UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – PLANT AND MACHINERY – air handling unit – whether rateable – whether used mainly or exclusively as part of manufacturing operations or trade processes – meaning of "trade processes" – reg.2, Valuation for Rating (Plant and Machinery) (England) Regulations 2000 – rateable value including air handling unit – appeal allowed – Rateable Value determined at £104,000

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE VALUATION TRIBUNAL FOR ENGLAND

BETWEEN **JANE A BERRY (VALUATION OFFICER)** **Appellant**

and

ICELAND FOODS LIMITED **Respondent**

Re: 4 Penketh Drive
Liverpool
L24 2WZ

Before: Martin Rodger QC (Deputy President) and P D McCrea FRICS

Sitting at: Liverpool Civil & Family Court
on
17-20 November 2014

Timothy Morshead QC and Zack Simons, instructed by the solicitor to HMRC, for the appellant
Daniel Kolinsky, instructed by Shoosmiths, for the respondent

The following cases are referred to in this decision:

Union Cold Storage Co Ltd v Southwark Assessment Committee (1932) 16 R & IT 160
Ellerker v Union Cold Storage Co Ltd [1939] 1 All ER 23
Hays v Raley (VO) [1986] 1 EGLR 226
Dorothy Perkins Retail Ltd v Casey (VO) [1994] RA 391
Allen (Valuation Officer) v English Sports Council [2009] RA 289
Edma (Jewellers) Ltd v Moore (VO) [1975] RA 343
Budgen V Andrew Gardner Partnership [2002] EWCA Civ 1125
Straker v Tudor Rose [2007] EWCA Civ 368 at [8] –[9].

The following further cases were referred to in argument:

Burton Upon Trent v Bass Ratcliff (1961) 8 RRC 155
Nurse v Morganite Crucible [1989] AC 692
Vibroplant Limited v Holland [1982] 1 AER 792
Girobank plc v Clarke [1996] STC 540 and [1998] 1 WLR 942
Sheffield City Council v ADH Demolition [1984] JPL 658
Kilmarnock Equitable Cooperative Society Ltd v Inland Revenue Commissioners [1966] SLT 224
Bestway (Holdings) Ltd v Luff [1998] STC 357
Godiva UK Ltd v Spital (VO) (unreported, 1991)
A-G v HRH Prince Ernest Augustus of Hanover [1957] AC 436
Bourne v Norwich Crematorium Ltd [1967] 1 WLR 691
Pointer v Norwich Assessment Committee [1922] 2 KB 471
Lotus & Delta v Culverwell (VO) [1976] RA 141
Futures London Limited v Stratford (VO) [2005] RA 75
Eastbourne Borough Council and Wealden District Council v Allen (VO) [2001] RA 273
Orange PCS v Bradford (VO) [2004] 2 All ER 651
Poplar Metropolitan Borough Assessment Committee v Roberts [1922] 2 AC 93

DECISION

Introduction

1. In determining the rateable value of a non-domestic hereditament, plant and machinery used mainly or exclusively as part of manufacturing operations or trade processes is assumed to have no effect on the rent at which the premises would be let. By a decision made on 18 October 2012 the Valuation Tribunal for England determined that an air handling system installed by Iceland Foods Limited in its retail warehouse at 4 Penketh Drive at Speke in Liverpool was used mainly in connection with a trade process, and was within this exemption.

2. The decision of the VTE arose out of a proposal made on behalf of Iceland on 8 October 2010. The proposal was to alter the rateable value shown for the appeal property in the 2010 rating list from £108,000 to £1 on the grounds that the assessment was excessive and bad in law. The VTE reduced the entry to £98,000 with effect from 1 April 2010, attributing no value to the air handling system.

3. The issues in this appeal from that decision by the Valuation Officer are, first, whether the VTE was right to regard the air handling system as used mainly as part of a trade process, and secondly, if not, what rateable value should be entered in the rating list to take account of the presence of the air handling unit in the appeal property.

4. Mr Timothy Morshead QC and Mr Zack Simons of counsel represented the appellant, and called the VO, Ms Jane A Berry, to give valuation evidence, Mr Nimal Rajapakse to give evidence concerning the air handling system, and Professor Judith Evans to give evidence on refrigeration. Mr Daniel Kolinsky of counsel appeared for the respondent, Iceland. He called Mr Paul Moran of Mason Owen who gave valuation evidence, Mr Ron Parry who gave evidence concerning the air handling system, Mr Michael Creamer who gave evidence on refrigeration and Mr Andrew Brown, Iceland's Property Manager.

Facts

5. The parties provided a short statement of agreed facts and, having heard the evidence, we conducted an inspection of the appeal property.

6. The absence of a greater level of agreement on technical issues was disappointing. Two experts were called on each side to give evidence of considerable complexity on engineering and refrigeration issues, but no joint statement was produced by these experts. This led to a considerable amount of time being spent in cross examination on technical detail concerning issues which neither party suggested were central to the resolution of the appeal. It ought to have been possible for the experts to have offered the Tribunal much more assistance by recording in summary form those matters on which they agreed and those on which they disagreed, with a brief explanation for their

disagreement. The Tribunal is entitled to expect such assistance from expert witnesses and, when it is not forthcoming, to question whether one or more expert truly understands their duties to the Tribunal.

7. In the light of the statement of agreed facts and the written and oral evidence, we take the following facts as the basis of our decision in this appeal.

8. Iceland is a well known supermarket operator specialising in the sale of refrigerated foods, both frozen and chilled, and, to a lesser extent, in the sale of general groceries. It operates from more than 800 stores in the UK and Ireland of which the appeal property is typical.

9. The appeal property is a small retail warehouse which forms part of a larger retail development known as the Speke Centre, comprising a mix of retail warehousing, smaller shops and a large Morrisons superstore, all surrounding a shared central car park. At the rear of the appeal property is a secure service yard which it shares with adjacent units.

10. The appeal property has a ground floor sales area of 449.25m^2 with a single public entrance at the front, and a further 134.62m^2 of ancillary accommodation arranged on one side at the rear which provides staff rooms, a small office and goods-in and storage areas (all areas are measured on a gross internal area basis and the ancillary accommodation is net of the area of a cold store).

11. Iceland took occupation of the appeal property in May 2007 under a 10 year lease on full repairing and insuring terms at an annual rent of £109,216. The appeal property was let in a shell condition and as part of its fitting out works Iceland installed an air handling system designed with its own style of trading in mind.

12. The air handling system provides a ventilating, heating and cooling service to the appeal property, and comprises three main elements. A large air handling unit with a mechanical cooling capacity of approximately 85 kW is located outside and to the rear of the building; this unit serves a network of ducts by which warm or cold air is supplied to and extracted from the retail area through an array of ceiling mounted diffusers and grilles. On our inspection we were able to observe the air handling unit and to contrast it with the very much smaller units on the rear walls of adjoining stores – one of which is considerably larger than the appeal property. Iceland's equipment occupies its own fenced compound and in size and shape resembles a very large refuse skip (4.5 metres by 2.35 metres in area) from which rise two vertical supply and return air ducts, each a metre square, which enter the rear wall of the building 4 metres above the ground. A separate but linked mechanical extract system is located at the rear of the retail area, furthest from the entrance, to deal with the removal of excess heat in that area. Finally, the whole system is controlled by means of a computerised control unit located adjacent to the air handling unit.

13. Other plant and machinery serving the appeal property includes a closed circuit television system, a cold store for frozen goods located in the rear storage area and a free-standing chiller in the rear storage/goods-in area. There is a shipping container used for storage situated in the service yard.

14. The opening hours of the store vary from day to day but in a typical week the store trades for 67.5 hours over 7 days. Staff will usually be present for a further two hours a day outside opening hours for cleaning, loading cabinets and other tasks. In total, therefore, customers or staff will typically be present in the store for a little under half of the total hours in a week.

15. Although Iceland stocks a modest selection of general or "ambient" groceries, its business is mainly focused on the sale of refrigerated products which represent roughly 80% of its sales by value, divided evenly between chilled and frozen lines.

16. Frozen and chilled products are stored and displayed in refrigerated cabinets arranged around the perimeter of the sales floor and in four aisles running from front to rear. The total number of these refrigerated cabinets has fluctuated between 79 and 84 since the store opened in 2007. As at 1 April 2010 there were 82 cabinets comprising 71 glass topped "integral" freezer cabinets, 3 open topped "integral" freezer cabinets, 7 open-fronted multi-deck "integral" chiller cabinets and one "remote" roll-in milk chiller.

17. All of the equipment in use at the appeal property on the material day was classified as "climate class 3" under the main British and European test standard used for testing retail display cabinets. This classification indicates that the cabinets are designed to operate at a surrounding air temperature of up to 25° C. It was suggested on behalf of the VO that some of the equipment was capable of operating at higher ambient temperatures, and that it was tested to climate class 4. We do not consider that such testing is relevant to the design and normal operation of the cabinets.

18. The description of some refrigerated display cabinets as "integral" and others as "remote" is of significance. The object of any refrigerator is to maintain the internal temperature (and thus that of the goods stored in it) at the desired level by absorbing heat from within the cabinet and expelling it outside the cabinet by means of a condenser. Integral cabinets achieve this using refrigeration equipment and condensers installed within the body of the cabinet itself, and by expelling heat to the environment immediately surrounding the cabinet. Remote cabinets, in contrast, employ refrigeration equipment at a distance from the cabinets; heat is absorbed by a liquid refrigerant which is conveyed to the cabinet through pipes permanently installed in the store and is expelled remotely through condensers located outside the building.

19. The advantages of integral over remote cabinets include flexibility, in that integral cabinets can be easily unplugged and moved around or replaced, whereas remote cabinets depend on their connection to a fixed network of pipes and centralised plant. Integral cabinets also minimise the risk of loss of stock in the event of refrigeration failure, as each cabinet is self-contained and operates independently. The disadvantage of integral cabinets is that not only do they generate heat in their own right, but the heat which they absorb from within is expelled from beneath or behind the cabinet into the surrounding space, causing the temperature of that space to rise.

20. As integral cabinets are designed to operate below a particular ambient temperature (25° C in the case of Iceland's climate class 3 cabinets) the heat generated by the cabinets themselves must be controlled to ensure that they perform as intended and do not malfunction. Where a large number of

integral cabinets is present in a confined space, it is necessary to provide an air handling system with a correspondingly large cooling capacity. If the design parameters of the cabinets are exceeded the permitted product storage temperature within the cabinets may be breached causing a deterioration in the quality of the products stored or displayed in them.

21. Iceland values the flexibility and lower capital cost associated with integral cabinets and they represent the great majority of the refrigerated cabinets in almost all of its stores. In the appeal property only the milk-chiller operates on the "remote" principle, with pipework allowing heat to be rejected outside the building. The remaining 81 cabinets are of the integral variety and reject heat directly into the sales floor.

22. The air handling system functions at all times, day and night. It is designed and programmed to maintain the store temperature during trading hours at an acceptable level for both the functioning of the refrigerated cabinets and the comfort of staff and customers, within a range between 18°C and 23 °C. This range is reduced to between 16° and 23°C outside trading hours.

23. The temperature of the air extracted from the store is measured by a single sensor in the return air duct. As the air in that part of the return duct has been drawn from all parts of the store, the sensor is unable to gauge the temperature on different parts of the shop floor. It is agreed that the temperature range across the floor will vary by +/- 2°. The air handling system has no localised cooling or heating capacity (although additional heating is provided by a heat curtain over the door and by separate fan heaters above the check out area, neither of which is part of the air handling system).

24. To achieve the acceptable temperature range during trading periods Iceland's control strategy targets a temperature within the store of 21°C which is in the middle of the range of comfortable temperatures for staff and customers recommended by the Chartered Institute of Building Services Engineers.

25. For the majority of the time an acceptable temperature is maintained on the sales floor without the use of mechanical cooling; warm air is extracted through the ducts and replaced by cooler fresh air from outside the building (a technique referred to as "free cooling"). At 21°C mechanical cooling commences, with full cooling capacity becoming engaged when an average temperature of 23°C is reached. By aiming to maintain a target temperature of 21°C during trading hours Iceland seeks to ensure that the maximum temperature at which the cabinets are designed to function is not exceeded (or at least not exceeded regularly or for prolonged periods).

26. Test data suggests that mechanical cooling was required on 123 days in a year, of which on 106 days mechanical cooling was required at times when the store was not trading.

27. The air handling system also contains two 12kW electric heaters. When the temperature within the store falls below 18.4°C during trading hours the heating function is engaged. Because the cabinets generate their own heat within the store the need for additional heating occurs relatively

infrequently and is engaged for only 2% of the time (about 3% of trading time). No heating is employed outside trading hours.

28. The cabinets would operate comfortably at much lower temperatures than the 21°C targeted during trading hours or the 18.4°C at which the air handling system is designed to commence heating.

29. There was considerable debate (instigated by the VO's experts) over the extent to which the cooling capacity of the system was required to deal with heat generated by the cabinets as compared to heat generated from other sources (principally from lighting, solar gain, and the presence of people in the store). The absence of cooperation between the experts to identify the extent of agreement between them and the reasons for their disagreement was particularly acute in relation to this topic, but in the end neither counsel placed much stress on its significance. We did not find this material helpful and we agree with Mr Kolinsky's submission that in a trading environment such a detailed analysis as was attempted by the VO's experts was unreal. It is sufficient to note that a substantial proportion of the heat load was generated by sources other than the cabinets, although these were by far the largest single contributor, exceeding half of the total on some approaches to the assessment and by any measure accounting for between about 40% and about 60% of the heat which required to be dealt with within the store. It is also clear that, without the integral cabinets, the air handling system installed in the store would not be required and a very much smaller system would be sufficient.

The statutory provisions

30. The rateable value of a non-domestic hereditament is determined in accordance with the provisions of Schedule 6 to the Local Government Finance Act 1988. Paragraph 2(1) of Schedule 6 prescribes that such rateable value shall be taken to be an amount equal to the amount at which it is estimated the hereditament might reasonably be expected to let from year to year on certain specified assumptions. Paragraph 2(8) of Schedule 6 gives the Secretary of State power to make regulations setting out further "prescribed assumptions (as to the hereditament or otherwise)". The Valuation for Rating (Plant and Machinery) (England) Regulations 2000 ("the 2000 Regulations") were made under that power.

31. Regulation 2 of the 2000 Regulations prescribes certain assumptions in relation to a hereditament in or on which there is plant or machinery. The effect of those assumptions is that certain plant and machinery is taken to be part of the hereditament (and valued as such), while other plant and machinery is taken to have no effect on the rent to be estimated in accordance with paragraph 2 of Schedule 6 to the 1988 Act.

32. Regulation 2 is in the following terms:

> "2. For purpose of determining the rateable value of a hereditament for any day on or after 1 April 2000 in applying the provisions of sub-paragraphs (1) to (7) of paragraph 2 of Schedule 6 to the Local Government Finance Act 1988 –

(a) In relation to a hereditament in or on which there is plant or machinery which belongs to any of the classes set out in the Schedule to these Regulations, the prescribed assumptions are that:

(i) any such plant or machinery is part of the hereditament; and

(ii) the value of any other plant and machinery has no effect on the rent to be estimated as required by paragraph 2(1); and

(b) in relation to any other hereditament, the prescribed assumption is that the value of any plant or machinery has no effect on the rent to be so estimated."

33. The Schedule to the 2000 Regulations categorises certain plant and machinery into four classes, all of which are to be assumed to be part of the hereditament. For the purpose of this appeal the relevant class is Class 2 which comprises:

> "Plant and machinery specified in Table 2 below (together with the appliances and structures accessory to such plant or machinery and specified in paragraph 2 of the List of Accessories set out below) which is used or intended to be used in connection with services to the hereditament or part of it, other than any such plant or machinery which is in or on the hereditament and is used or intended to be used in connection with services mainly or exclusively as part of manufacturing operations or trade processes.
>
> In this Class, "services" means heating, cooling, ventilating, lighting, draining or supplying of water and protection from trespass, criminal damage, theft, fire or other hazard."

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34. The plant and machinery specified in Table 2 includes air intakes, channels, ducts, gratings, louvres and outlets, and plant for filtering, warming, cooling, humidifying, deodorising and perfuming, and for the chemical and bacteriological treatment of air. The list of accessories in Class 2 includes pipes, ducts, valves and filters, as well as instruments and apparatus attached to the plant and machinery.

35. The parties agree that the air handling system installed by Iceland at the appeal property is within Table 2 of Class 2. The effect of Regulation 2(a)(i) is that unless it falls within the exception from Class 2 of plant or machinery "used or intended to be used in connection with services mainly or exclusively as part of manufacturing operations or trade processes", it will be taken to be part of the hereditament and will be valued as such. If the air handling system is within the exception, the effect of Regulation 2(a)(ii) or 2(b) is that it will be assumed to have no effect on the rent to be estimated in accordance with paragraph 2(1) of Schedule 6 to the 1988 Act.

36. Iceland's approach to cooling its stores is the result of its own experience over many years of trading, and has been in use for more than 15 years. In his capacity as Head of Operational Services at Iceland Mr Parry has been principally responsible for designing and developing the

system which is now installed in more than 90% of its stores. Its equipment is unlikely to suit the needs of other retailers and systems left in place when it disposed of 37 stores to Marks & Spencer in 2006 for use as food supermarkets was removed by the incoming operator. When Iceland takes on new premises it does not attempt to re-use an existing air handling system, but installs its own, as it did when, in 2009, it re-acquired four of the stores transferred to Marks & Spencer only three years earlier.

Issues

37. It is common ground that the air handling system is not used in relation to any manufacturing operation, and is not used exclusively in relation to trade processes.

38. The main issue in the appeal is whether the air handling system is used in connection with heating, cooling and ventilating services to the hereditament "mainly" as part of "trade processes." That issue gives rise to two separate sub-issues. First, whether the function performed by the air handling system is part of a trade process, and secondly, if it is, whether the system is mainly used as part of that process.

39. If both of those sub-issues are resolved in the affirmative, as Iceland contends they ought to be, the air handling system is not rateable. If either question is answered in the negative it will then be necessary for the Tribunal to consider the rateable value of the appeal property taking into account the effect which the air handling system has on the rental value to be determined under paragraph 2(1) of Schedule 6 to the 1988 Act.

Issue 1: Is the air handling system used as part of a trade process?

40. The VTE decided that the air handling system was not rateable because it was used mainly as part of Iceland's trade processes. At paragraph 45 of its decision it expressed its conclusion in this way:

> "The provision and maintenance of suitable conditions for the effective storage and preservation of frozen and refrigerated food, with a view to sale by Iceland, is part of its trade process."

The case for the appellant

41. For the appellant, Mr Morshead QC submitted that the maintaining of a temperature judged by the retailer to be best-suited to the requirements of its stock-in-trade is not correctly to be regarded as involving one or more "trade processes". The decision of the VTE involved a misuse of language or, as he put it, a "category error" (by which we took him to mean that the VTE had treated as a trade process an activity which could never be so regarded because it was of an entirely different nature to the activities intended to be signified by the use of the expression in the 2000 Regulations).

42. Mr Morshead's primary submission was that "trade processes" was a composite expression which had to be understood in the context in which it was used, as part of the couplet "manufacturing operations and trade processes". It was therefore a fallacy to approach the question of whether the air handling system was used as part of a trade process by asking separately whether there was some activity which could be described as a process and then whether that activity was carried on in connection with a trade. That, he suggested, was what the VTE appeared to have done.

43. Mr Morshead doubted that much was to be gained from dictionary definitions of individual words in isolation. Nonetheless, he referred us to the Oxford English Dictionary in which the chief current sense in which "process" is used is stated to be:

> "A continuous and regular action or succession of actions, taking place or carried on in a defined manner, and leading to the accomplishment of some result; a continuous operation or series of operations."

Expressing the relevant concept in his own language Mr Morshead said that a process involved a productive transition of one thing or state of being to another.

44. Properly understood, Mr Morshead said, the essence of both manufacturing operations and trade processes was that skill of some sort was brought to bear on some thing (usually a tangible object) to change it from one state or condition to another. The two concepts were closely related and the understanding of each ought to be influenced by their use as part of a composite expression. By way of example, by manufacturing operations raw materials might be used to create a car; by trade processes a car might be serviced or repaired.

45. In contrast, the storage and display of goods by a retailer involved no trade process. The fact that goods of one type or another required to be kept in an environment in which temperature, humidity, or light levels were controlled in a particular way, did not make the display of those goods or the maintenance of that controlled environment a trade process. Illustrating his point with a less prosaic example than the refrigeration of frozen food, Mr Morshead suggested that while a taxidermist who stuffs a dead owl could properly be said to be engaged in a trade process, the proprietor of a shop who displays the owl for sale in a glass case could not, even if he dehumidified the air in the glass case to protect the owl from deterioration.

46. The proposition that the air handling system was intended to facilitate the proper functioning of the refrigerated cabinets, by preventing their expelled heat from increasing the ambient temperature on the shop floor above the 25° C below which they were designed to operate, was regarded by Mr Morshead as placing further distance between the use of the equipment and the concept of a trade process

47. Therefore, he submitted, the VTE had been wrong in its conclusion that the air handling system was used in connection with trade processes.

The case for the respondent

48. On behalf of Iceland, Mr Kolinsky said that the VTE had accurately distilled its case in the following points:

> a. Iceland's retail business involves the sale of a preponderance of frozen and refrigerated food which must be preserved in that state through active intervention to keep it frozen or refrigerated.
>
> b. Iceland stores and displays its frozen and refrigerated food in integral cabinets which reject heat into the store.
>
> c. To carry on its business, Iceland must manage the discarded heat, otherwise the cabinets would become inefficient and ineffective.
>
> d. This is what the air handling system does. It has been specifically designed to deal with the heat rejected by the cabinets and operates all of the time (even when the store is closed).
>
> e. Its specifications and design would not be useful to an alternative occupier who did not have a similar quantity of integral cabinets rejecting heat into the store to deal with.

49. Mr Kolinsky submitted that the VTE had come to the right conclusion. The respondent's case (taken from paragraph 10 of its statement of case) was that the "continuous monitoring and regulating of air temperature to ensure appropriate conditions for the effective operation of Iceland's refrigeration equipment constituted a process". In his closing submissions he said that the process in question was the "preserving of frozen and refrigerated food in that state through continuous active intervention (as a necessary part of Iceland's retail trade)".

50. Mr Kolinsky suggested that a process could consist of a series of interventions designed to ensure that a state of affairs does not change, and thus could include continuous interventions in order to preserve frozen food in that condition. He referred to the definition of "process" in the New Shorter Oxford English Dictionary as:

> "A thing that goes on or is carried on; a continuous series of actions, events or changes; a course of action, a procedure; esp a continuous and regular action or succession of actions occurring or performed in a definite manner; a systematic series of actions or operations directed to some end".

That definition had been applied by the VTE in paragraph 43 of its decision, and it demonstrated, Mr Kolinsky submitted, that as a matter of language a "process" need not involve change, but was apt to include a continuous action or series of actions.

51. Reliance was also placed by Mr Kolinsky on two decisions on what constituted a trade process.

52. In *Union Cold Storage Co Ltd v Southwark Assessment Committee* (1932) 16 R & IT 160 the Divisional Court held that layers of cork or sawdust insulating material attached to the walls and floors of refrigerating chambers in a cold store and then covered with concrete or wood were properly taken into account in determining the rateable value of the buildings of which the chambers were part. The sole question for determination was whether the insulation materials were "in the nature of a building or structure" within the meaning of the Plant and Machinery (Valuation for Rating) Order 1927. The Court agreed that it was, and it followed that although the insulating material was agreed to be "plant", it was nonetheless rateable. Mr Kolinsky relied on Macnaghten J's comment at p.164 that:

> "This particular machinery in question, the cold storage plant or refrigerating plant, is admittedly plant on the hereditament for the purposes of manufacturing operations or trade processes."

53. There was no discussion in the *Union Cold Storage* case of what constituted "manufacturing operations or trade processes", and the report contains no description of the activity carried on by the ratepayer. Mr Morshead QC suggested that this deficiency could be made good by reference to a later decision of Macnaghten J's in *Ellerker v Union Cold Storage Co Ltd* [1939] 1 All ER 23. The question there under consideration was whether in the years 1928-1933 the 25 cold stores from which *Union* carried on its business were "mills, factories, or other similar premises" for the purpose of the Income Tax Act 1918. The processes carried on from all of the cold stores was described as comprising freezing, chilling, defrosting, trimming and cutting meat, approximately 25 to 30 percent of which arrived fresh and required to be frozen on the premises. It seems reasonable to infer that the cold storage plant or refrigerating plant about which there was agreement before the Divisional Court in the earlier appeal was used for the same processes.

54. Given the apparent consensus on the point in that case, and the nature of the operations to which that consensus appears to have related, we agree with Mr Morshead that the *Union Cold Storage* case is not of any great assistance in delimiting the "trade processes" which are referred to in Class 2 of the 2000 Regulations.

55. Mr Kolinsky also relied on *Hays v Raley (VO)* [1986] 1 EGLR 226, a decision of the Lands Tribunal (Mr J H Emlyn Jones FRICS) in which fire-fighting equipment, heating plant and dehumidifiers were held not to be rateable because they were installed to protect documents stored in a repository warehouse rather than the building itself. The Lands Tribunal held (at 228E):

> "...the trade so far as material on this point was the storage of sensitive materials and the process was the provision and maintenance of a suitable temperature and environment involving the application in an emergency of a non-toxic and harmless gas which had the effect of extinguishing a fire".

56. Mr Morshead submitted that *Hays* may have been wrongly decided but in any event the approach adopted by the Member was unreliable and ought not to be adopted. The Lands Tribunal appeared to have fallen into the mistake of which he accused the VTE in asking itself two questions

namely whether the purpose for which the equipment was installed (fire suppression) could be described as a process, and whether that process was connected to the ratepayer's trade.

Discussion and conclusion on issue 1

57. The question posed by the proviso to Class 2 of the 2000 Regulations is whether the plant or machinery in issue is used or intended to be used in connection with services to the hereditament other than in connection with services mainly or exclusively as part of manufacturing operations or trade processes.

58. We do not consider that the subjective labels attached to the plant and machinery by both parties assist in answering this question. In this appeal the VO has referred to the air handling system as an "air-conditioning system" and sought to make that designation by expert evidence, while Iceland labels it a "process cooling system". Such labels are self serving and unhelpful, and as some of the evidence in this case demonstrates, they may distract attention from more important considerations.

59. We are satisfied that Mr Morshead is correct in his basic proposition that the expression "trade processes" is a composite one which ought to be interpreted as expressing a single, coherent concept. Moreover, it ought to be interpreted in the context in which it is used, twinned with the cognate expression "manufacturing operations". While that approach does not dictate a decision in this appeal in favour of one party or the other, it does seem to us to rule out addressing the issue in two parts, first by asking if the relevant activity is a process, and then by seeking to relate it to the trade of the ratepayer. The relevant question is not whether the plant or machinery is used in connection with something which can be described as a process, for the benefit of someone conducting a trade.

60. To the extent that the Lands Tribunal expressed itself in *Hays v Raley* in terms which suggested it had such a two stage approach in mind, we do not think its decision is a sound guide.

61. Although the focus of the argument in this case has been on the narrow exception to the general rule expressed in regulation 2, we think it is right first to stand back and remind ourselves of the scope of that general rule. That is that plant or machinery within any of the categories or classes set out in the Schedule to the 2000 Regulations is assumed to be part of the hereditament and therefore to be rateable. Only plant or machinery which is not within any of the classes is taken to have no effect on rateable value.

62. Class 1 extends to plant or machinery used in connection with the generation, storage, primary transformation or main transmission of power, other than power mainly or exclusively for distribution for sale to customers. Class 2 encompasses plant and machinery used in connection with services supplied to the hereditament, including heating, cooling, lighting, the supply of water and protection from fire or theft, except where such use is mainly or exclusively in connection with manufacturing operations or trade processes. Class 3 comprises a wide variety of conduits, conveyances and associated equipment, including railway and tram lines, lifts, electricity supply cables,

communications cables, pipe-lines. Class 4 lists a wide range of industrial plant and machinery subject to exceptions which include any such item which is not, and is not in the nature of, a building or structure or which has a relatively short life or is of relatively modest size and is capable of being removed and reused elsewhere.

63. The essence of the 2000 Regulations is that plant and machinery within each of these very broad classifications is rateable. To that general rule there are limited exceptions, the most important of which is plant and machinery in connection with the supply of services used mainly or exclusively in connection with manufacturing operations or trade processes. Since all of the hereditaments which are liable to be rated under the 1988 Act are non-domestic, it is inevitable that a very substantial proportion of them will be in use for manufacturing or for trade in the broadest sense. It was not suggested that all plant and machinery installed in a retail store for heating, cooling, lighting, the supply of water and protection from fire or theft can be regarded as being used in connection with trade processes, simply by reason of its location in a hereditament from which trading takes place.

64. Considering the Regulations as a whole, we do not consider that it can have been intended that the exemption in Class 2 for manufacturing operations or trade processes should be interpreted so widely as to reduce the service plant and machinery liable to rating to such as has no trade connection at all. We repeat that such an interpretation was not suggested by either party, but the consensus against it highlights the difficulty of finding a satisfactory line to distinguish between uses which amount to trade processes and those which do not. We do not propose to attempt a comprehensive definition, as the statutory language speaks for itself, and must be applied to different situations as they arise. We do consider that both the conjunction of the expression with manufacturing operations and the fact that it is an exception to a general rule point to a less expansive approach to the scope of trade processes.

65. We think there is force in Mr Morshead's submission that the common defining characteristic of manufacturing operations and trade processes is activity bringing about a transition from one state or condition to another, including by the creation, completion, repair or improvement of the subject matter of that activity. While there may be exceptions, we do not consider that the display or storage of goods in itself could ordinarily be said to involve any trade process. Nor do we consider that the creation of an environment conducive to the display or storage of goods (at least in the context of a retail warehouse) is properly regarded as involving a trade process. The fact that the environment appropriate to the storage and display of the goods of a particular retailer requires more substantial or powerful equipment than is normally found in retail premises does not create a relevant distinction. Nor does the fact that the equipment in which the goods are stored and displayed depends for its efficient operation on the maintenance of a particular environment give rise to such a distinction. If anything, we agree with Mr Morshead that the suggestion that the plant and equipment is mainly for the preservation of the cabinets, rather than the stock within them, makes it more difficult, rather than easier, to regard it as being used in connection with trade processes.

66. All retail warehouses require heating, cooling and ventilation to a greater or lesser extent. We do not consider that the plant and machinery installed to provide those services can properly be regarded as being used or intended to be used as part of manufacturing operations or trade processes. We appreciate that the scale of Iceland's particular air handling system is dictated by

the presence in its store of substantial numbers of integral cabinets, each of which creates heat, and which collectively are essential to Iceland's preferred style of trading. A serious malfunction of the air handling system would therefore put its stock at risk. That feature distinguishes Iceland's air handling needs from those of other retailers, but we do not regard that difference as critical. Although the particular needs of Iceland create a greater need for those services than the norm, we do not agree that they make its air handling system an exception to the general rule that such plant and machinery is to be assumed to be part of the hereditament and therefore to be rateable.

67. For these reasons we answer issue 1 in favour of the appellant and allow the appeal.

Issue 2: If the air handling system is used as part of a trade process, is it "mainly" so used?

68. This issue arises only if we are wrong in our primary conclusion that the air handling system is rateable, because it is not used or intended to be used in connection with manufacturing operations or trade processes.

69. The greater part of the argument focussed on this issue, but given our primary conclusion, we can deal with it relatively briefly.

70. It was common ground that the air handling system was not used exclusively in connection with trade processes, and that additionally it had other uses, in particular the maintenance of a comfortable temperature within the store for customers and staff, including by heating the store. It was also common ground that heating the store was unnecessary for the proper functioning of the cabinets.

71. To ask whether something is used "mainly" for one particular purpose is to consider whether it is used more for that purpose than for all other purposes for which it is used. We take the sense of the combined expression "mainly or exclusively" in the exception to Class 2 of the 2000 Regulations as signifying more than just that use for a particular purpose is more important than use for any other individual purpose.

72. The basic facts have already been stated. From those we take the following as the most salient for the purpose of considering the stress laid on risk to stock in the event of failure of the air handling system.

73. The air handling system in issue is much larger and more powerful than would be found in a conventional retail supermarket of equivalent size which did not have Iceland's focus on frozen or refrigerated products and its reliance on large numbers of integral refrigerated cabinets. Such a large system would not be required were it not for the presence of the cabinets.

74. The air handling system functions all the time, monitoring the temperature within the store, providing free cooling where that is sufficient to maintain temperatures within the desired range, and engaging mechanical cooling (or, during trading hours, heating) where that is required. This is in contrast to more conventional supermarkets, which have no need of cooling outside trading hours, and whose refrigerated display cabinets are both much less numerous than Iceland's and, usually being of the "remote" variety, reduce the temperature of their surroundings, rather than increasing it.

75. Between 40% and 55% of the heat load which has to be handled within the store is attributable to the presence of the cabinets.

76. The control strategy is calculated to ensure that the ambient temperature of 25° C up to which the cabinets are designed to operate is not exceeded. The strategy also ensures that heating is provided if the temperature within the store falls below a comfortable level for staff and customers during trading hours. The heating function has nothing to do with the needs of the cabinets, but it is engaged relatively infrequently.

77. Although the hereditament is a retail store, we do not accept Mr Morshead's suggestion that greater weight should be given to the functioning of the air handling system during trading hours, than at other times. This is not a system which can be turned off at night and, if it were, the result on many occasions would be the loss of the stock which the cabinets exist to preserve, defeating the purpose of Iceland's occupation.

78. While we accept Mr Morshead's submission that, by design, a balance is maintained between the needs of the cabinets to be kept at a temperature below 25° C and the need to provide a temperature which is comfortable for staff and customers, we accept Mr Parry's evidence that the main technical and operational reason for Iceland's selection of this air handling system is its suitability for the maintenance of an environment in which integral cabinets can operate successfully.

79. For these reasons, had we been satisfied that the preservation of the environment within the store at a temperature appropriate to the effective operation of the refrigerated cabinets could properly be described as a trade process, we would have found in Iceland's favour that the air handling system was used in connection with services mainly as part of that trade process.

Issue 3: valuation

80. It remains for us to consider the rateable value of the hereditament which should be entered in the 2010 list taking account of the presence of the air handling system.

81. The parties agreed that the closed circuit television system, the cold store and the container store are rateable. They agreed that the value of the retail, storage and ancillary accommodation at the antecedent valuation date of 1 April 2008 was £155 per m^2. The effective capital value of CCTV

system was £3,465 at that date and the useful life of the heating, cooling and ventilation system was 20 years.

82. The appeal property had an original assessment of £108,000 in the compiled 2010 rating list, comprising:

Ground floor sales:	438.00 sqm @ £165.00	£72,270	
Ground floor storage:	201.30 sqm @ £165.00	£33,215	
"Air conditioning system":	438.00 sqm @ £7.00		£3,066
			£108,551
		(say)	£108,000 RV

83. Ms Berry explained that when the list was compiled, a "backstop" rate of £7.00 per sqm was used to reflect the presence of air conditioning in shops and retail warehouses. She stressed that this rate was a fall-back position, in the absence of any other evidence of value. In 2011, following a settlement of appeals in respect of the 2005 rating list, this rate was reduced to reflect the terms of settlement to £4.00 per sqm for retail warehouses.

84. By the time of the VTE hearing, a main space rate of £155.00 per sqm and revised floor areas had been agreed. The VTE adopted these and, having found that the air handling system was not rateable, determined a rateable value as follows:

Ground floor sales:	449.25 sqm @ £155.00	£69.634	
Internal storage:	183.34 sqm @ £155.00	£28,418	
			£98,052
		(say)	£98,000 RV

85. Before us, Ms Berry's valuation in the event that the air handling system is rateable was as follows:

Ground floor sales:	449.25 sqm @ £155.00	£69,634	
Internal storage:	134.62 sqm @ £155.00	£20,866	
Cold Store:	48.72 sqm @ £178.25		£8,684
External container:	14.49 sqm @ £38.75		£561
			£99,745
Plus			
CCTV system			
Cost £3,465			
yp 20 yrs @ 7.5% (10.6680)		£324	
Air handling system			
Cost £105,000			
yp @ 20 yrs @ 7.5% (10.6680)		£9,750	

		£109,819
	(say)	£109,750 RV

86. Ms Berry considered that in assessing the contribution made to value by reference to the cost of the air handling system it was inappropriate to use the statutory decapitalisation rate of 5% prescribed for use with the contractor's basis of valuation by regulation 2(1B) and (2B) of the Non-Domestic Rating (Miscellaneous Provisions)(No. 2) Regulations 1989 (as amended). She considered that the 1989 Regulations made the contractor's basis applicable only when the whole hereditament was being valued on that basis, rather than only part of it, and in any event that there was sufficient evidence to avoid the need for that approach. Instead, she had amortised the capital cost of the AHS and the CCTV system having had regard to comparable yields.

87. Mr Moran's valuation was:

Ground floor sales:	400.53 sqm @ £155.00	£62,082.15	
Internal storage:	183.34 sqm @ £155.00	£28,417.70	
Cold Store:	48.72 sqm @ £178.25		£8,684.34
External container:	14.49 sqm @ £10.00		£144.90
Plus			
CCTV system			
Cost £3,465 @ 5%			£173.25
			£99,502.34
		(say)	£99,500

88. Mr Moran provided three alternative methods of reflecting the presence of the air handling system in the event that it was rateable, which we discuss in further detail below, but of these he asked the Tribunal to adopt a method based on floor area at £4 per sqm, adding £1,775 to the rateable value. From this we have assumed, as he has not specifically stated, that he contends for a rateable value of £101,275 before rounding.

89. Alternatively, on a contractor's basis, Mr Moran said that a reduced capital cost of £83,500 should be used to avoid double counting – the remaining £21,500 being in respect of plant and machinery that had already been reflected in the agreed rate of £155 per sqm.

90. Nothing turns on the parties' slightly different breakdown of sales space to internal storage, as each has a rate of £155 per sqm applied.

91. The valuation issues for us to consider are therefore these:

(1) Whether Ms Berry's rejection of the contractor's basis and the statutory decapitalisation rate is well founded.

(2) Ms Berry's alternative approach of amortisation.

(3) Whether the whole capital cost of the air handling system, agreed at £105,000, should betaken into account, or whether a lower figure of £83,500 should be adopted to avoid double counting.

(4) If we are not persuaded by Ms Berry's approach, whether one or a combination of Mr Moran's three alternatives should be preferred.

(5) Finally, the rate to be applied to the external container.

The Contractor's Basis

92. Ms Berry said that there was sufficient rental evidence to avoid the need to adopt a contractor's basis of valuation, which in any event would be inconsistent with statute when valuing only part of a hereditament. She referred to the Non Domestic Rating (Miscellaneous Provisions) (No 2) Regulations 1989 which provided (at Reg 2(1)) that:

> "….this regulation applies in relation to a hereditament the rateable value of which is being ascertained by reference to the notional cost of constructing or providing it *or any part of it*." (emphasis added)

93. Ms Berry pointed out that after the decision of the Lands Tribunal (HHJ Marder QC, President) in *Dorothy Perkins Retail Ltd v Casey (VO)* [1994] RA 391, in which the contractor's method had been adopted to value an air conditioning system, the 1989 Regulation had been amended. Regulation 2(1) currently provides as follows:

> "…this regulation applies in relation to a hereditament (shown in a non-domestic rating list compiled on or after the 1 April 2010) the rateable value of which is being ascertained using the contractor's basis of valuation".

Ms Berry said that the omission of any reference to "part of" the hereditament suggested that the regulation was intended to apply only when the contractor's basis was being used for the whole hereditament - which it was not in this case.

94. In any event, Ms Berry suggested, the contractor's basis was only appropriate where rental evidence did not exist. Here, there was rental evidence sufficient to enable the valuation of the air handling system to be amortised to determine its annual equivalent and thereby arrive at an appropriate virtual rent.

95. On behalf of the respondent, Mr Kolinsky submitted that the VO had incorrectly interpreted the 1989 Regulations. As originally made, regulation 2 was as outlined by Ms Berry. However Regulation 2(2) specified an appropriate decapitalisation rate, which by sub-section 3 was defined as being:

> "the percentage rate applicable to the notional cost of constructing or providing the hereditament *or any part of it* for the purpose of estimating the rent at which it might reasonably be expected to let for year to year." (emphasis added)

96. For the 2010 rating list, regulation 2(3) of the 1989 Regulations, as amended, was unchanged.

97. Mr Kolinsky submitted that the 1989 Regulations, as amended made it plain that the statutory decapitalisation rate should continue to be used when only part of the hereditament was being valued using the contractor's basis. He referred to the decision of the Tribunal (George Bartlett QC, President, and Mr A J Trott FRICS) in *Allen (Valuation Officer) v English Sports Council* [2009] RA 289 where (at paragraph 67) the Tribunal stated:

> "The Non-Domestic Rating (Miscellaneous Provisions) (No.2) Regulations 1989 prescribed "the appropriate rate" for certain classes of hereditament in the 1990 rating lists, the rateable value of which "is being ascertained by reference to the notional cost of construction or providing any part of it" and successive amendment regulations have added similar prescriptions in relation to the 1995, 2000 and 2005 rating lists. For the 2005 rating list the insertion made by the amending regulations uses the words "is being ascertained using the contractor's basis of valuation". *There is no significance in the different wording, in our view.*" (emphasis added)

98. Mr Kolinsky also referred to the current edition of the VOA's rating manual (volume 4, section 3 – "Plant and Machinery") which refers to the use of the contractor's basis for the purposes of valuing "separately identified items of plant and machinery", and additionally refers to the contractor's basis guidance which states that the basis can be used either for the whole or any part of a hereditament the value of which is derived using a costs base approach.

99. On behalf of the VO Mr Morshead submitted that when the 1989 Regulations were amended, the draftsmen should be taken to have intended that the omission of the reference in regulation 2(1) to "*it or any part of it*" should have some substantive effect. Ms Berry was not using the contractor's basis, so regulation 2(2c) did not apply.

100. We prefer the respondent's approach to this issue, substantially for the reasons given by Mr Kolinsky. The reference to "part of" the hereditament survived the various amendments to the 1989 Regulations, and the Tribunal has previously held that there is no material difference between the two. We therefore consider that it is permissible to adopt the contractor's basis of valuation for part only of a hereditament.

101. In the event that we reached that conclusion there was no dispute that should the contractor's basis be adopted, the statutory decapitalisation rate of 5% ought to be used.

Ms Berry's alternative approach

102. Ms Berry referred to *Dorothy Perkins* and to *Edma (Jewellers) Ltd v Moore (VO)* [1975] RA 343 in support of her contention that tenant's improvements which were of value to the tenant should be taken into account when arriving at rateable value. Her approach to ascertaining the value of the air handling system proceeded in a hierarchy of three steps, reflecting the approach of the Lands Tribunal in *Dorothy Perkins*. First, evidence of rents of comparable premises which reflect the presence of air conditioning should be obtained, and then adjusted to ascertain the effect of the presence of that air conditioning on rent. Next, if suitable rental evidence was not available, comparable rating assessments should be considered, giving them appropriate weight depending upon how settled the list had become. Finally, where no rental or assessment comparable evidence could be found, an addition may be made by considering the cost of providing the system installed in the subject property – a virtual rent approach.

103. In *Dorothy Perkins* a fourth method which had been adopted by the Valuation Officer had been disapproved; that method, the addition of a flat rate percentage to reflect the presence of air conditioning, reflected neither the cost incurred in installing the system nor the value which it conferred on the hereditament. Since then the paucity of evidence which led to the adoption of that rough and ready approach has remained and the need for a fourth alternative has not diminished. That appears to be the reason for the adoption of what Ms Berry referred to as the "back-stop" addition of £7 per sqm employed when the 2010 list was compiled. Nonetheless, she suggested, this approach remained a last resort which ought only to be used in the absence of any more reliable evidence from steps 1-3.

104. Ms Berry considered that in this case no assistance could be derived from step 1 as there was no evidence available that could quantity the effect of a similar air handling system on rent. She considered that step 2 gave equally little assistance. Whilst there were settlements adopting £4 per sqm, these were on the rough and ready backstop basis which failed to address the relationship between cost and rent, and which at best merely offered support for the obvious proposition that air conditioning added value. This approach was at odds with *Dorothy Perkins* and *Edma (Jewellers)*. She said that for the appeal property, the VO had available, for the first time, the actual cost of installation of the air handling system (provided by Iceland at the VO's request), and methods of last resort could therefore be rejected.

105. Ms Berry's approach was to amortise the cost of installing the air handling system - £105,000 - over a period of 20 years, being its agreed economic life at the AVD, using a yield of 7.5% on a quarterly in advance basis (a divisor of 10.668) to arrive at a rateable value equivalent of say £9,750.

106. In arriving at her yield, Ms Berry had relied upon retail warehouse investment transactions in the locality: one at Long Lane, Aintree (10 miles from the appeal property), an investment sale in July 2007 at an initial yield of 6.35%; and a second at Winwick Road, Warrington (12 miles away), an investment sale in June 2008 at an initial yield of 6.88%. She also had regard to published property yield tables. From these sources, she considered a freehold yield of 6.5% to be appropriate, which she adjusted to 7.5% to reflect the leasehold tenure of the notional tenancy.

107. Mr Moran pointed out that Ms Berry's approach had never been accepted by ratepayers or their agents - a point which he said was acknowledged in the VOA Manual Practice Note - and had never been endorsed by the Tribunal. Standing back and looking at the VO's approach led to the conclusion that it was wrong, for a number of reasons. It was inappropriate to use a property investment yield to value an item of plant and machinery. Iceland's rental bid would only need to be high enough to exceed the best bid by any other hypothetical tenant. Iceland's trading system was unique and would not suit the trading needs of the majority of hypothetical tenants. Other potential tenants would bid no more for a unit with Iceland's air handling system than they would for a unit with a more conventional system. Finally potential tenants may bid less on the basis that the system was unsuitable for their needs, although he accepted in cross examination that they were unlikely to bid if that were the case Mr Moran also thought that Ms Berry's approach incorrectly assumed that the hypothetical landlord was in a position to dictate terms.

108. We agree that Ms Berry's approach is susceptible to significant criticism. Freehold investment yields on retail warehouses have limited relevance to a leasehold plant and machinery amortisation. The comparables (in the loosest sense) are freehold transactions where the prices paid would have had regard to the length of lease, the age and characteristics of the properties, the covenant strength of any tenants, and the expected growth in values. In our view they are of very limited, if any, assistance in amortising the capital cost of plant and machinery on a leasehold basis, even if adjusted to reflect the wasting nature of such an asset. We respectfully consider that Ms Berry's approach is unrealistic and we reject it.

The capital cost of the air handling system and double counting

109. The parties agreed that the capital cost of installing the air handling system at the AVD was £105,000, a figure arrived at by indexing the actual cost incurred by Iceland in June 2007. In a late amendment to his expert report, Mr Moran submitted that the figure to which the statutory decapitalisation rate should be applied was £83,500. The remaining £21,500 was, he suggested, incurred in the provision of functions that were already standard in other properties and for which no separate allowance was ever made. Those were heating and ventilation to the staff rooms, wc's and offices, and equipment supplying hot water for cleaning and washing, which collectively had an indexed cost of £18,500. The "air curtain" over the main entrance door had an indexed cost of £3,000. Mr Moran considered that attributing a separate rental value to those elements by including them in the sum to which the statutory decapitalisation rate was applied would lead to double counting as they were already accounted for in the agreed rate of £155 per sqm.

110. We accept Mr Moran's position up to a point. We are satisfied that the rate of £155 per sqm would have assumed that the wc's, office and staff room had some form of heating, and the supply of hot water for washing and cleaning. Ms Berry indicated, in answer to a question from the Tribunal, that in the event that a unit lacked these features she would probably apply a discount to the rate of £155 per sqm. We therefore find that to add an element of value over and above £155 per sqm where these features were already present would, as Mr Moran suggested, lead to double counting. There was no evidence, however, that the "air curtain" was common to other units, and Mr Moran did not suggest that there was, either in written or oral evidence.

111. In respect of the CCTV system, the parties had agreed a capital amount of £3,465. We therefore find that the relevant capital costs are as follows:

Air Handling System:		£83,500
Air Curtain:		£3,000
CCTV System:	£3,465	
Total:		£89,965

Mr Moran's approach

112. Mr Moran considered three alternative approaches to the valuation of the air handling system. The first was to apply a rate of £4 per sqm to the area benefitting from the AHS. He said that was a well-established and accepted approach which had been adopted in the settlement of very many appeals throughout England and Wales. It was endorsed by the VOA Practice Note, in the absence of any better evidence to the contrary, and would add £1,775 to the rateable value.

113. His second approach was using the contractor's basis, adopting the lower capital cost of £83,500 to avoid double counting, as previously explained. As amended in 2004 the 1989 Regulations prescribed a statutory decapitalisation rate of 5%, which he adopted. Mr Moran said that several factors should be reflected on a stage 5, or "stand back and look", assessment. Iceland's rental bid would only need to be high enough to exceed the best bid of any other prospective tenant; Iceland's system was unique to its particular style and would not suit the vast majority of hypothetical tenants; other potential tenants would bid no more for a unit with Iceland's system than they would with a more typical air conditioning or comfort cooling system; and other tenants might even bid less for a unit with Iceland's system because it would be unsuitable for them, although he accepted in cross examination that this was unlikely. Mr Moran considered that these factors should be reflected by an overall stage 5 discount of 65% which would result in the air handling system adding £1,461 to the rateable value. In answer to a question from the Tribunal, Mr Moran did not have a specific breakdown of how these factors individually led to his global discount of 65%.

114. Mr Moran's third method was what he termed the tenant's alternative, on the basis that the prospective tenant would consider how much it would have cost for it to fund the capital cost of providing the same system when deciding how much additional rent to pay for a unit that already had the system installed. He applied 5.25%, being the bank base rate at the AVD, to the lower capital cost of £83,500, to arrive at £4,384, to which he again applied a discount of 65% to result in an addition of £1,534 to the rateable value of the appeal premises.

115. Of his three alternatives, Mr Moran invited the Tribunal to adopt the method based on floor area at £4 per sqm, adding £1,775 to the rateable value.

External Container

116. This is a very short point. The external store is a steel shipping container connected to the building by an overhead electricity cable. It has an agreed gross internal area of 14.49 sqm. Ms Berry placed a rate of £38.75 per sqm on it (or 25% of main space rate); Mr Moran £10.00 per sqm. We consider Ms Berry's rate to be excessive, bearing in mind the nature of the store, and prefer Mr Moran's figure.

Conclusions

117. For the reasons outlined above, we accept Mr Moran's valuation in respect of the CCTV system and external store. Prior to an addition for the air handling system we therefore adopt his valuation, before rounding of £99,502.34 as follows:

Ground floor sales:	400.53 sqm @ £155.00	£62,082.15
Internal storage:	183.34 sqm @ £155.00	£28,417.70
Cold Store:	48.72 sqm @ £178.25	£ 8,684.34
External container:	14.49 sqm @ £10.00	£ 144.90
Plus		
CCTV system		
Cost £3,465 @ 5%		£173.25
		£99,502.34

118. We make no criticism of Ms Berry's slightly different breakdown of sales space to internal storage but nothing turns on this as each valuer's aggregate of these elements amounts to £90,500 or thereabouts.

119. That leaves the amount to be added for the air handling system. For the reasons previously given we adopt the contractor's basis of assessment and apply the statutory decapitalisation rate of 5% to the sum of £86,500 (the CCTV system already being accounted for above) to arrive at £4,325. We must then consider whether it is appropriate to make a stage 5 adjustment. Mr Moran was unable to advance any persuasive reason or breakdown in respect of his deduction of 65%, and we reject it.

120. A stage 5 adjustment is made to ensure that a figure arrived at by decapitalising the cost of providing the plant is true to the statutory hypothesis that the rateable value is an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year; to achieve that assurance the valuer must stand back and look at the figure produced in the previous stages of assessment and must consider whether the result is truly a figure which would be paid on such a letting. The contractor's basis of assessment is a method of last resort, where there is no more reliable evidence of value. In principle it should produce the same outcome as a valuation based on other methods, and where there is useful evidence from other methods it ought to be taken into account when scrutinising the valuation at stage 5.

121. We are satisfied from the evidence that, had the appeal property contained a conventional air-handling or air-conditioning system rather than the bespoke system installed by Iceland, an addition of £4 per sqm would have been appropriate – settlements relating to other hereditaments in the same block show that this is the case. Whether or not those constitute a tone is, to our minds, largely irrelevant. As Mr Moran suggested, an addition of that order would increase the rateable value by £1,775.

122. The issue is therefore whether the parties to the hypothetical letting of the appeal property would agree a higher figure to reflect the presence of Iceland's bespoke, air handling system. We are satisfied that they would so the remaining question is how much higher a figure would they agree? Both parties must be assumed to be willing to transact for the premises including the system, but neither party can be assumed to have a whip hand. The notional landlord must be taken to appreciate that the system is too powerful to meet the needs of most tenants in the market for a retail warehouse, and who would be unlikely to be willing to pay more than the £4 per sqm at which they would value the more modest system which would satisfy their requirements. The prospective tenant who wished to trade in Iceland's style (and there was evidence that Iceland was not the only such trader, although its direct competitors are relatively few in number) would realise that if it did not take these premises with a suitable air handling system already installed, it would be necessary for it to install its own system at a cost to it of £4,384 a year. In addition to that cost the hypothetical tenant would incur the time and inconvenience of fitting out, for which no rent free allowance can be assumed, and the likelihood that the system would have to be removed at the end of the term. In our view the landlord would be in the stronger negotiating position, and would argue that £4,325 was too low a figure to reflect the value and convenience of the existing system.

123. In the absence of any specific evidence from the VO justifying an upward adjustment at stage 5, we have concluded that it is not appropriate in this case to modify the figure of £4,325 arrived at by applying stages 1 to 4 of the contractor's method. As the addition of that figure to the other components of the valuation would produce the inconvenient sum of £103,827, we assume that the parties would agree a total rent for the property of £104,000.

Determination

124. The appeal is allowed in part. We determine that the appeal property must be entered in the local non-domestic rating list with a rateable value of £104,000 with effect from 1 April 2010.

125. This decision is final on all matters other than costs. The parties may now make submissions on costs and a letter giving directions for the exchange of submissions accompanies this decision.

Dated: 14 January 2015

Martin Rodger QC
Deputy President

P D McCrea FRICS

Addendum on Costs

126. The parties have now exchanged submissions on the issue of costs. The appellant invites the Tribunal to order that the respondent pay her costs of the appeal. The respondent suggests that the appropriate order is that the costs relating to the issue of whether the air handling system is used as part of a trade process, and those relating to the issue of valuation, should be paid by it to the appellant, but that the costs incurred in relation to the issue of whether, if the air handling system was used as part of the trade process, it was "mainly so used" should be paid by the appellant to it.

127. Both parties made sealed offers to resolve the appeal by agreement. On 7 March 2013 the appellant wrote (without prejudice save as to costs) offering to agree the valuation in respondent's own statement of case to the Tribunal (which was that the rateable value should be £99,750 instead of £98,000 determined by the Valuation Tribunal). The offer was said to be open for acceptance until 12 April 2013 and was on the basis that each party was to bear their own costs. The letter concluded by warning that if the offer was not accepted, and if the Tribunal should determine that the air handling system was rateable and that the rateable value of the hereditament was £99,750 or more, the appellant would ask the Tribunal to order that the respondent pay the whole of her costs of the appeal.

128. The respondent's sealed offer was made at a much later stage. On 28 October 2014 (about three weeks before the hearing) it wrote to the appellant proposing that the appeal be settled on the basis of a revised rateable value of £100,000 with an express acknowledgment that the settlement was on the basis that the air handling system was not rateable. The letter proposed that, if the rateable value was agreed at that figure, the issue of costs should be referred to the Tribunal for its determination.

129. We first ask ourselves which is the successful party in this appeal? The answer is clear. The appellant has succeeded not only in securing an increase in the rateable value but also on the issue of principle of whether the air handling system was rateable or not. Moreover, the appellant has achieved a better result than it was prepared to settle for in its sealed offer made at a relatively early stage of the appeal before the significant costs of expert evidence and trial had been incurred.

130. We next consider whether there is any reason to depart from the general rule that the successful party ought to recover its costs of the proceedings. In this case the respondent invites us to depart from that approach and to make an issue based costs order reflecting the success which it enjoyed in relation to the subsidiary issue concerning the main purpose of which the air handling unit was used. If we decline to make an "issue-based" order we ought nonetheless to consider whether it is appropriate in this case to deprive the successful appellant of some part of her costs to reflect the relative success of the parties in the appeal as a whole.

131. The thrust of the respondent's submissions is that, in relation to the admittedly subsidiary issue on which it was successful, the appeal was conducted by the appellant in a way which complicated the case and proliferated technical disputes unnecessarily and unhelpfully. The appeal was lengthened and very substantial costs were incurred in dealing with areas of technical disagreement which were eventually found to be of little significance. Even before the proceedings had been heard in the VTE the respondent had complained to the appellant that the approach taken by its technical expert in seeking to attribute the total heat load which required to be handled as between the cabinets themselves and other sources was "detached from reality". In due course that approach was rejected by the VTE as theoretical yet it was persisted with by the appellant before the Tribunal. We indicated in our decision that we had not found the debate over heat loss to be a helpful way of considering the issues in the appeal. Those features of the appellant's conduct of the appeal, coupled with the fact that the respondent was successful on the issue to which most of the technical evidence went, ought to result, it submits, in an issue-based order allowing it to recover its costs of the greater part of that evidence and the time spent in preparing and hearing it.

132. We do not find the respondent's approach persuasive. An issue-based costs order is liable to create great practical difficulties of assessment in a case where the scope and reception of the evidence is not confined to discrete points. In this case the evidence of the experts (other than that of the valuers) went both to the question on which the appellant succeeded (whether the air handling unit was used in connection with a trade process) and to the issue on which it failed (whether it was mainly so-used). All issues were considered at a single hearing. Although the respondent substantially succeeded on the contentious technical aspects of the case it gained no benefit from that success because the prior question of principle was decided against it. In those circumstances we do not consider that an issue-based order is appropriate.

133. Should we nonetheless reduce the costs which the appellant is entitled to recover for the reasons relied on in support of its unsuccessful request for an issue-based order? Had it not been for one important factor we would have considered that a reduction in the respondent's liability for the appellant's costs ought to be ordered because much of the elaborate and expensive expert evidence and disclosure went to the issue on which the appellant was unsuccessful. We are dissuaded from taking that course by the sealed offer made by the appellant on 7 March 2013. That offer represented

an almost complete capitulation by the appellant. While it is true that the appellant did not propose a public acknowledgement that the air handling unit was not rateable, the proposed adjustment to the rateable value determined by the VTE was so slight that it would have been very difficult for the appellant creditably to maintain in any future debate with the respondent that its air handling systems should be rateable.

134. An offer to settle a dispute without prejudice as to costs or, in civil litigation, a payment into court or CPR Part 36 offer, does not in principle provide protection against the consequences of misconduct of the proceedings. Simon Brown LJ said so in *Budgen v Andrew Gardner Partnership* [2002] EWCA Civ 1125, at [35], when declining an issue based costs order:

> "I entirely accept that a party remains entitled to have the other side's conduct taken into account under Rule 44.3(4)(a) (and, indeed, to have its own partial success recognised under (b) of the Rule) irrespective of the efficiency or otherwise (or even existence) of any payment in or offer to be considered under paragraph (c) of the Rule. To my mind, however, the court can properly have regard to the fact that in almost every case even the winner is likely to fail on some issues and it should be less ready to reflect that sort of failure in the eventual costs order than the altogether more fundamental failure to make an offer sufficient to meet the winner's true entitlement."

It follows that, in a case where a costs sanction is appropriate, the party to be sanctioned will not be protected from the consequences of its own bad behaviour by having beaten its own admissible offer to settle (see also *Straker v Tudor Rose* [2007] EWCA Civ 368, at [8] –[9]).

135. It would therefore be open to us, despite the appellant having done significantly better than her sealed offer, to reflect in our decision on costs any discomfort we felt over the manner in which the evidence was prepared on the issue on which she was unsuccessful. However, we have decided that the imposition of what would, in effect, be a sanction is not justified in this case. We do not regard the misdirected zeal of the appellant's experts, or the respondent's success on the secondary issue, as being sufficient to deprive the appellant of the full benefit of having made an offer which, as the decision of the Tribunal illustrates, the respondent would have done very well indeed to have accepted. The respondent has gained nothing out of its limited success and could have avoided the greater part of the costs had it been prepared to accept the appellant's proposal. In those circumstances we do not consider that the respondent's pyrrhic victory entitles it to a reduction in its total liability.

136. We therefore order that the respondent pay the appellant's costs of the appeal on the standard basis to be the subject of detailed assessment by the Registrar if they cannot be agreed.

Dated: 10 March 2015

Martin Rodger QC

Deputy President

P.D. McCrea FRICS