of the underground services that a purpose-built terminal would have, which were then costed using unit costs that had been input into the beacon exercise at an ICI plant at Wilton. These equated to £6,000 per acre.

132. Mr Glover then returned to the question of an allowance for under-utilisation of the tanks. The question of principle as to whether such an allowance was permissible either at stage 2 or stage 5 had already been addressed. However, the question remained whether such an allowance was appropriate on the evidence. Mr Glover submitted that the Tribunal should put itself in the position of the hypothetical operator who, at the AVD, is considering taking the hereditament and operating a terminal from it. The best proxy for this hypothetical operator is the actual operator. Mr Thomas was particularly well-placed to assist the Tribunal in this regard. It was pointed out that it was necessary to consider the outlook for the terminal at the AVD and to look forward. Mr Brown had not done that but had extensively referred to the position in the market after the AVD. Attention was drawn to the assessment of the market as given by Mr Kellaway and Mr Thomas and to the declining number of contracts with an outstanding period of more than nine months – reference being made to Mr Thomas's table CT 14 and to Mr Thomas's forecast of a requirement for 760,000 m^3 of tank capacity which Mr Kellaway had said was optimistic.

133. Mr Glover submitted that Mr Hughes had ignored this evidence, but that Mr Needham correctly had not done so. Instead Mr Needham recognised that there would be some of the actual capacity that would be of no value to the hypothetical operator, some capacity that would be of full value, and some which is neither valueless nor as valuable as the core capacity. This should be reflected in the valuation exercise. Accordingly, the Tribunal was invited to adopt the 32.5% under-utilisation allowance in respect of the tanks as contended for by Mr Needham.

134. Regarding the under-utilisation of the berths/jetties, Mr Glover submitted that as a matter of principle such an allowance was permissible if it was justified on the facts. He submitted that there was evidence which Mr Needham was justified in seeing as significant. He commended the approach adopted by Mr Needham in paragraphs 6.39 to 6.50 of his first report which led to the making of a 35% allowance for underutilisation. The respondent's suggestion that, in so far as any allowance for under-utilisation could be made, this was in fact already included in the 6.5% agreed allowance for location should, Mr Glover said, be rejected. He pointed out that Mr Hughes in cross examination had confirmed that there was no allowance for underutilisation in the agreed 6.5% figure.

135. Mr Glover then made submissions regarding the disputed stage 5 allowances which concerned operating costs, dredging costs and costs regarding the refinery. He pointed out that the justification for such allowances was the presence of an annual cost to the hypothetical tenant of dealing with these matters (i.e. a cost which would be incurred at the actual hereditament but not at the modern equivalent). At stage 2 Mr Needham's non age-related

allowances (leaving aside the question of underutilisation for the tanks and jetty) were assessed by reference to Mrs Martin's modern equivalent. However, while that exercise identified the capital value of the modern equivalent, the hypothetical tenant takes the actual hereditament. Accordingly, it is relevant to examine whether the actual hereditament has deficiencies which will cause extra costs to the hypothetical tenant beyond those which they would face with the modern equivalent. In the present case there are two categories of such costs, namely the additional annual operating costs of the actual as compared with the modern equivalent and the costs of keeping in repair (or at least keeping safe) the rateable parts of the unwanted refinery.

136. He referred to *United Kingdom Atomic Energy Authority v Highland and Western Islands Joint Board Assessor* [2006] RA 153 where the Lands Tribunal for Scotland was faced with an issue about an allowance for the costs which the hypothetical tenant would incur in maintaining buildings on the subjects which were simply a drain on resources. Two points which emerge from the decision are (i) that the Tribunal did not expect a pound for pound deduction but instead expected the additional expenses would be the subject of negotiations between landlord and tenant, and (ii) that the Tribunal concluded it was more appropriate to make the allowance as a £x sum rather than as a percentage.

137. As to the operating disadvantages, Mr Glover drew attention to Mr Thomas's evidence and the content of his table CT 19 where he identified additional operating costs of £598,000 per annum. He pointed out that the respondent had merely criticised this figure and the constituent parts thereof but had provided no evidence of its own upon it. CT 19 is the best evidence available. This £598,000 reflects (unavoidably) the disadvantages of both the rateable and non-rateable elements of the actual hereditament. It is only the former which is relevant for this exercise. Mr Glover commended Mr Needham's approach of allocating about £390,000 as being properly attributable to the rateable assets. In respect of additional dredging costs there was no disagreement between the parties that the likely extra annual cost would be about £40,000. Accordingly, the hypothetical tenant in the negotiations could draw attention to additional costs of about £430,000 per annum above the costs of operating a modern equivalent. Mr Needham's deduction of only £250,000 allows the hypothetical landlord substantial success in the negotiations. The deduction of £250,000 per annum should be accepted.

138. In relation to redundant refinery equipment, there is on the hereditament a significant amount of rateable refinery equipment as well as some non-rateable equipment which must be ignored for rating purposes. The hypothetical tenant would be forced into annual costs in relation to this rateable refinery equipment for two reasons: first, because under their tenancy they would have an obligation to repair this equipment and secondly because the general law imposes safety requirements on them. Mr Glover noted that the respondent in the closing submissions suggested that paragraph 2(1) of Schedule 6 to the 1988 Act did not impose an obligation on the hypothetical tenant to repair the rateable elements of refinery plant; he noted that this argument was not developed but merely asserted; and that it has not been raised in the opening skeleton argument. He suggested that in any event this point for the purposes of the present case is of academic interest, because there is no suggestion by the respondent that the hypothetical tenant would not have the obligations of the general law in respect of safety. Although only of academic interest Mr Glover did however, go on to submit that the hypothetical tenant takes the tenancy of the hereditament with an obligation to bear the costs of

repairing it. The hereditament includes the location of the redundant refinery equipment and the repairing obligations applied to it. He also pointed out that the respondent appeared to be proceeding on the basis that the hypothetical tenant would have had the option not to repair or keep safe the refinery equipment but instead to break up the rateable assets of the redundant refinery plant – he pointed out that it is trite law that the hypothetical tenant does not have the option of dismantling the hereditament.

139. The only evidence regarding the additional expenses which the hypothetical tenant would incur in repairing/keeping safe the redundant refinery equipment is to be found in Mr Thomas's evidence and in his table CT 39 as amended. The provenance of the document referred to by Mr Thomas as supporting CT 39 does not matter because Mr Thomas using his own knowledge was able to support the categories of expenditure which would be necessary and, broadly, the quantum. Having identified the additional costs for the whole of the redundant refinery it is then necessary to assess the proportion of the annual costs (somewhat over £160,000 per annum) which would be caused by the presence of the rateable redundant refinery assets alone. Mr Needham has performed this exercise. His figure of £35,000 per annum should be adopted.

Discussion

140. The appeal, as we have said, concerns the rateable value to be ascribed in the 2005 compiled list to the hereditament which is described as "bulk liquid storage depot and premises" and is located at Waterston, Milford Haven, Pembrokeshire. The appeal site extends to about 260 acres and formerly comprised part of the Gulf Oil refinery. It was designed and constructed for use as a refinery, and at the AVD the refinery structures remained. The attendant tankage, its layout, the infrastructure and rateable plant was thus not designed for use as a bulk liquid storage depot and has had to be adapted for its current use.

141. Both parties agree that the appropriate approach to assessing the rateable value in accordance with the statutory formula is to adopt the contractor's basis of valuation. We agree this is the correct basis. It must however be remembered that the contractor's basis is merely a recognised valuation method (described in the past as a method of last resort) by which assistance can be given to solving the question posed by paragraph 2(1) of Schedule 6 of the 1988 Act, namely what is the rent at which it is estimated the hereditament might reasonably be expected to let from year to year on the statutory assumptions.

142. The rateable value is defined by reference to the amount of this rent. It is not defined as being the de-capitalised amount (at the appropriate decapitalisation rate) of £x, where this amount £x is the figure arrived at after precise and un-deviating application of a set of rules regarding the contractor's basis as extracted from RICS guidance and from decided cases. We agree with Mr Glover's submission that it is important not to allow the mechanics of the contractor's basis to obscure the crucial question in the case, namely what is the rent contemplated under paragraph 2(1) on the statutory assumptions. The assessment of figures pursuant to the contractor's basis will be relevant to the hypothetical negotiations between the landlord and the tenant, but it remains necessary to take into consideration every intrinsic quality and every intrinsic circumstance which tends to push the rental value either up or down,

see per Scott LJ in *Robinson Bros (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee.*

143. It is regrettable that, due to differences in the approach adopted by Mr Needham and Mr Hughes a common format for their valuations was not possible. It is in these circumstances that there is before the Tribunal Mr Needham's revised valuation at pages 3743 to 3752 covering 607 lines which produces a rateable value of £750,000 – which in turn was further amended during the hearing to £830,000 (pages 3,799 b – k). Mr Hughes's final valuation is at pages 3753 to 3757, covers 324 lines and arrives at a valuation of £1,458,000. This was not amended during the hearing. It is agreed between the parties that in these circumstances it is not possible for the Tribunal itself to come to a final conclusion upon valuation. Instead we are invited to decide various points of principle.

144. We propose first to consider the question of the extent to which the modern equivalent has a role to play in the present case and whether Mrs Martin's design and specification is an appropriate modern equivalent to consider for this purpose. We will then consider the question of whether, as a matter of principle, an allowance for under-utilisation (in particular regarding the tanks) can be made as part of stage 2 or stage 5 of the valuation. We will then turn to consider in sequence the points at issue as described by the respondent (see paragraph 85 above) which we understand to be a broadly accurate summary of the issues – Mr Glover did not suggest otherwise.

Modern equivalent

145. Both parties have referred to the Guidance Note produced by the Joint Professional Institutions' Rating Valuation Forum in relation to the contractor's basis of valuation. We have in mind the theory underlying the adoption of the contractor's basis and the observations in the Guidance Note that "In the view of the Rating Forum, the further the valuer strays from reality the less weight can be attached to the valuation produced" (paragraph B.9). We note the observation in paragraph B.14 that the valuer should not venture into a world of speculation which involves departing too far from the replacement of the actual property and that it is the Rating Forum's view that "in most cases" the costing exercise should be related to the notional reinstatement of the actual property which is the subject of the valuation exercise. However we also have in mind that the Guidance Note recognises that there may be exceptional cases where it would be appropriate to cost a modern substitute rather than the actual property as it exists on the hereditament. Paragraph 3.1.16 and 3.1.17 read as follows:

> "3.1.16 Where a property is such that perhaps because of age, design or type of construction it would not be realistic to envisage rebuilding it in its present form, an alternative to estimating the cost of the actual property can be adopted with the valuer estimating the cost of a modern substitute property in order to arrive at any adjustments appropriate to Stage 2.
>
> 3.1.17 Where a substitute property approach is adopted costs should be estimated on the basis of the substitute being of a design and specification to enable the use of the actual property to be carried out in a fully satisfactory manner."

146. We were referred by the respondent to the decision of the Lands Tribunal for Scotland in *Shell UK Exploration and Production Ltd v Grampian Assessor* which showed that it was appropriate to avoid costing an ideal modern equivalent which was far removed from the actual hereditament and which would invite excessive artificiality. It may however be noted that in that case it was observed by the Tribunal that the alternative design had its genesis in a concept of building a plant which would minimise rates liability; that the Tribunal was not satisfied that the exercise had produced a plant which would be chosen by a hypothetical tenant as the optimum plant for their requirements at the site; that the ratepayers did not base their argument on any specific deficiencies in the existing site; and that the suggested modern equivalent involved very substantial work and analysis which had generated 30 boxes of material in support which the assessor had (justifiably) declined to examine.

147. In the present case Mrs Martin's modern equivalent design is the subject of a comparatively simple presentation, being one which has been examined by the respondent and the respondent's expert Mr Brown with no apparent difficulty. Also in the present case, there are plain deficiencies in the existing site because the site was designed and laid out as a refinery extending to 260 acres whereas the hereditament to be rated (and what the appellant needs to occupy for its business) is an oil terminal requiring approximately half as much land, a different layout and an absence of the unwanted refinery installations.

148. In *British Car Auctions Ltd (T/A Blackbushe Airport Ltd v Hazell (VO)* the Upper Tribunal recognised that in an appropriate case the first stage of the contractor's basis could properly contemplate the construction of a modern substitute, but that it was important that the modern substitute chosen must reflect the use of the actual hereditament which had to be valued and should be able to do the same basic job as the actual hereditament did – the choice of a modern substitute not being the opportunity to adopt a new business model.

149. In the present case we conclude that there are exceptional circumstances fully justifying the consideration of a modern equivalent. There are clearly deficiencies in the existing site for use as an oil terminal bearing in mind it was designed and laid out as a refinery. A tenant in the hypothetical negotiations with the landlord, when discussing the cost to the tenant of their building the tenant's alternative, would be able to argue with force that if they were building an oil terminal for themselves they would build it over a substantially different area and to a substantially different layout and detail as compared with what is actually on the site. In short they would build an oil terminal not a refinery.

150. We have summarised the evidence from Mr Thomas and from Mrs Martin as to what is a reasonable modern equivalent which the hypothetical tenant could be expected to have in mind when assessing the alternative of constructing their own property. There have been various criticisms of this on behalf of the respondent but we do not find substance in any of them. There are three principal reasons for this conclusion. First, we consider that Mr Thomas, with his long experience of the site, is in a particularly good position to give authoritative evidence as to what an operator at the site would consider to be a suitable design to adopt for a modern equivalent. Secondly, we are impressed by the care and expertise which Mrs Martin has brought to her analysis of the situation and her design of a modern equivalent. Thirdly we note in the evidence from Mr Brown, a witness called by the respondent, that he considers Mrs

Martin's modern equivalent design to be a very reasonable (he also said an eminently sensible) layout, and one of numerous possibilities for the site bringing with it technical and cost benefits. Accordingly, we see no reason to adopt anything different from Mrs Martin's suggestion when it comes to identifying the modern equivalent to apply for the purposes of the contractor's basis.

Underutilisation allowance

151. We accept that it has been established in various cases that, as a matter of principle, a reduction can properly be made (when adopting the contractor's basis) to reflect underutilisation of the hereditament. In *Heart of Midlothian Football Club Ltd v Assessor for Lothian Region* the Lands Tribunal for Scotland was considering the annual value of a football stadium and adopted the contractors' basis of valuation. At page 140 the Tribunal stated:

> "We now deal with the reduction factor for the underutilisation of the stadium in regard to which parties appeared to be agreed that no legal issues were involved. This factor is to reflect the modification which would be sought by the tenant, or indeed a purchaser, because he would rarely, if ever, require all the accommodation in the stadium. The expectation would also be that the hypothetical landlord would be prepared to accept a lower rent in consequence."

152. In that case it is right to notice that the assessor himself was proposing an allowance for underutilisation and therefore the point of principle was not in dispute between the parties. Also, it was recognised that if a tenant was considering his requirements he would not want to restrict the possibility of a large attendance caused by, say, the visit of teams with large followings like Rangers and Celtic, or by a derby game with Hibernian when the two Edinburgh teams meet. Accordingly an allowance for underutilisation was made even though it was recognised that occasionally the ground would be used to full capacity.

153. We have considered *Civil Aviation Authority v Assessor for Strathclyde Region* which is a decision of the Lands Valuation Appeal Court concerning the rating of airports at Islay and Tyree where there was a limitation on the areas of the runways required, and also a limitation on the amount of actual use which was to be made of the airports. 70% discount on effective capital value was applied to reflect the limited extent to which use could be made of the subjects. Reference was made to the *Heart of Midlothian Football Club* case. Lord Clyde remarked that the subjects could not be used to the extent of their full capacity and that this factor could be reflected when assessing its value. Lord Prosser stated:

> "Even after every allowance has been made for limitations on usefulness in the physical subjects, any true hypothesis for valuation may require to reflect variations in their maximum potential use, flowing perhaps from their location, or the need or demand for them, or perhaps from some inherent characteristic of the use to which they are being put. Even after all physical limitations have been allowed for, it is necessary to get away from some notional view of the subjects' capacity for use, and move to a realistic view of their maximum potential, or expected, or likely use. It will be a matter of impression and degree, to distinguish the true potential capacity for use of given subjects from some higher notional

capacity, or indeed from some lower and more limited capacity which is merely a reflection of a particular tenant's failure to put subjects to full use."

154. In *United Kingdom Atomic Energy Authority v Highland and Western Islands Joint Board Assessors* the Lands Tribunal for Scotland was considering the rating of the civil nuclear installation at Dounreay. At paragraph 117 the Tribunal, in relation to a claimed allowance for superfluity, stated:

> "Another recurring justification for claims of superfluity was where there was partial use of facilities, i.e. suggesting over-capacity. Where this was temporary, for example as a result of the Direction, we would not propose any allowance. There were, however, cases in which there was no reasonable prospect of facilities being used to their capacity, for example a fuel store which, as of January 2000, had spare capacity and would not have been expected to take in any further material. In principle, over-capacity on a long-term basis should be reflected in an appropriate allowance. We do not, however, think that it is simply a mathematical calculation of the extent of use. A facility with half the capacity is not necessarily worth only half."

155. On behalf of the respondent Mr Singh submitted that an underutilisation allowance is not permissible at stage 2 as a functional obsolescence allowance because it is not such an allowance. Therefore, at stage 2 there is no scope (as he put it) "to shoehorn it into stage 2 on the spurious basis that the outcome at stage 3 should reflect the open market capital value of the hereditament". He then further submitted that at stage 5 an allowance for underutilisation could only be made in a truly exceptional case. Accordingly, the door was closed to Mr Needham's proposed underutilisation allowance at both stage 2 and stage 5, which were the only possible stages at which it could even theoretically come in. There should, in the respondent's view therefore, be no allowance for underutilisation.

156. Mr Glover contended that the respondent was wrongly seeking to set up barriers of alleged legal or valuation principle so as to prohibit consideration of a matter which (so the appellant contends) is in fact a relevant matter that would weigh in the minds of the hypothetical landlord and tenant during their negotiations for agreeing a rent of the hereditament upon the statutory terms. He submits that such an approach is contrary to principle.

157. In *Mersey Docks & Harbour Board v Assessment Committee of Birkenhead* Lord Halsbury LC made reference to the statutory provision which set out how the rateable value was to be calculated and stated at page 180:

> "That is the proposition which is put before the parish officers – that is the question which they have to answer; and they are to arrive at that value, so far as I know, unfettered by any statute as to the way in which they can do it. I am not aware of any rule of law or statute which has limited them as to the mode in which they shall arrive at it. It is not a question of law at all – it is a question of fact…. but still one must bear in mind that the thing to be done is to answer a plain question of fact, namely, what is the rent which a tenant might

> reasonably be expected to give for the premises, subject to the deductions mentioned in the statute, as a tenant from year to year?"

At page 182 he stated:

> "What you are to find out is what a tenant will reasonably give, looking, surely, at all the circumstances of the particular occupation, including therein the business that has been done on the premises…… All the circumstances of the particular occupation, the mode in which the trade is being carried on, and the circumstances affecting either the restriction or the amplitude of the trade, are all legitimate subjects of enquiry…"

We consider that this points away from rather than towards the restrictive approach commended to us by the respondent.

158. We note that part of the respondent's argument upon this point, allegedly precluding any underutilisation allowance at stage 2, is based upon a submission that it is wrong at stage 2 to be considering open market capital value of the hereditament and instead it is necessary to consider "adjusted replacement cost" as adopted by the Lands Tribunal in *Imperial College of Science and Technology v Ebdon*. It is submitted that the Court of Appeal decision in that case supports the Lands Tribunal in a conclusion that effective capital value is a long-established misnomer, and that stage 2 was not a conversion of cost into value but an attempt to arrive at a cost which is more closely related to the actual buildings – Mr Singh's submission apparently being that stage 2 is concerned with adjusted replacement cost and not with open market value. We are unable to accept Mr Singh's argument on this point. His claim to support from the Court of Appeal decision in this case for some revision of the proper approach to stage 2 is unjustified. In the Court of Appeal Glidewell L J made clear that there was before that court no issue as to stages 1, 2 or 3 – the court was only concerned on appeal with stages 4 and 5. All that the Court of Appeal did in relation to stage 2 was to record that the step to be taken at stage 2 was:

> "To adjust this cost to take account of the actual state of the buildings comprising the hereditament. The resulting figure is often known as "effective capital value", but Mr Mallett in his decision prefers to call it "adjusted replacement cost".

There is nothing in the Court of Appeal decision in that case to indicate approval of some fresh approach to stage 2.

159. We consider that at stage 2 the valuation process is concerned with assessing what can properly be described as effective capital value. This is clear from numerous cases including the passages in *Monsanto v Farris* relied upon by Mr Glover. There is no rule of law or valuation principle to prohibit from being considered as a topic of possible relevance, when assessing effective capital value, the question of whether the capacity of the hereditament is excessive having regard to prospective usefulness of that capacity assessed at the AVD, and taking into account all relevant matters including the state of the market and the future prospects for business at the hereditament.

160. In the hypothetical negotiations in the present case between the landlord and the tenant it is open to the tenant to use as a bargaining counter the fact (if it be a fact) that if they were to build a modern equivalent as extensive as regards tank capacity as the actual hereditament then they would be building something which would include capacity some of which would be of no use to them and some of which would be of limited use to them. The argument would be that they could build the tenant's alternative in the form of a modern equivalent and could beneficially, without changing their business model, carry on the relevant business with a modern equivalent of smaller capacity. It would of course be open to the hypothetical landlord to argue that, even though there was little (or no) immediate prospect of using the full tankage capacity, the capacity for potential greater use was in itself an asset and that the tenant could not expect to have this asset without paying for it.

161. However we do not see anything in the rationale of the contractor's basis, or in any of the decided cases, or in the RICS Guidance Note to prohibit the hypothetical tenant from raising the argument that, having regard to circumstances as at the AVD, the hereditament contained substantially greater tank capacity than any hypothetical tenant could reasonably require, such that the hypothetical tenant would expect some allowance for underutilisation rather than paying effectively the same full price per cubic metre of capacity for every cubic metre from the first to the 1,336,596th (per Mrs Martin's modern equivalent). We do not accept that such an argument is prohibited on the grounds that it fails to bring the claimed allowance within one of the heads of "obsolescence" referred to in the Guidance Note. As recognised in *Winchester City Council v Handcock* the modern equivalent can depart from the physical circumstances of the hereditament (it would not be a modern equivalent if it did not do so) and there is no offence to the doctrine of rebus sic stantibus in contemplating for valuation purposes a modern equivalent that is different, possibly very different, from the hereditament to be valued – provided the substitute bears a sufficient relationship to the hereditament in question to be a useful method of valuing that particular hereditament and not some other quite different hereditament.

162. We note the authorities relied upon by Mr Singh which, he contends, show that while an underutilisation allowance can in principle be made at stage 5, it is only in very unusual circumstances that such an allowance should be made. We make the following observations regarding this point. In *Colville & Sons Limited v Lanarkshire Assessor* Lord Salveson said at page 481:

> "On the other hand, it has always been a well-recognised rule of this Court that a mere temporary setback in an industry is no reason for altering the yearly value of heritable subjects, which, when once properly fixed, must be considered as being a more or less permanent figure."

163. It may be observed that what is here being said is that a mere temporary setback is no reason for altering the rateable value because "when once properly fixed" this must be considered as being a more or less permanent figure. In the present case the proper rateable value of the appeal hereditament as an oil terminal has not previously been properly fixed – the appeal hereditament was previously (part of) a refinery. There seems to us to be a distinction between on the one hand getting the appropriate rateable value determined in the first place and on the other hand seeking (potentially on a regular basis) to adjust that rateable value because

of periodic fluctuations in the state of the market for oil storage. Separately we note that in the *Colville* case it was recognised that "a drastic allowance must be made for the permanent depression which, until there is an entire change of circumstances, will continue to affect all these steelworks. I think that that depreciation cannot be estimated at less than fifty per cent .." – see at page 483.

164. It would in our view be surprising if the proper analysis was that in exceptional circumstances a drastic allowance (as much as 50% or more) could be made for underutilisation, but that otherwise nothing at all could be so allowed. That would prevent a properly nuanced approach being brought to bear and would involve awkward analysis as to whether facts were sufficiently exceptional to justify a (large) allowance or whether that crucial threshold had not been crossed. The cases relied upon by Mr Singh do not affect our conclusion that, as already explained in earlier paragraphs, an underutilisation allowance can be made (if the facts justify it) at stage 2. Also it is not necessary for this underutilisation allowance to be either very substantial (reflecting truly exceptional circumstances) or nothing at all.

165. Having dealt with the specific arguments relating to the principles of the use of modern equivalent in the contractor's basis and the principles relating to the inclusion or otherwise of underutilisation allowances at stage 2, we turn now to consider in sequence the various specific issues as summarised by the respondents and which for convenience we reproduce again here:

> (i) Whether there should be a 32.5% 'underutilisation' allowance [at stage 2] in respect of the tanks.
>
> (ii) Whether there should be a 35% 'underutilisation' allowance [at stage 2] in respect of the jetty.
>
> (iii) Whether a 12.5% technical obsolescence allowance should be applied [at stage 2] on the basis that a modern equivalent tank would have an ADR/IFR as opposed to an EFR.
>
> (iv) The stage 1 costs of underground services and bund walls.
>
> (v) The effect the modern equivalent put forward by Mrs Martin should have on certain stage 1 and stage 2 allowances.
>
> (vi) The appropriate end allowance [at stage 5] for layout and other disadvantages.

Issue (i): Underutilisation allowance for tanks

166. As regards issue (i), we have already concluded that there is nothing as a matter of legal or valuation principle which prohibits any underutilisation allowance being made at stage 2 as part of the hypothetical negotiations between landlord and tenant. On the question of whether on the facts any such allowance should be made in this case, our conclusions are as follows.

167. In his valuation Mr Needham has referred to Mr Thomas's forecast of the most realistic expectation of capacity as at April 2003 at 760,000 m^3, being 56.04% of the total existing

capacity of the terminal (which he took as 1,356,000 m³). Attention was drawn to the state of the market for oil storage as at the AVD. Mr Needham observed that it was probable that utilisation would continue to fluctuate because of the emphasis on short-term contracts and the prevailing market conditions, and he recognised that the figure of 760,000 m³ did not indicate an absolute level. He contemplated that the prospective owner occupier would consider that there were gradations of capacity either above or below that level which would have reflected degrees of additional or less value. Based on those figures he deemed it reasonable to assume a realistic medium-term forecast utilisation of 760,000 m³ which in his view should be reflected by a functional allowance of 32.5%.

168. It is important to note how the arithmetic behind this 32.5% claimed allowance arises. If one applies a 32.5% allowance to the whole of 1,356,000 m³ this gives about 915,000 m³, which is of course substantially more than the forecast utilisation of 760,000 m³. However, it is agreed between Mr Needham and Mr Hughes that there are two tanks (numbers 2 and 11) which were out of service at the material day and to which no value should be attributed, such that a 100% allowance is applied (those two tanks having been highlighted in blue in Mr Needham's detailed valuation workings on page 3745). The gross capacity of those tanks is, respectively, 40,290 m³ and 101,481 m³ and they are *included* within the 1,356,000 m³ capacity of the existing terminal. There are also other tanks which are agreed between Mr Needham and Mr Hughes to have had no commercial value as of April 2005 and to which a 100% allowance has been applied so that they have no effect upon the effective capital value obtained at the end of stage 2 – these are highlighted in pink in Mr Needham's valuation and their volume is **not** included within the 1,356,000 m³ capacity of the existing terminal. Thus, they can for the purposes of the present exercise be ignored. If one deducts the volumes of tanks 2 and 11 from the total capacity one obtains approximately 1,215,000 m³. If one then applies a 32.5% allowance to this, the result is 820,000 m³.

169. In cross examination, Mr Needham drew attention to the fact that upon using his 32.5% allowance the hypothetical tenant would, in effect, be paying at full rate for that 820,000 m³ of capacity which was significantly more than Mr Thomas's estimate of a requirement for about 760,000 m³. This, he said, lent further support to the reasonableness of claiming a 32.5% allowance. In summary therefore, what appears from the foregoing is that of the existing 1,356,000 m³ of capacity (i) the valuers agree that tanks 2 and 11 should attract a 100% allowance and (ii) Mr Needham contends that this remaining tankage (about 1,215,000 m^3) should be subjected to the proposed 32.5% allowance, whereas Mr Hughes does not consider that any underutilisation allowance should be made at all at stage 2, whatever the base figure or starting point is. In that regard, we note that Mr Hughes, in his valuation, attributes full value to a lower level of capacity of 1,067,010 m^3 (as set out in appendix VO21.1 to his first report) which was derived from his approach of analysing the existing tankage and adopting a modern equivalent on a different basis from that which we have accepted (Mrs Martin's exercise). That figure was based upon a total usable capacity of 1,083,023 m^3 less 16,013 m^3 relating to two itemised ballast tanks which were not oil tanks. Having rejected his approach, the implications of his lower "base" figure of usable capacity are not relevant to the determination.

170. We observe (Mr Thomas's table CT34 in volume 3 of the bundle at page 361), that during each of the months from October 2001 to December 2002 the leased volume was more (and in some cases substantially more - namely over 1,100,000 m³ for one month) than the

820,000 m³ taken by Mr Needham as the effective result of his adjustment. We also note Mr Thomas's evidence that in order to accommodate about 1,100,000 m³ of product it is necessary to have available about 1,200,000 m³ of tank capacity.

171. Accordingly, in the hypothetical negotiations between landlord and tenant each party has, amongst their various other arguments, an argument based upon the prospect (or lack of prospect) for underutilisation. The landlord is entitled to point to the matters summarised in the previous paragraph, to observe that recently before the AVD the operations at the terminal had effectively needed the full 1,215,000 m³ of capacity, and to observe that there is value in having storage capacity available even if it is not for the time being in active use. The tenant is entitled to point to the level of demand more recently before the AVD and to the prospect for the future demand for capacity at the terminal assessed as at the AVD.

172. Upon this latter point regarding the prospects for the market as at the AVD our conclusions in summary are as follows. The market was significantly backwardated and as a result there was overcapacity as at the AVD. However, the experts agreed the market is cyclical and the prospect was therefore that in due course it would revert to contango (although Mr Kellaway stressed that the periods of backwardation tended to be significantly longer than those of a contango market). Thus, accordingly, the overcapacity was temporary rather than being such that there was no reasonable prospect of the full 1,215,000 m³ of tankage ever being used to its full capacity. However, the mere fact that the overcapacity was temporary does not as a matter of principle prohibit the hypothetical tenant from raising this, and other matters, as factors in negotiations for the rent of the hereditament on the statutory terms.

173. Mr Brown accepted in cross-examination that the actual operator is the best proxy for the hypothetical operator, and in his evidence took no exception to Mr Thomas's forecasts for post AVD as set out in his appendix CT 38. We take into account, and accept, the views expressed by Mr Kellaway (as summarised at paras 53 & 54 above) as to the whole range of factors that would affect prospects for the oil storage market as at the AVD as applying to this appeal hereditament in particular. So, not only was there a prospect of a potentially long period of backwardation, but there were the other considerations such as the hereditament's poor location in trading terms putting it at a disadvantage to other operators when, and if, the market improved. As regards location Mr Glover reminded us that Mr Hughes confirmed in cross-examination that there was no allowance for underutilisation in the agreed 6.5% allowance for location under stage 5. Such matters would in our judgement contribute to the potential for continued underutilisation, and would support the argument that some allowance should be made under this head.

174. Thus, in these circumstances, we conclude that whilst the hypothetical landlord could successfully resist an argument that an allowance of as much as 32.5% should be applied to this 1,215,000 m³ of tankage, the tenant's argument upon this point regarding overcapacity is not something to which the landlord could successfully accord no effect at all. We consider that in all the circumstances of this case, the tenant would succeed in these negotiations in obtaining a 10% allowance upon this 1,215,000 m³ of tankage to reflect the prospective underutilisation.

Issue (ii): Underutilisation allowance for jetty

175. As regards issue (ii), Mr Needham concluded that a 35% allowance for underutilisation of the jetty should be made. He justified this on the basis that the potential owner occupier would look carefully at the historic and prospective use of the jetty having regard to the probable business model for operation of the terminal, and would recognise that there was a substantially underused berth capacity. He referred to Mr Thomas's table 7 at paragraph 201 of his first statement showing that berth occupancy for an assumed two berth operation ranged between an annual average of 32% and 50% for the years 2000-2005 which averaged 40% both in respect of this full six-year period and also in respect of the more appropriate three-year period 2000-2002.

176. We cannot accept Mr Needham's arguments regarding the jetty. The appeal site is an oil terminal the essential function of which is to store large volumes of oil and distillates. The only access for such items is by sea. It is an indispensable requirement for the operation of the terminal that it has adequate berths for the ships of varying sizes (some of them large) which will attend to deliver or collect large volumes of product. Without the jetty and its two berths the terminal could not operate at all. We recognise that the berths will only be in active physical use for much less than 100% of the time, but that does not in our judgement justify any allowance for underutilisation. We conclude that for the appeal site to operate as an oil terminal at all it is necessary that there is at all times proper access to it. There was no evidence before us to suggest that potential clients, wishing to store products at the terminal, would be content with anything less than the terminal having potential access for delivery/collection at any time. It would be surprising if such potential clients would be content with being told that the terminal at which they were going to store their product was one where for 35% of the time there was no sea access for vessels. The fact that the front (and only) door to a hereditament is only in fact used for X% percent of the time does not alter the fact that it provides value (and indeed is indispensable) 100% of the time.

177. We therefore make no allowance for the claimed underutilisation of the jetty.

Issue (iii): Technical obsolescence allowance – tank roofs

178. It follows from our conclusions regarding the modern equivalent and its usefulness and applicability in the present case, and from those relating to the soundness of Mrs Martin's design, that we accept the argument that the modern equivalent would include construction of tanks with ADR/IFR as opposed to EFR. As regards cost of construction of such tanks we also accept the evidence of Mrs Martin and the analysis of Mr Needham regarding such costs. We consider her costs to be carefully considered and reliable. Mr Brown has impressive professional qualifications and has many years of working in and advising upon the oil industry. However he agreed that he was a chemical engineer not a mechanical engineer and that he had not provided any cost data himself regarding construction costs of ADR/IFR tanks.

179. We accept therefore that the cost of constructing the ADR/IFR tanks warrants a 12.5% deduction from the stage 1 costs of the tanks (the cost of constructing equivalent tanks with

EFRs). The latter cost can be obtained from the VOA costs guide. We consider Mr Needham is justified in applying a 12.5% allowance thereto.

Issue (iv): Stage 1 costs – underground services and bunds

180. We accept the arguments advanced by Mr Glover, as summarised in paragraph 131 above, for the reasons he gave. We conclude that the bunds should be costed in relation to 7,650 m in length and a height of 2.25 m at a rate of £46 per linear metre. As regards the underground services we agree that these should be costed at £6,000 per acre.

Issue (v): Mrs Martin's modern equivalent

181. We have concluded that at stages 1 and 2 reference can and should properly be made to a modern equivalent as designed by Mrs Martin. We are unclear precisely what items of dispute, which are not separately decided elsewhere in this decision, remain to be dealt with under issue (v). We do however note the areas of dispute and the figures attached thereto which are set out on document page 3799L. In summary regarding these points (insofar as arising under stages 1 and 2 and not dealt with elsewhere) our conclusions are as follows:

(1) As to the substations we find that the appropriate modern equivalent to take is that identified by Mrs Martin with three substations.

(2) As regards tanks, we have already concluded that the appropriate modern equivalent to take is that identified by Mrs Martin (with ADR/IFR) and that the appropriate costs of construction for such tanks is to be taken as that supported by Mr Needham, namely 12.5% less. We trust that this also serves to resolve any outstanding problems regarding tank bases. Our decision on tank bunds is as outlined above.

(3) In respect of the jetty we understand there is no dispute regarding the cost of construction of the modern equivalent, and we trust that any outstanding dispute regarding jetty ancillaries can be resolved.

(4) As to drainage and separators, fire protection and land, we have found in favour of Mrs Martin's modern equivalent and trust that this resolves this point or will enable the parties to reach agreement upon it where such agreement has not already occurred (e.g. fire protection) and in any other areas where there was a dispute - e.g. site lighting and roads/bridges.

(5) Any remaining issues relating to site infrastructure we believe have been dealt with under issue (iv) above.

Issue (vi): Stage 5 "stand back and look" allowances

182. There is agreement between the parties that there should be a 6.5% allowance for location and 5% allowance for the temporary disturbance from works on the Dragon LNG site. The points in dispute concern the allowance to be made for the additional running costs of the

actual hereditament (as compared with the modern equivalent) and the costs of repairing/keeping safe the unwanted refinery.

183. As regards the evidence on behalf of the appellant to the effect that the running costs of the terminal at the appeal site would be substantially more (even ignoring for the moment the costs of maintaining the refinery) than the running costs for a modern equivalent terminal, we accept that there would indeed be substantial such costs and that the categories of such costs and the amount of such costs would be broadly as described by Mr Thomas and as contained in CT 19. Various challenges were put to him by way of cross examination, but we conclude that his evidence on these points is well-founded. We notice that Mr Brown did not seek himself to consider in any detail these points or to put forward any likely costings of his own. Instead Mr Brown's approach was to refer to exhibit CT 19, to observe that he had not been able to verify Mr Thomas's calculation and then to express these likely costs as cost per cubic metre per month. The conclusion we reach is that, broadly for the reasons advanced by Mr Thomas, the cost of running a terminal business on the appeal site as at the relevant time would have been substantially greater than running such a business at a modern equivalent with the additional costs being of the order of £598,000 per annum.

184. We agree that only a portion of those costs would apply to the rateable part of the hereditament. We accept that Mr Needham has made an informed appraisal regarding what proportion of this £598,000 should be attributed to the rateable parts of the hereditament and we accept his conclusion that £390,000 could appropriately be allocated to them. There is also to be added the additional dredging cost of £40,000 per annum. The hypothetical tenant would therefore in the negotiations with the landlord be drawing attention to additional costs of about £430,000 per annum above the costs of operating a modern equivalent. We agree with Mr Needham's conclusion that a deduction of £250,000 is appropriate and recognises that the hypothetical landlord is entitled to be recognised as having some success in the negotiations.

185. We conclude therefore that a stage 5 allowance of £250,000 per annum should be made in recognition of the additional costs to the hypothetical tenant of maintenance of the actual hereditament (as compared with the modern equivalent) and of dredging. We agree with Mr Glover that this is more appropriately made in specific monetary terms as an allowance of £250,000 per annum as opposed to being identified as a certain percentage of the figure arrived at the end of stage 4.

186. As regards the appellant's evidence that the hypothetical tenant would face substantial ongoing costs in performing repairs (or at the very least basic maintenance) to the unwanted refinery so as to prevent accidents and to enable the oil storage terminal to be conducted properly and safely, once again we accept that there would be such costs and that the categories and amounts of such costs would be broadly as described by Mr Thomas. We notice the respondent's criticism of the sources supporting his table CT 39. However, we found weight in Mr Thomas's personal appraisal, from his own experience at the site including of financial matters there, which was to the effect that costs would be incurred in these categories and they would be broadly of the amount described by him. We also note Mrs Martin's evidence that she considered some of Mr Thomas's assessment of costs to be conservative. Upon this point Mr Brown did not seek to give any evidence either regarding categories of potential

expenditure or amounts thereof. Accordingly we conclude that the hypothetical tenant taking a tenancy of the hereditament on the statutory terms would be faced with the prospect of ongoing expense and responsibility for the unwanted refinery (or more precisely such parts of it as were rateable) and that categories of expenditure and the amount thereof are broadly represented by the contents of CT 39 and by the sum of approximately £160,000 per annum.

187. We note that this figure of £160,000 per annum applies to the whole of the refinery assets and not merely the rateable parts thereof. We accept Mr Needham's analysis that, in the hypothetical negotiations between landlord and tenant, an allowance of £35,000 per annum would be agreed.

Disposal

188. This determines the issues of principle that were before us, and the parties have 14 days in which to consult and forward to the Tribunal their agreed valuation based upon our findings. If the parties are unable to submit an agreed valuation they must each, within this 14 day period, submit their separate valuations with an agreed explanation as to why there is a difference. The Tribunal expects the parties to use their best endeavours to agree a valuation in the light of the Tribunal's decision on the many points of principle and detail which were in issue in this case. The parties should be aware that failing agreement, the Tribunal will only reconvene the hearing for further argument/evidence if it considers it essential to do so rather than resolve any outstanding differences upon the material that is already before it, coupled with its ability and duty to "stand back and look" as part of stage 5 of the contractor's method.

189. Finally, we have referred to the difficulties caused to us due the valuers' inability to agree upon, and adopt, the use of a common valuation format. This would have been even more of a problem if we had been required to determine each and every one of the disputed issues in specific valuation terms. This problem has arisen in other significant cases and it is our view that the time has now come for those involved in rating disputes to take action to resolve the situation. It is suggested therefore that the relevant committee or panel within the RICS should take it upon itself to work with the VOA and the Rating Surveyors Association in an attempt to achieve a common valuation format under the contractor's basis, perhaps along the lines, or adopting the principles, behind the software now known as Argus Developer which was developed and is in universal use for residual valuations.

Dated: 19 January 2018

His Honour Judge Nicholas Huskinson

Paul Francis FRICS

ADDENDUM

190. The Tribunal has now received further submissions from the parties in accordance with the directions set out at para 188 above. Unfortunately, due to the valuation experts having failed to reach agreement on two issues, there remained a difference between them of some £66,000. The first, and the only one where the sums at stake could be considered significant, relates to the parties' understanding of the Tribunal's decision on Modern Equivalent costs of constructing the 53 storage tanks agreed to have commercial value. The appellant referred to what we said at paras 39, 178 and 181 of the interim decision (which we do not repeat here) and confirmed that Mr Needham has included in his final valuation the relevant 12.5% allowance against all tanks and applied an underutilisation allowance of 10% as determined by the Tribunal. Mr Hughes, on the other hand, submitted that his interpretation of what the Tribunal meant (and what was summarised in para 179 above) was different, and drew a distinction between the existing tanks that have EFRs and the larger ones that have fixed roofs. This involved a complex calculation which resulted, according to the appellant, in an effective underutilisation discount of 6% rather than the 10% promulgated by the Tribunal. Nevertheless, Mr Hughes said that if the Tribunal found in favour of the appellant's argument on this point that he agreed the difference was c. £66,000.

191. It was pointed out by Mr Needham that the figures Mr Hughes produced were intertwined with an 'other allowance' of 15.4% that formed part of his valuation (at column 17) but how that was calculated and the relevance to this issue was not explained. It was not a matter that was dealt with at the hearing or raised with any of the witnesses We are satisfied that Mr Needham's understanding is correct and adopt his resultant figure for "tanks and tank bases' shown in his summary valuation at £1,042,205.

192. The remaining issue related to rounding. Mr Needham's final valuation amounted to £1,168,222 which, in accordance with the VOA rounding policy relating to the 2005 Rating List, was to round down to the next RV £10,000 for assessments greater than £1,000,000. Thus, he adjusted down to an RV of £1,160,000. Mr Hughes, whose revised valuation came to £1,234,072 (which he rounded down to £1,234,000), said that such a large rounding as proposed by Mr Needham effectively amounted to an additional stage 5 allowance of 0.7%. He reproduced para 4 of the VOA policy in full, and which, he said, makes provision for circumstances such as this in the last sentence which reads: *"Here it is not always appropriate*

to follow the rounding guidance and agreements may be reached at figures which both parties are content to agree." We agree that the rounding as proposed by the appellant in this case is too high, and consider that the rounding down should be to £1,165,000.

193. This concludes the matter before us, and we determine that the rateable value shall be amended in the 2005 rating list, effective from 1 April 2005, to RV £1,165,000.

194. This decision is now final on all matters other than the question of costs in the reference. The parties are therefore now invited to make submissions on such costs and a letter giving directions for the exchange and service of submissions accompanies this decision.

Dated: 27 February 2018

His Honour Judge Nicholas Huskinson

Paul Francis FRICS

ADDENDUM ON COSTS

195. Submissions on costs have been received from the parties. The appellant pointed out that that, in accordance with Paragraph 12.3 of the Tribunal's Practice Directions, the general rule is that the successful party ought to receive its costs. The determination by this Tribunal of RV £1,165,000 is, it was submitted, a significant reduction (in the region of 20%) from the VTE's decision that the appeal hereditament should be entered in the 2005 rating list at £1,442,000. The respondent VO (who did not cross-appeal) sought to defend the VTW's assessment although he had, in fact, spoken to a higher valuation at £1,458,000. Thus, the appellant was clearly the successful party, and there were no conceivable grounds by which the respondent could argue otherwise. In the circumstances, the appellant seeks its costs from the respondent on the standard basis, to be assessed by the Registrar if not agreed.

196. The respondent VO submitted that, as it had failed to achieve the very significant reduction that it was seeking (initially to RV £750,000 – latterly to £830,000), the appellant could not be described as 'the successful party'. The RV determined by this Tribunal is £415,000 higher than the initial figure sought, and £335,000 above the latter figure which was a very late concession made after the hearing had commenced. Thus, the RV as determined was very much closer to the VTW's figure (being £277,000 lower). In the circumstances, it was argued that costs should follow the event and that the appellant should be ordered to pay the respondent's reasonable costs.

197. In the alternative, it was submitted that if the Tribunal decided that neither party was successful, the appropriate approach should be that there be no order as to costs. This was the approach taken by the Upper Tribunal in *Lamb (VO) v Go Outdoors Ltd* [2015] UKUT 0366 (LC) where the RV that was determined was not in the region of either party's proposed figure (there being an appeal and cross-appeal). Whilst it was acknowledged that there were significant factual differences between that case and this one, the Tribunal determined at [129]:

> "… However in this case, both parties accepted that the VTE's decision was wrong, to consider costs solely in the context of the appellant succeeding in achieving an increase of £95,000 above the VTE's determination would, in my judgement, be an unjust starting point."

Thus, simply achieving a figure which is an improvement on the RV found by the Valuation Tribunal is not sufficient to show that a party has 'won'.

198. The respondent VO therefore seeks either its own costs, or that there should be no order.

199. In response, it was submitted that the respondent's suggested approaches to costs were entirely fanciful and if the Tribunal were to accede to his argument, a principle would be established that was "profoundly malign". To suggest that the appellant should be ordered to pay the respondent VO's costs unless the Tribunal's determination "comes close to" the valuation spoken to by the respondent's valuer is unsupportable. It would, it was argued, be repugnant were the Tribunal to adopt a rule that a taxpayer who, in the teeth of the taxing authority's opposition, achieves a significant reduction in its tax liability should have to pay the costs of that authority's attempt to deny him that, or any, reduction.

200. In this case, not only did the taxpayer achieve a near 20% reduction in its liability, but the Tribunal dismissed the VO's valuation and rejected his position on all the issues of valuation principle, all the issues of cost and all but one of the issues of valuation judgement. For the VO to argue that he had been successful was entirely without merit.

201. Further, it was pointed out that the respondent had failed to mention that, on 17 September 2017, after all the evidence had been exchanged, its solicitor had made a *Calderbank* offer, a copy of which had been deposited with the Tribunal in a sealed envelope, offering to settle the appeal at an RV of £1,340,000 on condition that each party bears its own costs. That offer, which was time limited, was not accepted. The appellant has clearly beaten

that offer by a considerable margin. It is an unarguable fact that the appellant would not have achieved the substantial reduction that it did had it not pursued the appeal to completion.

202. Rather than rely on *Lamb*, which was so significantly different as to be inappropriate to consider in this case, the Tribunal should, it was submitted, follow the principles on costs established in *Commissioner of Valuations v Jamaica Gypsum Ltd* (1971) RRC 4 and which has been referred to in a number of recent UT cases including *Selfridges v Humphries (VO)* [2010] RA 260 and *British Car Auctions v Hazell (VO)* [2015] RA 108. *Jamaica Gypsum* was a case which concerned the assessment of land value in Jamaica. The Commissioner argued for £9,500, the taxpayer for £2,000. On appeal the valuation board decided on a value of £4,300 and ordered the commissioner to pay 50% of the taxpayer's costs. The Commissioner appealed against the assessment and the taxpayer against the costs award. The Court of Appeal dismissed the Commissioner's appeal, upheld the taxpayer's appeal and ordered the Commissioner to pay the whole of their costs. The Privy Council dismissed the Commissioner's further appeal on both matters. The relevant part of the judgment on costs reads, at [11]:

> "The Court of Appeal in its judgement went fully into the issue of costs. In their view the real issue was whether the value assessed, viz., £9,500 was too high; the respondent was successful in showing that it was too high by a substantial amount. The case was an intricate one involving difficult questions. The Court could find no trace of misconduct by the respondent or any other sufficient reason for depriving the respondent of 50% of its costs. No reasons for so doing have been given by the board. The respondent should have its costs in full. Their Lordships agree with the decision of the Court of Appeal… **In principle their lordships consider that a person who successfully secures a reduction in the valuation, unless that is of a minimal amount, should be entitled to its costs, and that, unless by doing so he has added to the length or expense of the proceedings, the fact that he has supported a figure which turns out to be less than that finally accepted should not be to his detriment."** [emphasis added]

203. It was submitted that the *Jamaica Gypsum* principle has been, and continues to be, a guiding light on costs in the Lands Tribunal and now the Upper Tribunal. It is the principle whereby the appellant ratepayer who persuades the Tribunal to reduce the rateable value by more than a minimal amount is treated as the successful party and therefore should be entitled to his costs.

204. In this case there has been no suggestion that the appellant ratepayer has acted unreasonably or has by arguing for a lesser amount than awarded, added to the length or cost of the proceedings. There can certainly be no question of arguing that the reduction achieved was minimal. The Tribunal's determination was for a RV £175,000 less than had been offered by the respondent in its Calderbank offer, and so there can be no possible justification for the claim that the appellant should pay the respondent's costs, or even that it should cover its own.

205. We agree entirely with the appellant's submissions. This appeal bore resemblances to *Jamaica Gypsum* and whilst there can be no denying that the appellant's expectations were for a significantly larger reduction in the RV, the VO in supporting, and indeed, speaking to a

higher figure than determined by the VTW, could be argued to have had excessive expectations himself.

206. We also accept that, considering the evidence, the appellant has been successful in most of its arguments and we can see no justifiable reason why the normal rule should not apply.

207. It is therefore determined that the appellant shall have its costs, such costs to be subject to a detailed assessment by the Registrar if not agreed.

Dated: 28 March 2018

His Honour Judge Nicholas Huskinson

Paul Francis FRICS