Case Nos: CA-2021-000537, 000538, 000539 and 000540

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
MR JUSTICE ZACAROLI AND JUDGE JONATHAN RICHARDS
[2019] UKUT 342 (TCC) and [2020] UKUT 356 (TCC)

Neutral Citation Number: [2022] EWCA Civ 1422

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 31/10/2022

Before :

LORD JUSTICE LEWISON
LORD JUSTICE NEWEY
and
LADY JUSTICE ANDREWS

- -

Between :

COBALT DATA CENTRE 2 LLP **COBALT DATA CENTRE 3 LLP**	**(The "LLPs")** **Appellants and Respondents**
- and - **THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS**	**("HMRC")** **Appellants and Respondents**

- -

Adrian Williamson KC, Nicola Shaw KC and Michael Jones KC (instructed by **Macfarlanes LLP**) for the **LLPs**
David Ewart KC, Stephen Kosmin, Edward Waldegrave and Laura Ruxandu (instructed by **HM Revenue and Customs**) for **HMRC**

Hearing dates : 11, 12 and 13 October 2022

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Approved Judgment

This judgment was handed down remotely at 10.30am on 31.10.2022 by circulation to the parties or their representatives by e-mail and by release to the National Archives (see eg https://www.bailii.org/ew/cases/EWCA/Civ/2022/1169.html).

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Lord Justice Lewison:

Introduction

1. At the time of the events with which we are concerned, Parliament encouraged investment on the construction of industrial buildings in disadvantaged areas by permitting generous allowances against tax on construction expenses. The relevant disadvantaged areas were enterprise zones, and the allowances were referred to as enterprise zone allowances or EZAs. The issues that arise on these appeals are whether the taxpayers ("the LLPs") are entitled to EZAs on the whole or part of the sums which they paid in order to obtain rights under contracts relating to the construction of such buildings at the Cobalt Business Park in the Tyne Riverside Enterprise Zone. The buildings that were eventually constructed were two data centres ("DC2" and "DC3"). The Upper Tribunal (Zacaroli J and Judge Jonathan Richards) held that they were entitled to EZAs on some, but not all, of their expenditure. The principal decision of the UT is at [2019] UKUT 342 (TCC), [2020] STC 23. In a second hearing the UT went on to determine the financial consequences of their principal decision. The second decision is at [2020] UKUT 356 (TCC), [2021] BTC 501. Both are impressive, detailed and closely reasoned. HMRC appeal on the basis that the LLPs have no entitlement to EZAs at all. The LLPs cross-appeal on the basis that they are entitled to EZAs on the whole of their expenditure.

2. One unusual feature of the hearing before the UT was that the appeals against the closure notices were heard together with a claim for judicial review. The latter claim succeeded. There is no appeal against the UT's decision on the claim for judicial review.

The legal framework

3. EZAs were a sub-set of industrial building allowances (or IBAs). Under section 294 of the Capital Allowances Act 2001 ("CAA 2001"), capital expenditure incurred on the construction of certain types of building qualified for IBAs. It provided:

> "If—
>
> (a) capital expenditure is incurred on the construction of a building, and
>
> (b) the relevant interest in the building has not been sold or, if it has been sold, it has been sold only after the first use of the building,
>
> the capital expenditure is qualifying expenditure."

4. By reason of section 272 expenditure on the construction of a building did not include expenditure on the acquisition of land or rights in or over land. Consequently, sums spent to acquire land, as distinct from sums spent on the construction of a building, did not attract IBAs. If the relevant building was on a site in an enterprise zone, it would be an "EZ building" within the meaning of section 298(2) of CAA 2001 and, provided the expenditure was incurred within the relevant time limit, section 299 would treat the expenditure as qualifying enterprise zone expenditure with the result

that section 305 of CAA 2001 would apply to confer entitlement to the generous 100% EZAs. Section 296 of CAA 2001 extended the allowances to cases in which a person purchased an unused building from a developer. It provided:

> "(1) This section applies if—
>
> (a) expenditure is incurred by a developer on the construction of a building, and
>
> (b) the relevant interest in the building is sold by the developer in the course of the development trade before the building is first used.
>
> (2) If—
>
> (a) the sale of the relevant interest by the developer was the only sale of that interest before the building is used, and
>
> (b) a capital sum is paid by the purchaser for the relevant interest,
>
> the capital sum is qualifying expenditure.
>
> …
>
> (4) The qualifying expenditure is to be treated as incurred by the purchaser when the capital sum referred to in subsection (2)(b) or (3)(b) became payable."

5. Section 286 (1) defined "the relevant interest" as:

> "the interest in the building to which the person who incurred the expenditure on the construction of the building was entitled when the expenditure was incurred."

6. In the case of an enterprise zone, EZAs were only allowable if the expenditure was incurred within a particular timeframe. Thus section 298 provided:

> "(1) For the purposes of sections 299 to 304, the time limit for expenditure on the construction of a building on a site in an enterprise zone is—
>
> (a) 10 years after the site was first included in the zone, or
>
> (b) if the expenditure is incurred under a contract entered into within those 10 years, 20 years after the site was first included in the zone."

7. Section 300 described the entitlement to EZAs:

> "If –

> (a) expenditure is incurred on the construction of an EZ building, and
>
> (b) all the expenditure is incurred within the time limit
>
> any qualifying expenditure given by sections 295 and 296 in relation to that expenditure is qualifying enterprise zone expenditure."

8. Section 356 dealt with the apportionment of sums partly referable to non-qualifying assets. It relevantly provided:

> "(1) If the sum paid for the sale of the relevant interest in a building is attributable—
>
> (a) partly to assets representing expenditure for which an allowance can be made under this Part, and
>
> (b) partly to assets representing other expenditure,
>
> only so much of the sum as on a just and reasonable apportionment is attributable to the assets referred to in paragraph (a) is to be taken into account for the purposes of this Part."

Essential facts

9. I can take the facts from the decision of the UT.

10. The site was within the Tyne Riverside Enterprise Zone between February 1996 and 18 February 2006. In 2006 Highbridge North Tyneside Developer One Ltd (the "Developer") and Highbridge North Tyneside Contractor One Ltd (the "Contractor") were established as special purpose vehicles, with a view to further development of land within the enterprise zone; and to ensure that the ability to claim EZAs on future development of the site would not cease. On 17 February 2006 the Contractor and Developer (referred to as the "Owner" in the relevant contract), executed a contract (referred to as "the Golden Contract") which incorporated the conditions of the JCT Standard Form of Building Contract with Contractor's Design 1998 Edition (the "JCT Contract") and made modifications to that JCT Contract. The Golden Contract was, therefore, entered into the day before the enterprise zone at the site expired and formed part of arrangements that both the Developer and Contractor hoped would ensure that EZAs could still be claimed on future construction work on the Site.

11. One significant amendment to the JCT Contract embodied in the Golden Contract was that, while the JCT Contract envisages that the Contractor would be obliged to perform, and the Employer would be obliged to pay for, a single building project, the Golden Contract contained a number of different options. Each of the options was linked to a specific part of the overall site, designated respectively as Site A, Site B and Site C (each of which was shown on a plan). The Golden Contract defined "the Works" as:

> "the design, construction and commissioning the Employer wishes to obtain for the Works Option stated in the Notice to Proceed which for the avoidance of doubt shall either be Works Option 1 Works Option 2 Works Option 3 Works Option 4 Works Option 5 or Works Option 6 and referred to in the Employer's Requirements and the Contractor's Proposals for that Works Option and including any work needed to ensure that the Tests on Completion and the Performance Tests are passed and any changes made to these works in accordance with this Contract."

12. The six Works Options provided for in the Golden Contract varied significantly in size and scope. Works Option 1 was the design, construction and commissioning work comprising an industrial unit to accommodate the manufacture of an eight-inch board on Site C. Works Option 2 was the design, construction and commissioning work comprising an industrial unit to accommodate the manufacture of a twelve inch board on Site B and Site C. Works Option 3 was the design and construction works comprising an office business park on Site A. Works Option 4 was the design and construction work comprising a light industrial business park on Site A. Works Option 5 was the design and construction work comprising a mixed used office and light industrial business park on Site A. Works Option 6 was the construction of a single industrial unit on Site A. The contract sum varied for each Works Option. The contract sum for Works Option 1 was £102.5 million; for Works Option 2 £183 million; for Works Option 3 £70 million; for Works Option 4 £22.335 million-odd; for Works Option 5 £50 million and for Works Option 6 £13.67 million-odd.

13. This ties in with recital A to the Golden Contract which stated that the Employer wished to "obtain the design, construction and commissioning (if any) of the Works detailed in either [of the six] Works Option[s]". It further provided that the Employer had issued to the Contractor its requirements in relation to "each" Works Option; and recital B stated that the Contractor had examined those requirements and was satisfied that its proposals would meet them.

14. Article 1 of the Golden Contract provided:

> "Upon and subject to Article 1A and the Conditions the Contractor will, for the consideration mentioned in Article 2, be responsible for the design of the Works which has already been carried out as at the date of this Contract and whether such design is contained in the Employer's Requirements or the Contractor's Proposals and by whomsoever it is carried out and the Contractor will complete the design and carry out and complete the construction of the Works."

15. Article 2 required the Employer to pay the Contractor the Contract Sum "or such other sum as shall become payable hereunder." The Contract Sum was itself defined by reference to various appendices "being the amount which is necessary for completing all works required in respect of the relevant Works Option to which such Appendix relates".

16. Article 10 provided for a priority between different documents "where there is a discrepancy or conflict between the Contract documents". The Contract itself was at the top of the list; the Conditions (i.e. the JCT Contract as amended) was in second place and the Employer's Requirements/Contractor's Proposals were in fourth place.

17. Clause 23A of the Golden Contract provided:

> "23A.1 The Employer shall serve upon the Contractor a written notice ("Notice to Proceed") stating when the Contractor shall proceed with the Works. The Date of Possession for the purposes of this Contract shall be the date 20 Working Days after the date of the Notice to Proceed.
>
> 23A.2 The Notice to Proceed shall state which Works Option the Contractor shall carry out and complete."

18. The UT said at [36] that as originally drafted clause 23A required the Employer to select a single Works Option by delivering the "Notice to Proceed." This flowed from the definition of the Works by means of an "either" "or" formula. The LLPs do not challenge that interpretation.

19. The Golden Contract defined "the Employer's Requirements" as:

> "the document referred to in Appendix 14 Appendix 15 Appendix 16 Appendix 17 Appendix 18 Appendix 19 (as the case may be) setting out the requirements of the Employer in relation to the relevant Works Option."

20. Clause 12.1 of the JCT Contract, as modified by the Golden Contract, permitted the Employer to make what were defined as "Changes in the Employer's Requirements." These in turn were defined as:

> "a change in the Employer's Requirements which makes necessary the alteration or modification of the design, quality or quantity of the Works, otherwise than such as may be reasonably necessary for the purposes of rectification pursuant to clause 8.4, including
>
> 12.1.1.1 the addition, omission or substitution of any work
>
> 12.1.1.2 the alteration of the kind or standard of any of the materials or goods to be used in the Works,
>
> 12.1.1.3 the removal from the site of any work executed or materials or goods brought thereon by the Contractor for the purposes of the Works other than work materials or goods which are not in accordance with this Contract"

21. Clause 13 of the JCT Contract provided:

> "The Contract Sum shall not be adjusted or altered in any way whatsoever otherwise than in accordance with the express provisions of the Conditions."

22. In February 2009 and April 2009, the parties effected two variations to the Golden Contract ("Variation Agreement One" and "Variation Agreement Two") which permitted the Employer to submit Notices to Proceed in respect of combinations of specified Works Options. The first of these agreements stated that notwithstanding the giving of a Notice to Proceed as respects Works Option 2, the Employer could also give a Notice to Proceed as respects Works Option 3. The second substituted Works Option 1 in place of Works Option 2. Thus, following Variation Agreement Two the Employer was entitled to proceed with both Works Option 1 and Works Option 3.

23. On 20 November 2009 the Developer's agent, EC Harris LLP, issued Change Order 1. That order referenced Works Options 1 and 3 and required the Contractor to undertake the design and construction of a data centre within a specified area. It also required changes to the Employer's Requirements for Works Option 1 so as to provide for the shell and core of the data processing building. Following that change order DC1 was constructed on Site C (which was the site allocated to Works Option 1). It achieved practical completion in 2011, although the UT made no finding as to the month. DC1 is not directly in issue on these appeals. But, as I will explain, the UT did not consider the effect of Change Order 1 and its implementation by the construction of DC1 on the issues that arise in these appeals.

24. The LLPs' case (which HMRC dispute) is that the Developer exercised its rights under Clause 12 on two further occasions relevant to these appeals.

25. First, on 1 April 2011, the Developer's agent, EC Harris LLP, issued "Change Order 2". This also referred to Works Option 1 and stated:

> Undertake the design, construction and commissioning of 1 no. Data Centre ("DC2") totalling 3,360 square metres net technical space together with support facilities and enclosed plant. The Works will include drainage, external works and services all in accordance with the Employer's Requirements ref. Draft Version March 2011 and Appendices listed therein.
>
> For the sum of £54,845,150.00 exclusive of VAT.
>
> Shell & Core is to proceed from the date of a Notice to Proceed under the contract."

26. It went on to require the Contractor to add to the Employer's Requirements for Works Option 1 so as to provide the shell and core for a data centre. That data centre was DC2.

27. The LLPs say that this was given under Clause 12 of the JCT Contract and legitimately altered the scope of Works Option 1 so that, instead of involving the construction of a semiconductor manufacturing facility, Works Option 1 would involve the construction of a data centre. The Developer then served a Notice to

Proceed, also on 1 April 2011 and the Contractor ultimately built DC2. The Notice to Proceed stated that it was given under clause 23A of the Golden Contract.

28. Second, on 4 April 2011, EC Harris issued "Change Order 3" which the LLPs also assert invoked Clause 12, altering the scope of Works Option 1 yet again so that it involved construction of a further data centre. The Developer then served a Notice to Proceed and the Contractor ultimately built DC3.

29. Both Change Order 2 and Change Order 3 required the Contractor to proceed with Works defined in the "Employer's Requirements ref. Draft Version" (with Change Order 2 referencing a document dated "March 2011" and Change Order 3 referencing a document dated "April 2011"). But neither of those documents was in evidence. Instead, the UT were shown two documents both dated January 2012 and entitled "Employers Requirements Cobalt DC2 – Contract Version" and "Employers Requirements Cobalt DC3 – Contract Version". These later documents set out employer's requirements for the purposes of a contract between the Contractor and its sub-contractors (in which the Contractor was the "Employer" and the relevant subcontractor was the "Contractor").

30. On 1 April 2011, the Developer paid the Contractor £54,845,150 being the Contract Sum due in respect of the construction of DC2. On 4 April 2011, the Developer paid the Contractor £42,284,000 being the Contract Sum due in respect of the construction of DC3. The Developer borrowed the amounts due to the Contractor from Bank Winter by means of a short-term loan with the Developer repaying Bank Winter out of the proceeds of sale due to it under the Sale and Development Agreements.

31. The LLPs are two LLPs ("CDC2" and "CDC3") which were incorporated on 19 January 2011 and 15 March 2011 respectively.

The sale and development agreement

32. Three days after the issue of Change Order 2, on 4 April 2011, CDC2 executed a document entitled "Sale and Development Agreement relating to the sale and development of DC2" (the "SDA") with, among other parties, the Developer and the Contractor. This agreement was supplemented by a variety of other agreements dealing with financing and other matters (including a "Services Agreement" between, among others, the Developer, the Contractor and the relevant LLP, and various security documents).

33. Clause 2.1 of the SDA recited that the Developer had been granted a lease of the property; and clause 2.2 provided that the Developer had agreed to assign that lease for £1. Clause 2.3 stated that the Developer had agreed to procure the construction of the Building (i.e. DC2) and the carrying out of the building works "on the terms recorded in this Agreement". Clause 2.5 stated that the Developer had paid some £54.8 million to the Contractor under the Golden Contract. Clause 3 provided that in consideration of the Developer assigning the benefit of the Golden Contract; and fulfilling its obligations under the SDA, CDC2 would pay the Price (£153.7 million-odd). Clause 4.1 required the Developer to deliver a number of duly executed documents on completion, including the Services Agreement.

34. Clause 5 annexed a copy of the contract for construction to shell and core which had been agreed between the Developer and the Contractor and which had been approved by CDC2. That clause also contained a process for amplifying the design of the building. Clause 6 dealt with the fit-out contract. Clause 11 contained a procedure for measuring the floor area of the constructed building. Clause 14 contained an agreement by both the Developer and the Contractor to procure that the shell works were begun on or before 31 December 2011 and to use all reasonable endeavours to complete the works by 31 December 2012.

35. On 4 April 2011, in pursuance of the SDA, the Developer entered into a deed of assignment under which it assigned the benefit of its rights under the Golden Contract in respect of DC2 to CDC2.

36. On 5 April 2011, CDC3 entered into a materially similar sale and development agreement relating to DC3. A materially similar suite of contractual documents to those relating to DC2 was entered into. It is not necessary to refer to those agreements in any detail as any decision in relation to the SDA will apply to that one too.

The issues

37. It is convenient to take the issues in roughly chronological order. On that basis, the first issue is HMRC's contention that the LLPs are not entitled to any EZAs. This contention is based on two separate arguments:

    i) Until such time as a Notice to Proceed had been issued the Golden Contract was not a contract of the kind contemplated by section 298. It was no more than an option given to the Developer; and it could not be said that any expenditure on the construction of a building would be incurred at all, let alone on what kind of building.

    ii) The changes made to the contract by the two Works Orders issued by EC Harris were of such magnitude that they amounted in law to a new contract which was made outside the 10 year period. Accordingly, any expenditure was not incurred under a contract made within the 10 year period.

Contract not within section 298?

38. In their skeleton argument the LLPs reserved their position on the first of the arguments, on the basis that it might not have been within the terms of the permission to appeal granted by Asplin LJ. The ground for which she gave permission was that the UT erred in finding that the expenditure was incurred under "a statutorily relevant contract" within the 10 year period referred to in section 298 (1) (b) of CAA 2001. In my judgment that ground of appeal, as formulated, is wide enough to encompass the first argument. In the event no objection to this argument was raised in oral submissions.

39. For convenience I repeat section 298:

> "(1) For the purposes of sections 299 to 304, the time limit for expenditure on the construction of a building on a site in an enterprise zone is—

> (a) 10 years after the site was first included in the zone, or
>
> (b) if the expenditure is incurred under a contract entered into within those 10 years, 20 years after the site was first included in the zone."

40. It is common ground that the approach to the interpretation of CAA 2001 is that laid down by the House of Lords and Supreme Court respectively in *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51, [2005] 1 AC 684 and *Tower MCashback LLP 1 v HMRC* [2011] UKSC 19, [2011] 2 AC 457. In *BMBF* Lord Nicholls (in an opinion of the Appellate Committee) said at [32]:

> "The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found."

41. In *Tower MCashback* Lord Walker endorsed that approach at [41], as did Lord Hope at [87].

42. The purpose underlying the creation of enterprise zones in disadvantaged areas was to encourage investment in and regeneration of those areas. Those areas needed relatively speedy regeneration, which is why the designation of enterprise zones was time limited. Hence the primary requirement that the expenditure had to be incurred within 10 years of the designation of the zone. The expenditure had to be expenditure on the construction of a building, and not expenditure on anything else. But Parliament recognised that not all arrangements would have come to fruition within that initial period, and accordingly extended the relief to expenditure incurred under contracts made within that period. The expectation must have been that the contracting party was committed within that period to incur qualifying expenditure.

43. HMRC argue that sections 298 (1) (a) and (b) must be equivalents. Under section 298 (1) (a) the expenditure must have been incurred on the construction of a building within the 10 year period. Expenditure incurred means (at the very least) expenditure that the taxpayer is legally and unconditionally liable to pay. That is the general rule embodied in section 5 (1) of CAA 2001. The subject-matter of the expenditure is the construction of a building. Necessarily, that means that the building can be identified. The policy underlying the extension of EZAs to expenditure incurred under a contract entered into within the 10 year period is that the taxpayer who has assumed a legal liability to pay should be treated in the same way as one who has actually paid.

44. The terms of the Golden Contract were such that within the 10 year period the Developer had no legal liability to pay anything. A liability to pay would only arise if and when a Notice to Proceed was given; and no such notice was given within that period. Moreover, given the wide disparities between the various Works Options, no building could be identified as the object of the expenditure unless and until one of those options had been selected. Even if it could be said that the construction of the data centres became identifiable as a result of the Change Orders, they became identifiable outside the 10 year period; and correspondingly the Developer's obligation to pay for them likewise arose only after the 10 year period had expired.

45. I do not consider that this argument carries the day. In my judgment, the questions to be answered under section 298 are:

    i) Has expenditure been incurred?

    ii) If yes, has it been incurred on the construction of a building?

    iii) If yes, is the building on a site in an enterprise zone?

    iv) If yes, was the expenditure incurred under a contract entered into within 10 years after the site was first included in the zone?

    v) If yes, was the expenditure incurred within 20 years after the site was first included in the zone?

46. The legislation does not mandate any particular kind of contract; and the exercise of answering these questions is a retrospective one, looking back from the time that the expenditure is incurred. The drafter of the Act was alive to the question whether expenditure has been incurred, as shown by section 5 (1). By contrast, section 298 is not concerned whether expenditure has been incurred within the 10 year period (as opposed to the 20 year period); but only whether a contract has been entered into within the shorter period. I agree with the UT's conclusion at [117]. Nevertheless, Mr Williamson KC, who presented this part of the argument, accepted (correctly in my judgment) that the contract under which the expenditure is incurred must be the same contract as that which was entered into within the first ten year period. It could not, for example, have been Parliament's intention that parties could enter into a contract within the ten year period to construct a building in an enterprise zone, complete construction within that period and then nine years later purport to vary that contract so as to agree to construct a second building. That leads to HMRC's second argument.

Was the expenditure incurred under the same contract?

47. HMRC put this argument in two ways. The first way that it is put is that the effect of the Change Orders was so radical as not to amount to a variation of the Golden Contract, but rather took effect as the rescission of that contract and its substitution by a new contract as at the date when the Change Orders were given. Accordingly, the expenditure was not incurred under the original contract, but under a new and different contract made outside the 10 year period. They point out that the data centres constructed in consequence of the Change Orders were not any of the original Works Options and were not constructed on site C which was the site allocated to Works Option 1.

48. The second way that it is put is that even if the Golden Contract was not rescinded, nevertheless a new and self-standing contract came into existence as result of the Change Orders.

49. The expenditure in question is expenditure by the Developer on the construction of a building in an enterprise zone. The underlying question is whether the contract under which that expenditure was incurred was the same contract as that which was made within the ten year period. Whether it is characterised as a rescission of the old contract and its replacement by the new one, or is simply a new contract does not, in my judgment, matter, as Mr Williamson agreed.

Clause 12

50. The LLPs' first response to this argument is that the change orders were validly given under clause 12 of the Golden Contract. The UT rejected that argument at [76]:

> "In our judgment, there is a limit on the nature and scope of the changes that can be made pursuant to clause 12.1, namely that those changes cannot effect a change in the definition of the Works."

51. The LLPs challenge that conclusion by way of Respondent's Notice. Mr Williamson says that a wide power of amendment is entirely conventional in building contracts. It is obviously necessary to confer upon the Employer a virtually unlimited power to change his requirements so that, in the finished product, he gets exactly what he wants.

52. Both before the UT and in his skeleton argument in this court, Mr Williamson argued that the power to instruct changes "permits unlimited change[s] to the Employer's Requirements". I find that stark submission difficult to accept. Not only is each Works Option defined by reference to a particular type of building, each Works Option is also site specific. It would, I think, be extraordinary if a contract to build an industrial unit could be unilaterally changed by the employer to require the contractor to design and build a nuclear power station; still more extraordinary if instead of requiring the industrial unit to be built in Tyneside, the employer could require the nuclear power station to be built in Suffolk. I think that, in the course of oral argument, Mr Williamson accepted that there must be some limits to the power to instruct changes under clause 12. The difficulty with his argument, to my mind, is that he was unable to identify what those limits were.

53. In my judgment, the extent of a contractual power of variation must be a question of interpretation of the contract in question. *Thorn v Mayor and Commonalty of London* (1876) 1 App Cas 120 concerned the rebuilding of Blackfriars Bridge. The contractor was provided with plans prepared by the employer's engineer (but which were not warranted). The plans envisaged the use of caissons; but they turned out to be impractical, and the bridge had to be constructed in a wholly different way. The contractor's claim for damages for breach of an implied warranty failed. In the course of his speech Lord Cairns LC said:

> "My Lords, it appears to me, that under those circumstances, the Appellant must necessarily be in this dilemma, either the

> additional and varied work which was thus occasioned is the kind of additional and varied work contemplated by the contract, or it is not. If it is the kind of additional or varied work contemplated by the contract, he must be paid for it, and will be paid for it, according to the prices regulated by the contract. If, on the other hand, it was additional or varied work, so peculiar, so unexpected, and so different from what any person reckoned or calculated upon, that it is not within the contract at all; then, it appears to me, one of two courses might have been open to him; he might have said: I entirely refuse to go on with the contract— *Non haec in foedera veni* : I never intended to construct this work upon this new and unexpected footing. Or he might have said, I will go on with this, but this is not the kind of extra work contemplated by the contract, and if I do it, I must be paid a quantum meruit for it."

54. In *Sir Lindsay Parkinson & Co Ltd v Commissioners of His Majesty's Works and Public Buildings* [1949] 2 KB 632 a building contract contained a clause permitting the employer to require changes in "the works". But this court held that although the clause could, on a literal interpretation, be said to be unlimited, in the context of a building contract under which the works were priced, it could not be interpreted so as to give the employer a free hand in changing the works. Cohen LJ said at 659-660:

> "The work executed so far exceeded the stipulated work, that is to say, the work comprised in the original estimate of 4l. million that it seems to me, to use Mr. Rewcastle's language, fantastic and absurd to suppose that such a large increase as in fact occurred was within the contemplation of the parties when the deed of variation was executed. We are, I think, amply justified (a) in reaching the conclusion that the basis of the varied contract was that the quantum of work which the Commissioners were entitled to require was work measured approximately by the said sum of 5l. million; and (b) in implying a term that the Commissioners should not be entitled under the contract to require work materially in excess of that sum."

55. Asquith LJ said at 668:

> "Literally, therefore, the "work" in the contract as varied includes an unlimited quantity of "extras." But, for the reasons given above, I think the contract as varied should not be construed according to its literal tenor, having regard to the circumstances surrounding the execution in particular of the deed of August, 1937, and the implications, in the light of those circumstances, of the sums of 150,000l. and 300,000l. expressed in it. In the result, the quantum of work exigible, including extras, is measured by 5,000,000l. roughly, the extras constituting about 500,000l. worth, at bill of quantities prices, of this total. Some margin above this may be taken as contemplated and covered, but anything resembling 2,000,000l.

> worth of "extras" over and above this is, in my view, impliedly excluded from the contemplation of the parties and the scope of the contract."

56. Singleton LJ also agreed that there "must be a limit" on the scope of the right to order extras under the contract.

57. In *Blue Circle Industries plc v Holland Dredging (UK) Ltd* [1987] BLR 40 Holland tendered for dredging work. The contract included an arbitration clause and also a clause permitting variations (although the clause is not set out in the report). It was agreed that the dredged material would be used to form an island for use as a bird sanctuary. Holland successfully tendered for that work too. That work was not successful and Blue Circle sued Holland. The question was whether Holland was entitled to require the claim to be arbitrated; and that depended on whether the work of forming the island was a variation of the original dredging contract, or a new contract. Purchas LJ said that it was necessary to pose the question:

> "Could the employer have ordered the work required by it against the wishes of the contractor as a variation under clause 51?" If the answer is no – then the agreement under which such work is carried out cannot constitute a variation but must be a separate agreement."

58. He answered that question as follows:

> "The original dredging contract provided that the spoil from excavating the channel should be deposited in "areas within Lough Larne to be allocated … upon approval by the local authorities" . In the event, as a result of local pressures and the attitude of the licensing authorities, this term of the contract was impossible to fulfil legally. The only alternatives were dumping at sea or the creation of an artificial bund with the formation of an island. Either of these two solutions was wholly outside the scope of the original dredging contract and therefore, had Holland not been willing, they could not, in my judgment, have been obliged to accept the work as a variation."

59. In *Abbey Developments Ltd v PP Brickwork* [2003] EWHC 1987 HHJ Humphrey Lloyd QC held that variation clauses had to be "construed carefully". He went on to say:

> "… the purpose of a variations clause is to enable the employer to alter the scope of the works to meet its requirements. As a project proceeds it may become clear that some change of mind is needed to attain the result now desired. That might be a simple realisation that something is no longer needed (especially if it was always an option, typically signalled by the use of a provisional sum or some other indication of lack of commitment or by the absence of the necessary definition) or it might be for some other reasons such as lack of money, or a change in the requirements of the actual or prospective

> occupier or user. The test must therefore be whether the variations clause is or is not wide enough to permit the change that was made. If, with the advantage of hindsight, it turns out that the variation was not ordered for a purpose for which the power to vary was intended then there will be a breach of contract."

60. Likewise, in *Supablast (Nationwide) Ltd v Story Rail Ltd* [2010]EWHC 556 (TCC), [2010] BLR 211 Akenhead J said:

> "What one needs to do is to look at the variation clause in question and determine, depending on what the variation clause covers, whether the extra or varied work falls within it or not."

61. I agree, therefore, with the editors of Hudson's Building and Engineering Contracts (14th ed) para 5-030:

> "Whether additional or omitted work which has been ordered is of the character contemplated by the contract, and so within the conditions of the contract relating to the power to order variations, or whether on the other hand it is outside the contract, will depend in each case on the nature of the work and the terms of the contract."

62. Even a widely drawn variation clause has its limits. In Wilmot-Smith on Construction Contracts (4th ed) para 14.06 it is stated that the change ordered "cannot alter the essential characteristic of the contract itself". The editors go on to say at 14-07:

> "… it is a matter of fact and degree as to whether the instruction for a variation goes beyond a change envisaged by the contract and instructs something over and above that which was expected and contracted for. … As with all matters of fact and degree it is easier to demonstrate at the extremes that it is at the margin. So, for example, a contract to build a beach house will have implicit within the variations clause the right to change the colour of the external paintwork. It will not extend to the right to order that the contractor build a lighthouse alongside."

63. To similar effect the authors of Construction Contract Variations say at para 5.20 that even in the case of a broad power to vary, the courts have found that there are implied limits on this right. They continue at para 5.21:

> "The reasoning that has been adopted is that a "variation" means a change to the works that the contract describes, and not the building of something quite different, and that any change is therefore constrained by the scope of the project envisaged by the contract."

64. The UT explained why they had reached the conclusion that they did:

> "77. First, clause 12.1 makes a clear distinction between the Works and the Employer's Requirements and contemplates changes being made in the Employer's Requirements, not the Works. It is true that it contemplates such changes might affect the Works, however, only to the extent that they necessitate alteration or modification of the "design, quality or quantity" of the Works. In other words, it does not contemplate a change in the Employer's Requirements necessitating a change in the definition of the Works themselves. The wide words relied on by the LLPs ("addition, omission or substitution of any work") specifically apply to the changes in the Employer's Requirements, not to the "Works".
>
> 78. Second, the respective definitions of the "Works" and the "Employer's Requirements" demonstrate that the latter exist as part of, and are subordinate to, the former. Specifically, the Employer's Requirements are defined as the requirements of the Employer "in relation to the relevant Works Option", and in the definition of Works Option 1, they are the requirements issued by the Employer for the construction of an "industrial unit to accommodate the manufacture of an eight inch board on Site C".
>
> 79. Third, there is support for this conclusion in the fact that the "Works", as a defined term, are the design, construction and commissioning the Employer wishes to obtain for the "Works Option" stated in the "Notice to Proceed". Accordingly, until the Notice to Proceed is issued, there are no "Works" which can be the subject of any change under clause 12.1 as the Notice to Proceed is required to specify which Works Option the Contractor is required to carry out and complete. The contractual scheme therefore proceeds on the basis that the question whether there is an "alteration or modification" in the design, quality or quantity of the "Works" can only be answered once the Employer has given a firm instruction to proceed with a particular Works Option."

65. The essence of Mr Williamson's attack on the UT's conclusion is that the definition of the "Works" is, as he put it, "itself predicated on the Employer's Requirements". The definition of the "Works" identifies the six Works Options which are "referred to in the Employer's Requirements". Since the Employer's Requirements can be changed in unlimited fashion, it follows that the Works can also be changed. This argument, in my judgment, assumes what it has to demonstrate. If the Employer's Requirements can be changed in unlimited fashion, it may well be that the Works can also be changed. But the very question which the UT had to answer was *whether* the Employer's Requirements could be changed in an unlimited fashion.

66. I agree with the UT that the Employer's Requirements were requirements about how the particular Works Option was to be achieved. The Golden Contract recited that the Employer wished to obtain the design, construction and commissioning of one of the Works Options, each of which was described in detail. The whole contract was

drafted on that basis. Each Works Option was both building specific and site specific. In addition, the Golden Contract required the Contractor to provide the design for each Works Option, and it was entered into on the basis (as recited) that the Contractor's proposals met the Employer's Requirements for each of the Works Options. It cannot have been the meaning of clause 12 that the Employer was entitled to require a complete redesign which had the effect of substituting a different project. In effect those are the UT's first two reasons for rejecting the LLPs' interpretation of clause 12. The UT's second reason gains added force from the order of priority of documents laid down by article 10 of the contract. The third of the UT's reasons needs a little more explanation. As I understand it, the UT differentiated between the Works Options on the one hand, and the Works on the other. What clause 12 permitted was a change in the Employer's Requirements in relation to the Works, not in relation to the Works Options. But a Works Option only became the Works once it had been selected by means of a Notice to Proceed. Although there is some force in this point, in my judgment it is less persuasive than the other two. The reason for that, I consider, is that it relates more to a question of timing than to the scope of clause 12. If clause 12 were as broad as Mr Williamson says it is as regards the Works, then it would have that breadth once a Works Option had been selected as the Works.

67. Nevertheless, I consider that the UT's first two reasons were good ones. I would reject the LLPs' argument under this head.

Was the expenditure incurred under the same contract as that which was made in the first 10 year period?

68. It is important to have in mind that the relevant question is whether the expenditure incurred by the Developer on the construction of DC2 and DC3 was incurred under the same contract that was made within the ten year period. It is not necessary to decide whether the original contract was rescinded (in the sense of having been wholly discharged by agreement) or whether the works encompassed in Change Order 2 were simply undertaken under a different contract. As *Blue Circle* shows, it is quite possible for changes in the work that the contractor undertakes to be referable to a new contract without necessarily discharging the original contract. The two may well exist side by side.

69. In my judgment, it is necessary as a preliminary to consider the effect of Change Order 1 and the construction of DC1. As noted, the Golden Contract, as originally drafted, gave the Developer the right or obligation to proceed with only one of the various defined Works Options. The second variation agreement entitled the Developer to proceed with both Works Option 1 and Works Option 3. But it did not alter the Developer's essential right to proceed with only one project (or in the case of Works Options 1 and 3 two projects). The Developer exercised that right by issuing Change Order 1; and DC1 was duly constructed. Neither the Golden Contract as originally drafted nor the Golden Contract as varied by the variation agreements permitted the Developer to exercise the right more than once, let alone more than once in relation to the same Works Option. The effect of issuing Change Order 1 and its implementation, in my judgment, was that the Developer's right to require Works Options under the Golden Contract (other than in accordance with clause 12) was spent. If, as I think, the Developer had already exercised the rights that the Golden Contract gave it before Change Order 2, it must follow that Change Order 2 and the

Contractor's agreement to carry out the work that it described amounted to a different contract.

70. Nevertheless, the UT found that the Golden Contract was subsequently varied by agreement. The UT did not identify where that agreement was to be found. Any variation of a contract must itself be contractually agreed. It requires the consent of both parties. Although the UT referred to Change Order 2 they did not identify anything which amounted to agreement on the part of the Contractor. Mr Williamson submitted that agreement could be inferred from the fact that the Contractor accepted payment from the Developer, and built DC2 and DC3. I will proceed on that basis (mainly because HMRC did not contend in the UT that no agreement at all had been reached as a result of Change Order 2), although it would have been preferable for the UT to have identified where the agreement was to be found.

71. I deal first with the question whether there was a rescission of the Golden Contract as a result of the changes (although, as I have said, it is not strictly necessary to decide that question).

72. At this stage there is a major difference of approach between the parties. HMRC say that the question whether alterations to a contract amount to a rescission and substitution is a question of law to be decided by a comparison between the original obligations and the new ones. Although it is competent for the parties to agree what changes to make to a contract, it is not competent for them to agree what the legal effect of those changes is. The LLPs, on the other hand, argue that the question is one of the intention of the parties, albeit that that intention must be objectively ascertained. In ascertaining that intention the extent of the variation is not the only factor; the surrounding circumstances must also be taken into account.

73. The general principle is stated in Chitty on Contracts (34th ed) at 25-030:

> "A rescission and replacement of the contract will also be implied where the parties have effected such an alteration of its terms as to substitute a new contract in its place. The question whether a rescission has been effected is frequently one of considerable difficulty, for it is necessary to distinguish a rescission of the contract from a variation which merely qualifies the existing rights and obligations. If a rescission is effected the contract is extinguished; if only a variation, it continues to exist in an altered form. The decision on this point will depend on the intention of the parties to be gathered from an examination of the terms of the subsequent agreement and from all the surrounding circumstances. Rescission will be presumed when the parties enter into a new agreement which is entirely inconsistent with the old, or, if not entirely inconsistent with it, inconsistent with it to an extent that goes to the very root of it. The change must be fundamental and:
>
> "… the question is whether the common intention of the parties was to 'abrogate', 'rescind,' 'supersede' or 'extinguish' the old contract by a 'substitution' of a 'completely new' or 'self-subsisting' agreement."

> It is not necessary to create a scintilla temporis between the old and the new agreement for there to be a rescission and replacement; it can be achieved concurrently in the same document."

74. Treitel on Contract (15th ed), on the other hand, states at para 5-036:

> "Whether a subsequent agreement is a rescission or a variation depends on the extent to which it departs from the original contract. It is a rescission if it alters the original contract in some essential way, but if it does not go to the very root of the contract it is only a variation. "

75. Halsbury's Laws of England vol 22 (2019) states at para 377:

> "Whether the parties intended to rescind or vary is to be determined in the light of all the circumstances of the case; but the parties will be presumed to have intended to rescind the old contract and to have substituted a new one wherever the new agreement is inconsistent with the original contract to an extent which goes to the very root of it."

76. In *Morris v Baron & Co* [1918] AC 1 a written contract was entered into for the sale of some cloth. A dispute arose and legal proceedings were begun. The parties orally agreed that the action and counterclaim should be withdrawn, that an extension should be given to the buyer for payment of a sum owed by him under the contract and that he should have an option to purchase the goods remaining due to him instead of being bound to take delivery. The problem was that at that time a contract for the sale of goods of more than £10 in value was required to be evidenced in writing, otherwise it was unenforceable. The House of Lords held that the original written agreement had been rescinded by the oral agreement, even though the latter agreement was unenforceable because it was not in writing. Viscount Haldane said at 19:

> "What is, of course, essential is that there should have been made manifest the intention in any event of a complete extinction of the first and formal contract, and not merely the desire of an alteration, however sweeping, in terms which still leave it subsisting."

77. When he came to consider the facts, however, he drew his conclusion about the parties' intentions solely from the letter recording their agreement. He concluded, on the facts, that the terms of that agreement went beyond a variation and amounted to a rescission.

78. Lord Dunedin said at 25-6:

> "The difference between variation and rescission is a real one, and is tested, to my thinking, by this: In the first case there are no such executory clauses in the second arrangement as would enable you to sue upon that alone if the first did not exist; in the second you could sue on the second arrangement alone, and the

> first contract is got rid of either by express words to that effect, or because, the second dealing with the same subject-matter as the first but in a different way, it is impossible that the two should be both performed. When I say you could sue on the second alone, that does not exclude cases where the first is used for mere reference, in the same way as you may fix a price by a price list, but where the contractual force is to be found in the second by itself."

79. Lord Atkinson said at 31:

> "Moreover, rescission of a contract, whether written or parol, need not be express. It may be implied, and it will be implied legitimately, where the parties have entered into a new contract entirely or to an extent going to the very root of the first inconsistent with it."

80. He then examined the terms of the two agreements and held that apart from the price of the cloth the terms of the two agreements were in conflict. Thus, he concluded at 33:

> "It is quite impossible, in my opinion, to reconcile the agreement of April 22, 1915, with that of September 24 previous. With the exception already pointed out as to price, they are in conflict in all those material and fundamental provisions which go to the root of each of them. It is, I think, impossible to arrive at any rational conclusion as to the meaning, aim, and effect of this new arrangement other than this, that it was the clear intention of both the appellant and the respondents to put aside, in their future dealings, the original agreement, and to treat it thenceforth as abandoned or non-existent."

81. Lord Parmoor began his speech at 36 by saying:

> "My Lords, in my opinion, the determining factor, on which the appeal depends, is the intention of the parties at the time when the parol arrangement was made in April, 1915. This question is one of fact, and depends on the conclusions to be drawn from the acts and conduct of the parties."

82. That seems to me to say that a conclusion about the parties' intentions is to be drawn from what they said and did. At 38 he said:

> "It is necessary further to inquire whether the conditions have been so changed in their essential character that there is a substantial inconsistency, such as to lead to the inference that the parties did intend to rescind the earlier contract of September. It is not possible to lay down any general principle, but where the alteration is such that the conditions of the earlier contract cannot be restored without placing one of the parties

> under a permanent and substantial disability there is a strong prima facie probability of an intention to rescind."

83. This test also focuses on a comparison between the old terms and the new.

84. The House of Lords returned to the question in *British and Beningtons Ltd v North Western Cachar Tea Company* [1923] AC 48. The appellants agreed to buy tea from the respondents on the terms of written agreements, delivery to be made in London. The consignments of tea were diverted to different ports, but the parties agreed orally that the buyers would accept delivery at the other ports, with a reduction in the price. The oral agreement was unenforceable for lack of writing. The question was whether the original written agreements remained in force. Lord Atkinson said at 62:

> "A written contract may be rescinded by parol either expressly or by the parties entering into a parol contract entirely inconsistent with the written one, or, if not entirely inconsistent with it, inconsistent with it to an extent that goes to the very root of it."

85. This test is very similar to that which he himself had formulated in *Morris*; and concentrates on the differences between the old agreement and the new one.

86. Lord Sumner formulated the question at 67:

> "The question is whether the common intention of the parties on May 12, 1920, was to "abrogate," "rescind," "supersede" or "extinguish" the old contracts by a "substitution" of a "completely new" and "self-contained" or "self-subsisting" agreement, "containing as an entirety the old terms, together with and as modified by the new terms incorporated"."

87. He pointed out at 68 that the new agreement dealt with only a portion of the original cargo, and did not apply to cargos which were in bonded warehouses in various locations as regards which the original contracts remained applicable. He then considered the extent of the changes and said:

> "Under these circumstances it is plain that the three original contracts were not made an end of on May 12, 1920, but were meant at most to be subjected to a variation or alteration as to the manner and measure of performance of the original terms. The change does not go to the very root of the original contracts nor is it inconsistent with them: it merely varied the written contract by parol, the situation of the parties being otherwise unchanged. I, therefore, think that the agreement de facto of May 12, 1920, has no effect on the original contracts, not having been reduced into writing and signed by the buyers, and not having superseded the original contracts."

88. The test that Lord Sumner in fact applied, like that applied by Lord Atkinson, looked at a comparison between the old terms and the new. Both their Lordships thus

considered that the acid test was whether the changes went to the root of the original contract or were inconsistent with it.

89. He continued:

> "It was, however, argued before your Lordships that, even so, the old contracts were discharged because a varied contract is not the old contract, and as you cannot have a new and varied contract and an old and unvaried contract regulating the same thing at the same time, the old contract, like other old things, must be disregarded. As a matter of formal logic, this may possibly be so, but such was not the view taken by this House in *Morris v Baron*, since, if their Lordships had thought that any variation whatever would make a new contract and discharge the old one, they would have said so expressly and would not have dealt with the extent and completeness of the changes, as they did. The variation may be a new contract, so as to make writing, duly signed, indispensable to its admissibility, for this is a matter of form and of the words of the statute, but the discharge of the old contract must depend on intention, tested in the manner settled in *Morris v Baron & Co*."

90. In my judgment the manner settled in *Morris*, as explained in *Benington*, was the test applied by both Lords Atkinson and Sumner in the latter case.

91. In *United Dominions Corporation (Jamaica) Ltd v Shoucair* [1969] 1 AC 340 a moneylender made a loan at the rate of 9 per cent. Following an increase in the bank rate it purported to increase the rate of interest temporarily by 2 per cent; but the accompanying documentation did not satisfy the statutory requirements then in force. The money lender then sought to enforce the loan at the original rate of interest. The decision of the lower courts to the effect that the purported variation discharged the original loan contract was reversed by the Privy Council. Lord Devlin described the competing views about the effect of an ineffective variation. One view was that once the contract had been varied (even if ineffectively) the original contract was no longer the real contract. He continued at 348:

> "The disadvantage of this view is that a minor variation may destroy the effect of the whole of the transaction between the parties. The alternative view, adopted by the House of Lords in *Morris v Baron* and again in *British and Benningtons Ltd v NW Cachar Tea Company Ltd* (where Lord Sumner referred to the former view as possibly correct "as a matter of formal logic"), is based on the intention of the parties. They cannot have that which presumably they wanted, that is, the old agreement as amended; so the court has to make up its mind which comes nearer to their intention - to leave them with an unamended agreement or without any agreement at all. The House answered this question by rejecting the strict view propounded by Sankey J and distinguishing between rescission and variation. If the new agreement reveals an intention to rescind

> the old, the old goes, and if it does not, the old remains in force and unamended. …. The choice before the board lies between solving the problem by means of what Lord Sumner called formal logic or solving it by giving effect as far as possible to the intention of the parties as was done in *Morris v Baron*."

92. He concluded on the facts that it would be impossible to contend that a temporary variation in the rate of interest revealed an intention to extinguish the debt and the mortgage. That, once again, looks at the extent of the difference between the old terms and the new in order to reach a conclusion about the intention of the parties.

93. In *Sookraj v Samaroo* [2005] 1 P & CR DG11, [2004] UKPC 50 one of the issues was whether an agreement of 23 February 1981 for the sale of property was intended to discharge an earlier one. Lord Scott said:

> "The question whether in signing the 23 February 1981 agreement Mr Ramute and Mr Samaroo intended to discharge the 3 November 1980 agreement is a question of fact to be decided by inference from the surrounding circumstances and the contents of the two agreements."

94. The only difference between the two agreements was that the second agreement substituted a different completion date which, as the lower court found, "did not go to the root of the first agreement". On that basis, the second agreement did not discharge the first one.

95. In *Samuel v Wadlow* [2007] EWCA Civ 155 a singer and his manager entered into a management agreement. A dispute between them was compromised on the terms of a settlement agreement which terminated the management agreement. One of the issues argued was whether the settlement agreement amounted to a rescission of the original management agreement. That was said to be relevant to a claim to set aside the management agreement on the ground of undue influence. Toulson LJ said:

> "[39] However, it may not be easy to determine whether the parties "intended" that the original contract should continue to exist as a matter of legal analysis but in varied form, or whether as a matter of legal analysis it was intended to be discharged and replaced, since the distinction is one of legal theory which might have little commercial meaning for the parties.
>
> [40] In the present case it is plain what the parties intended to be the effect of the settlement agreement in terms of their ongoing financial rights and obligations; but to ascribe to them an intention to achieve that result by variation of the management agreement, as distinct from its replacement by the settlement agreement, or vice versa, is artificial. From a practical viewpoint it is a distinction without a difference."

96. In the end Toulson LJ did not have to answer the question, which he described as a sterile one. It is true that in most cases it makes no difference whether a contract has

been varied or rescinded. It is often the intervention of legislation that brings the question to the fore.

97. One such example is *Plevin v Paragon Personal Finance Ltd (No 2)* [2017] UKSC 23, [2017] 1 WLR 1249. In that case the claimant entered into a conditional fee agreement to cover proceedings up to and including trial. The question arose whether a change to the agreement extending it to cover an appeal amounted to a variation or to a discharge and replacement of it. The significance was that the law about the recovery of success fees under conditional fee agreements had changed during the course of the proceedings; and in order to recover the success fee it was necessary to show that it was payable under an agreement made before the change came into force. Lord Sumption said at [13]:

> "Whether a variation amends the principal agreement or discharges and replaces it depends on the intention of the parties."

98. He then quoted Lord Haldane in *Morris* and continued:

> "At the time when the two deeds of variation were executed, the CFA still subsisted (there were outstanding proceedings relating to the costs, for example). Both deeds are expressly agreed to be a variation of the CFA, leaving all of its terms unchanged except for the addition to the coverage of a further stage of the litigation and a change in the amount of the success fee. While the description given to the transactions by the parties would not necessarily be conclusive if the alleged variation substituted a different subject matter, that cannot be said of either of the deeds of variation."

99. It is to be noted that in that case the parties had expressly agreed that the changes were a variation of the CFA; and also that Lord Sumption made it clear that if the variations substituted a different subject-matter the position would be different.

100. The UT said at [96]:

> "Mr Kosmin [counsel for HMRC] submitted that their Lordships [in *Morris*] had laid down a principle to the effect that where the differences or inconsistencies between the later agreement and the existing agreement were so fundamental as to go to the root of the contract, then this was sufficient to constitute an implied rescission. We do not accept this submission. It seems to us that the case is authority for the proposition that the difference between rescission and variation is dependent on the intention of the parties. In the absence of other evidence, the fact that changes effected by the subsequent agreement go to the root of the existing contract, or that some changes are "inconsistent" with the contract's original terms, might lead to an inference that the parties intended to rescind the contract, but the question remains one of intention. In the absence of other evidence, the fact that changes effected by the

> subsequent agreement go to the root of the existing contract, or that some changes are "inconsistent" with the contract's original terms, might lead to an inference that the parties intended to rescind the contract, but the question remains one of intention."

101. The UT considered the decision of the Special Commissioners in *Shell UK Ltd v HMRC* [2007] SPC 00624 in which the Commissioners had applied HMRC's suggested test; but they held that it was wrong.

102. Nevertheless, the UT accepted at [105] that the parties' intention is to be objectively determined taking into account both the changes to the contract and the surrounding circumstances. Turning to the facts, they held at [106]:

> "Applying a test based on the parties' intentions, we are in no doubt that they intended the Change Orders only to vary the Golden Contract, not to rescind it. This case is far from the type of case referred to by Toulson LJ in *Samuel v Wadlow*, where the parties do not turn their minds to the somewhat legalistic question of whether or not a variation is intended to rescind the original agreement. Viewed objectively, the parties to the Golden Contract clearly intended that contract to preserve the entitlement for someone to claim EZAs on construction expenditure on the Site. The Change Orders were similarly intended to result in a building being constructed that was somewhat different from those provided for in the Golden Contract, but for EZAs nevertheless still to be available on the costs of construction. Mr Williamson QC was correct to submit that the parties' common desire to ensure that EZAs would be available to the purchaser of the building ultimately constructed is strong evidence of a common intention that the Change Orders would not result in rescission."

103. They added at [107] that:

> "…the desire for construction expenditure to qualify for EZAs was a common goal shared by the Developer and the Contractor and is thus directly relevant to the objective ascertainment of their intentions."

104. At [108] the UT set out a number of differences between the Golden Contract in its original form and the arrangements in force after the Change Orders. They included the following.

> "(1) Works Option 1 set out in the original Golden Contract envisaged the construction of a facility for the manufacture of microchips whereas ultimately the Contractor built two Data Centres. However, while the Contractor built different buildings from those originally envisaged by Works Option 1, we accept Mr Pulford's evidence that, from a construction perspective, the differences were not significant. To build the

> Data Centres, the Contractor used broadly the same subcontractors it would have used to build the microchip facility (the principal difference being that, to build the microchip facility, the Contractor would have needed to engage fluid-handling sub-contractors but it did not need to do so in order to build the Data Centres). Otherwise, constructing the Data Centres involved broadly similar skills and expertise to those that would have been involved in building the microchip facility.
>
> (2) Works Option 1 as set out in the original Golden Contract envisaged that the microchip facility would be built on "Site C". However, while the Data Centres were built on the Cobalt Business Park and in the vicinity of Site C, they were not actually built on Site C (largely because, by the time DC2 and DC3 were constructed, DC1 was already present on Site C). We accept Mr Pulford's evidence that ultimately DC2 and DC3 were built around 20 metres from Site C and accept his description of this change as not being a "big deal".
>
> (3) Notwithstanding the point we make at (1) above, there was some inconsistency between Works Option 1 as set out in the original Golden Contract and the works necessary to build DC2 and DC3. The original Works Option 1 envisaged that the Contractor would have to "work around" existing buildings located on Site C. For example, the Employer's Requirements applicable to that original Works Option 1 envisaged that an "Existing Bulk Gas Facility" would be retained to supply the newly built microchip facility. By contrast, before DC2 and DC3 could be built, existing buildings located on the site chosen for those Data Centres needed to be demolished.
>
> (4) Because Works Option 1 envisaged the construction of buildings on Site C specifically and because, by the time of the Change Orders, DC1 was either present or in the course of construction on Site C, absent amendments to the Golden Contract it would not have been possible, at the time the Change Orders were made, for Works Option 1 to be completed as set out in the original Golden Contract.
>
> (5) In return for building the Data Centres, the Contractor was entitled to receive a contract price of £54,845,150 for DC2 and £42,284,000 for DC3 (both sums exclusive of VAT), with payment being made in advance. If the Contractor had constructed Works Option 1 as set out in the Golden Contract, it would have received an aggregate price of £102,500,000 exclusive of VAT."

105. They concluded on that point at [109]:

> "In our judgment however, none of those differences, whether individually or together, was inconsistent with the parties having a common intention that the Golden Contract should be amended, as opposed to rescinded."

106. HMRC have mounted a full-scale attack on the UT's conclusion that whether changes to a contract amount to a variation or rescission is a question of intention. The argument is that the question must be approached in two stages. Stage 1 enquires: what have the parties agreed? That is a question of interpretation and to that extent may be described as a question of the parties' intention. But stage 2 is different. Stage 2 simply enquires: what is the legal effect of what the parties have agreed? That is not dependent on professed intention at all. HMRC illustrate the argument by well-known cases in which the courts have distinguished between interpretation and categorisation. For example, in *Street v Mountford* [1985] AC 809 the question was whether an agreement amounted to a licence or a tenancy. Lord Templeman said at 819:

> "My Lords, Mr Street enjoyed freedom to offer Mrs Mountford the right to occupy the rooms comprised in the agreement on such lawful terms as Mr Street pleased. Mrs Mountford enjoyed freedom to negotiate with Mr Street to obtain different terms. Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade."

107. In *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 the question was whether an agreement amounted to a fixed or floating charge. Lord Millett said at [32]:

> "The question is not merely one of construction. In deciding whether a charge is a fixed charge or a floating charge, the court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered

> from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it."

108. There are cases in which, despite the intention of the parties to vary a contract, the legal result of what they have agreed is to create a new one. For example where the parties had entered into what they believed was a sub-tenancy, but the term of the sub-tenancy, properly interpreted, was greater than the remining term of the head tenancy, the legal result was an assignment of the head tenancy; and not the creation of the sub-tenancy that both parties intended: *Milmo v Carreras* [1946] 1 KB 306.

109. There are other examples where the consequences of what the parties have done are not what they hoped, subjectively intended or expected them to be. An agreement purporting to add land to a tenancy agreement is one such example. It takes effect as a surrender and regrant. In *Souglides v Tweedie* [2012] EWCA Civ 1546, [2013] Ch 373 one of the issues was whether the benefit of an option had passed to the purchaser of an underlease of a flat as a "successor in title" to a previous underlessee. Following the purchase, the purchaser and the head tenant agreed by deed that a roof terrace should be added to the premises demised but that the underlease should "continue in full force and effect". The trial judge held that although technically the addition of property to the demise took effect as a surrender and regrant (and was therefore a different title), it was also possible, as a matter of interpretation, to describe the deed as having varied the underlease. Accordingly, he held that the benefit of the option had passed to the purchaser. This court disagreed. Sir Andrew Morritt CHC said that he accepted the appellant's submission, which he summarised at [10] as follows:

> "Counsel for the Tweedies contends that the judge was wrong. He points out that the surrender and re-grant effected by the second deed of variation was a legal consequence of the parties' wish to add premises to those demised by the earlier lease. It was not a consequence which the parties could contract out of and its terms could not affect the proper construction of the term "successors in title" appearing in the earlier Option and section 9. Accordingly, so he submitted, the considerations to which the judge referred in the paragraphs from his judgment I have quoted are irrelevant to the questions before us."

110. The two-stage approach has found favour in Australian Courts when considering whether there has been a variation of a contract. In *Seven Cable Television Pty Ltd v Telstra Corp Pty Ltd* [2000] FCA 350 at [132] Tamberlin J said:

> "The question whether there has been a "variation" is dependent on the intention of the parties, objectively determined, from the words of the contract. Regard must be had to the nature and extent of any differences. It does not follow, that because the parties have asserted that their mutual intention was not to vary a contract, that what is otherwise a variation is converted into a non-variation. … Of course, an express statement of intention is an important consideration when interpreting a contract but if the changes are of such a nature

> and degree as to give rise, on objective comparison, to a variation in law the mutual declarations of the parties as to their intention will not circumvent that legal consequence."

111. He then cited and applied the approach laid down by *Street v Mountford*.

112. As Toulson LJ rightly pointed out it will often make no difference to the parties whether as a matter of legal analysis they have made a new contract or varied an existing one. But in this case it does matter, so it is necessary to undertake what Toulson LJ described as a formalistic legal analysis. The ultimate question for us is not whether there was a rescission or a variation; but whether the contract under which the expenditure was incurred was the same contract as that which was entered into during the first ten year period. Our focus must therefore be on the new terms that the parties are taken to have agreed.

113. It is, however, necessary to be clear about what intention is relevant. To return to *Street v Mountford*, Lord Templeman said at 826:

> "My Lords, the only intention which is relevant is the intention demonstrated by the agreement to grant exclusive possession for a term at a rent."

114. In other words, the question of intention is not at large; still less is it to be equated with a desire to achieve a particular result. This approach is not confined to the application of legislation. In *IRC v Raphael* [1935] AC 96 (cited in *Sir Lindsay Parkinson*) clause 7 of a will made provision for the testator's children; and clause 8, after reciting that the children might become entitled on the testator's death to funds subject to the trusts of a certain settlement and a certain will, directed that each child should before the expiration of six months from the testator's death settle the interest in the funds subject to those trusts and make the settlement to the satisfaction of the testator's trustees and "so far as possible on the lines of the settlement contained in the last preceding clause hereof," with one permitted variation. Following the testator's death, his son made the settlement. The deed of settlement recited that it had been prepared in order to give effect to the desire of the settlor to settle his interest in accordance with clause 8 of the testator's will, and that the testator's trustees were satisfied with it (as testified by their being parties thereto) and that it was as far as possible on the lines of the settlement contained in clause 7 of the testator's will. Nevertheless, despite the recital of the settlor's intention, the House of Lords held that the deed had not achieved its professed objective. Lord Wright (with whom Lords Thankerton and Atkin agreed) said at 142-3:

> "It must be remembered at the outset that the Court, while it seeks to give effect to the intention of the parties, must give effect to that intention as expressed, that is, it must ascertain the meaning of the words actually used. There is often an ambiguity in the use of the word "intention" in cases of this character. The word is constantly used as meaning motive, purpose, desire, as a state of mind, and not as meaning intention as expressed. The words actually used must no doubt be construed with reference to the facts known to the parties and in contemplation of which the parties must be deemed to have

> used them: such facts may be proved by extrinsic evidence or appear in recitals: again the meaning of the words used must be ascertained by considering the whole context of the document and so as to harmonize as far as possible all the parts: particular words may appear to have been used in a special sense, which may be a technical or trade sense, or in a special meaning adopted by the parties themselves as shown by the whole document. Terms may be implied by custom and on similar grounds. But allowing for these and other rules of the same kind, the principle of the common law has been to adopt an objective standard of construction and to exclude general evidence of actual intention of the parties; the reason for this has been that otherwise all certainty would be taken from the words in which the parties have recorded their agreement or their dispositions of property."

115. In my judgment when applying their preferred test of "intention", the UT erroneously equated "intention" with the parties' desire to achieve a particular result. The desired result was the retention of the ability to claim the EZAs. The desired result in *Street v Mountford* was to avoid security of tenure under the Rent Acts. Yet Lord Templeman said:

> "I accept that the Rent Acts are irrelevant to the problem of determining the legal effect of the rights granted by the agreement. Like the professed intention of the parties, the Rent Acts cannot alter the effect of the agreement."

116. Similarly, in *Rabin v Gerson Berger Association Ltd* [1986] 1 WLR 526 this court held that a desire to avoid capital gains tax (and counsel's opinion expressing the view that a document that he had settled would have the desired result) was irrelevant in deciding whether the document did in fact achieve that result.

117. Moreover, as Mr Ewart KC pointed out, there was in fact no evidence of the parties' actual intention at the time of Change Order 2; so any "intention" could only be deduced from what the parties actually said and did. In my judgment, therefore, the UT were wrong to have rejected the submission that they recorded at [96].

118. The parties' objective intention must be deduced from what they said and did. That is not to say that the expressed intention of the parties is irrelevant (see *Antoniades v Villiers* [1988] 3 WLR 139, 146 per Bingham LJ); but that expressed intention is no more than one of the objective facts that the court must take into account. In marginal cases, it may be an important one. I consider that in taking as their starting point the inference that the parties' desire was to retain the ability to claim EZAs, equating that desire with the parties' objectively ascertained intention, and then asking whether the facts were inconsistent with that desire, the UT erred in principle.

119. In addition, I consider that there are a number of relevant features that the UT overlooked. First, the Change Order purported to be given under clause 12 of the contract; but as the UT correctly held it was outside the terms of that clause. But the professed intention of Change Order 2 was not to vary the contract (in the sense of altering its terms) but to give effect to it. Second, Change Order 2 and the notice to

proceed purported to be given in relation to Works Option 1. But that Works Option had already been selected by Change Order 1, so it was no longer available. Third, the Golden Contract both as originally drafted and also as varied by the two variation agreements only permitted the selection of one project (albeit that under the second variation agreement that single project could consist of both Works Option 1 and Works Option 3). But the single project had already been selected with the consequence that under the contract, the Developer had exhausted its options. Fourth, the SDA contained comprehensive obligations to procure the construction of DC2 (including the incorporation by reference of the contract between the Developer and the Contractor). The SDA was plainly in contemplation when the Change Order was issued, so from the perspective of securing the construction of the building there was no commercial imperative to keep the Golden Contract alive.

120. HMRC also rely heavily on the UT's finding at [108] (4) that absent amendments to the Golden Contract it would not have been possible, at the time the Change Orders were made, for Works Option 1 to be completed as set out in the original Golden Contract, because DC1 had already been built on Site C (which was the site allocated to Works Option 1). If Lord Dunedin's test is applied (i.e. that it was impossible for the original contract to be performed), that leads to the conclusion that there was a rescission as opposed to a variation. HMRC also point to what they describe as "key inconsistencies" between the original contract and the contract after the Change Orders. Thus at [108] (3) the UT found that the original Works Option 1 envisaged that the Contractor would have to "work around" existing buildings located on Site C. By contrast, before DC2 and DC3 could be built, existing buildings located on the site chosen for those Data Centres needed to be demolished. In addition, DC2 and DC3 were built on entirely different sites. Although the sites were proximate to the site originally designated for Works Option 1, there was in fact no overlap between them. HMRC also point to the very large difference between the original contract price for Works Option 1, and the substantially reduced price for the works carried out after the Change Orders. If Lord Atkinson's test or Lord Parmoor's test is applied, that also leads to the conclusion that what the parties agreed went beyond a variation. In short HMRC say that a contract to construct a materially different building on a wholly different site and at a substantially different price satisfies whatever is the right test to result in a new contract rather than a variation.

121. I agree. Whether that also results in a rescission does not matter.

A new contract?

122. The UT rejected this argument. They held that it was a question of the parties' intentions, objectively ascertained. Since they had held that the parties intended to vary the Golden Contract (rather than to replace it) it followed that they did not intend to enter into a new contract.

123. There is plainly a substantial degree of overlap in these two ways of putting the case. The essential points, in my judgment, are:

    i) The Developer's right to instruct the carrying out of a Works Option under the Golden Contract had already been exercised.

ii) The work described in Change Order 2 is radically different in kind from that described in Works Option 1 (different building, different site, radically different price).

iii) Works Option 1 as described in the Golden Contract was impossible to construct.

iv) The SDA contained (either expressly or by incorporation) comprehensive terms for the construction of the building.

124. All these features lead inexorably to the conclusion that DC2 was not constructed under a contract entered into within the ten year period. If, therefore, the parties did not rescind the Golden Contract (in the sense of abrogating it) the result of what they said or did was the making of a new contract. I agree with Andrews LJ that it does not matter whether that contract was the SDA, entered into a few days later; or a separate agreement formed by reason of the Contractor's acceptance of the price when tendered and performance of the work in due course.

Result

125. I would allow HMRC's appeal.

126. It was agreed that in that event the matters covered by the LLPs' cross-appeal do not arise for decision.

127. Despite the fact that, in the light of my decision on HMRC's appeal, the issues raised by the LLPs' appeal do not arise, the LLPs urged us to decide those issues. They pointed out that the LLPs' appeal is a freestanding one under section 13 of the Tribunals, Courts and Enforcement Act 2007. Section 14 of that Act provides:

> "(1) Subsection (2) applies if the relevant appellate court, in deciding an appeal under section 13, finds that the making of the decision concerned involved the making of an error on a point of law.
>
> (2) The relevant appellate court—
>
> (a) may (but need not) set aside the decision of the Upper Tribunal, and
>
> (b) if it does, must either—
>
> (i) remit the case to the Upper Tribunal or, where the decision of the Upper Tribunal was on an appeal or reference from another tribunal or some other person, to the Upper Tribunal or that other tribunal or person, with directions for its reconsideration, or
>
> (ii) re-make the decision."

128. As the LLPs correctly submit, this court's powers under section 14 (2) only arise if the court finds that the UT has made an error of law. As they also correctly submit,

this court has the power to decide that question on the LLPs' appeal.

129. Nevertheless, although this court has the power to decide those issues, whether it exercises that power is a different question.

130. In *Hutcheson v Popdog Ltd (Practice Note)* [2011] EWCA Civ 1580, [2012] 1 WLR 782 Lord Neuberger of Abbotsbury MR set out the principles applicable to appeals which have become academic. He said at [15]:

> "save in exceptional circumstances, three requirements have to be satisfied before an appeal, which is academic as between the parties, may (and I mean 'may') be allowed to proceed: (i) the court is satisfied that the appeal would raise a point of some general importance; (ii) the respondent to the appeal agrees to it proceeding, or is at least completely indemnified on costs and is not otherwise inappropriately prejudiced; (iii) the court is satisfied that both sides of the argument will be fully and properly ventilated."

131. The UT's decision on the issues raised by the LLPs' appeal turned in part on the particular facts of the case and the evidence led, and in part on the interpretation of the contractual arrangements. Those issues do not satisfy the first of the quoted criteria.

132. Second, anything we were to say on those issues would be obiter and would not bind any future tribunal. Third, HMRC were refused permission to appeal on one of the issues (which is closely related to those raised by the LLPs' appeal) despite the merits of the point, on the ground that it was academic. We do not think that it would be right to decide the issues raised by the LLPs' appeal in circumstances where HMRC have been prevented from challenging a closely related issue.

133. It is, of course, possible that in the fullness of time our decision on HMRC's appeal might be reversed. In that event, the issues on the LLPs' appeal would no longer be academic. That leaves us with two choices. Since the issues raised by the LLPs' appeal are questions of law, the Supreme Court would be equally capable of deciding them as we are. So we could simply dismiss the LLPs' appeal. Alternatively, we could adjourn the LLPs' appeal with liberty to HMRC to apply for its dismissal if our decision on their appeal stands, and liberty to the LLPs to apply to reinstate their appeal in the event that our decision is reversed. On balance, because we have heard full argument on those issues, I consider that the second course is preferable to the first. I would therefore adjourn the LLPs' appeal with liberty to apply as described.

Lord Justice Newey:

134. I agree with Lewison and Andrews LJJ that HMRC's appeal should be allowed and that the LLPs' appeal should be adjourned. Since, however, my reasons for concluding that HMRC's appeal succeeds differ slightly from Lewison LJ's, I must explain them.

135. Lewison LJ has surveyed the authorities relevant to the distinction between rescission and variation in considerable detail. I would add only the following:

i) *Chitty on Contracts*, 34th. ed., states at paragraph 25-036:

> "at the end of the day, the question whether there has been a rescission or a variation depends upon the intention of the parties as evidenced by the terms of the subsequent agreement and its surrounding circumstances. Thus, if it was their intention to replace the initial contract, the subsequent agreement may amount to a rescission even in the case where the subsequent agreement is not fundamentally inconsistent with the initial agreement";

ii) In *Morris v Baron & Co*, Lord Finlay LC said at 12:

> "The evidence in the present case points to the conclusion that the parties intended not merely to vary the original contract but to set it aside and substitute another for it, giving a mere option to take delivery of the parcel undelivered. This is the effect of the language of the memorandum of April 22, 1915, and it was on this assumption that all the subsequent dealings and correspondence of the parties proceeded. It is true that neither party adhered to its terms …. But neither party ever referred to the original contract as governing their rights; on the contrary, they treated it as at an end."

Lord Finlay then asked at 13 whether "the law [is] such as to prevent effect being given to the intention of the parties to treat the original contract as rescinded";

iii) In the same case, Viscount Haldane said at 21 that he would "draw the inference from the letter as read with reference to the circumstances of the case that the new arrangement was to be a complete settlement of the dispute and to initiate new relations between the parties";

iv) Also in *Morris v Baron & Co*, Lord Dunedin spoke at 26 of "the question whether what is intended to be effected by the second contract is rescission or variation"; and

v) In *Morris v Baron & Co*, the parties had not themselves specified whether the oral agreement they were making was to effect a variation, on the one hand, or rescission, on the other. Nor had anything been said about whether (a) rescission or (b) variation was intended in *British and Beningtons Ltd v North Western Cachar Tea Co* ("*British and Beningtons*"), *Sookraj v Samaroo* or *Samuel v Wadlow*.

136. I would myself derive the following from the various authorities:

i) Where a contract is rescinded, it is at an end. If, on the other hand, a contract is varied, it continues in existence but in an altered form;

ii) To a great extent, the question whether a subsequent agreement operates by way of rescission or variation depends on the intentions of the parties.

Numerous references to the significance of the parties' intentions are to be found in the cases. For example, in *Morris v Baron & Co* Lord Finlay referred to evidence that "the parties *intended* not merely to vary the original contract but to set it aside and substitute another for it", Viscount Haldane said that it was essential that there should have been made manifest "the *intention* in any event of a complete extinction of the first and formal contract, and not merely the *desire* of an alteration, however sweeping, in terms which still leave it subsisting", Lord Atkinson said that it was "the clear *intention* of both the appellant and the respondents to put aside, in their future dealings, the original agreement, and to treat it thenceforth as abandoned or non-existent" and Lord Parmoor observed that "the determining factor … is the *intention* of the parties at the time when the parol arrangement was made" (emphasis added in each case). Likewise, in *British and Beningtons* Lord Sumner observed that the question was whether "the common *intention* of the parties … was to 'abrogate,' 'rescind,' 'supersede' or 'extinguish' the old contracts" and that "the discharge of the old contract must depend on *intention*"; in *Sookraj v Samaroo* Lord Scott adverted to the "question whether … Mr Ramute and Mr Samaroo *intended* to discharge the 3 November 1980 agreement"; in *Samuel v Wadlow* Toulson LJ mentioned the difficulties which may arise in determining what was "intended"; and in *Plevin v Paragon Personal Finance Ltd (No 2)* ("*Plevin*") Lord Sumption was explicit that "[w]hether a variation amends the principal agreement or discharges and replaces it depends on the *intention* of the parties" (once again, emphasis added in each case);

iii) As is common with contractual issues, the parties' intentions fall to be determined on an objective basis rather than by reference to what they in fact, subjectively, had in mind. As Lord Denning MR noted in *Storer v Manchester City Council* [1974] 1 WLR 1403 at 1408, "[i]n contracts you do not look into a man's mind" and "[a] contract is formed when there is, to all outward appearances, a contract". Similarly, "[t]he law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent" when interpreting a contract: see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 913 ("*ICS*"), per Lord Hoffmann;

iv) Where the issue is whether a written agreement effected a variation or rescission, assessment of the parties' intentions may involve reference to the terms of that agreement, comparison with the prior agreement, evaluation of the extent (if any) to which obligations under the prior agreement remained to be performed and consideration of any relevant background circumstances. Thus, Lord Scott spoke in *Sookraj v Samaroo* of the question of what was intended being "decided by inference from the surrounding circumstances and the contents of the two agreements". That background circumstances can have a part to play accords with the Courts' general approach to issues of contractual interpretation. In *ICS*, for instance, Lord Hoffmann explained at 912-913 that interpretation is "the ascertainment of the meaning which the document would convey to a reasonable person *having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract*" (emphasis added) and that, "[s]ubject to the requirement that it should have been reasonably

available to the parties and to the exception to be mentioned next, [the background] includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man";

v) If the parties have stated their intentions in terms in the later agreement, that will, within limits, be determinative. In *Plevin*, Lord Sumption said that "the description given to the transactions by the parties would not necessarily be conclusive if the alleged variation substituted a different subject matter", but, that not being the case, the fact that the deeds in question were "expressly agreed to be a variation" prevailed. If the later agreement provides expressly for the rescission of the earlier one, that will be the consequence regardless of whether the former would otherwise be thought fundamentally inconsistent with the latter. Conversely, an express statement that a previous agreement is being varied rather than rescinded can result in that being the case even where rescission would otherwise have been presumed;

vi) The tax position can potentially be a relevant background circumstance. In particular, if the parties knew, or can be expected to have known, that from a tax point of view variation would be preferable to rescission, that can fall to be taken into account when determining the parties' intentions. That is not because the parties' subjective intentions are material, nor to confuse motive with intention. Rather, tax considerations may bear on the inherent likelihood of the parties intending (a) variation or (b) rescission and so have a role in the objective assessment of what was intended;

vii) Where the later agreement did not specify whether it was intended to effect variation or rescission, the earlier agreement will normally be taken to have been rescinded, and not merely varied, if the new one is "entirely or to an extent going to the very root of the first inconsistent with it" (to quote Lord Atkinson in *Morris v Baron & Co*). In a similar vein, Lord Parmoor referred in *Morris v Baron & Co* to conditions having been "so changed in their essential character that there is a substantial inconsistency" and Lord Sumner said of the change at issue in *British and Beningtons* that it "does not go the very root of the original contracts nor is it inconsistent with them". Whether or not it is appropriate to deem a prior agreement to have been rescinded in any particular case may, however, be affected by background circumstances and, perhaps more importantly, by whether it is apparent that obligations for which it provided remained to be performed;

viii) There are limits to the extent to which the parties can deem a change to operate by way of variation rather than rescission. In *Plevin*, Lord Sumption noted that "the description given to the transactions by the parties would not necessarily be conclusive if the alleged variation substituted a different subject matter". More generally, it seems to me that the parties could not opt for variation rather than rescission if the reality were that the later agreement resulted in the "complete extinction" of the former (to use words of Viscount Haldane in *Morris v Baron & Co*). Where a contract has been brought to an end in its entirety, the law will characterise it as rescinded whatever the parties have said;

ix) In the context of property, there are other examples of situations where, regardless of the parties' wishes, the law will not permit a contract to be merely varied. Thus, in *Souglides v Tweedie* it was recognised that a deed of variation enlarging demised premises necessarily took effect as a surrender and re-grant: as Morritt C noted at paragraph 8, it was "common ground that the legal effect of the variation of a lease so as to include further land is a surrender by the lessee of the original lease and the re-grant of a lease of the original and the additional land for a term equal to the unexpired term under the surrendered lease and otherwise on the equivalent terms and conditions". In a somewhat similar way, the grant of a "sub-tenancy" resulted in an assignment of the head tenancy in *Milmo v Carreras*. Lord Greene MR observed at 310 that, "in accordance with a very ancient and established rule, where a lessee, by a document in the form of a sub-lease, divests himself of everything that he has got (which he must necessarily do if he is transferring to his so-called sub-lessee an estate as great as, or purporting to be greater than, his own) he from that moment is a stranger to the land, in the sense that the relationship of landlord and tenant, in respect of tenure, cannot any longer exist between him and the so-called sub-lessee".

137. Turning to the facts of the present case, the following points are noteworthy:

i) The Golden Contract, as originally drafted, entitled the Developer to require the Contractor to undertake just one of the six Works Options described in it;

ii) Works Option 1 involved the design, construction and commissioning work comprising "an industrial unit to accommodate the manufacture of an eight inch board on Site C" in accordance with the "Works Option 1 Employer's Requirements", which explained that "the intention is that the Contractor shall provide a fixed lump sum price for the works described within this document which comprise the construction of an 8 inch fab semi-conductor manufacturing facility, together with all associated hardstandings and external works";

iii) Works Option 3 related to the design and construction works comprising an office business park on Site A;

iv) Site C is part of Site A, as is Site B;

v) The Golden Contract was amended in 2009, by Variation Agreement One and Variation Agreement Two, in such a way as to allow the Developer to give Notice to Proceed in respect of two specified combinations of Works Options. The Developer could thus opt for both Works Option 1 and Works Option 3 or both Works Option 2 and Works Option 3;

vi) By Change Order 1, which was issued in respect of Works Options 1 and 3 on 20 November 2009, the Developer required the Contractor to undertake the design, construction and commissioning of a data centre on Site C. The Change Order concluded by stating, "Further Change Orders may be issued in respect of the buildings within Works Option 3 or otherwise in accordance with the contract to the extent that they relate to that part of the land not affected by this Change Order";

vii) DC1 was built on Site C in pursuance of Change Order 1, achieving practical completion in 2011;

viii) We were provided by the LLPs during the hearing with a further document described as "Change Order 1". This was dated 8 July 2010, referred to Works Option 3 and envisaged the design and construction of an office block on Site A. However, no reference to this document is to be found in the UT's decision, and no submissions relating to it were advanced before us. It was not even confirmed to us that the document had been issued. In the circumstances, I do not think we can attach any significance to it;

ix) Change Order 2, which was dated 1 April 2011 and stated to be given in respect of Works Option 1 and pursuant to clause 12 of the Golden Contract, purported to require the Contractor to undertake the design, construction and commissioning of what became DC2 on Site A, not Site C;

x) The Contractor issued an invoice dated 1 April 2011 to the Developer for "Payment of construction sums due under contract between us dated 17th February 2006 and pursuant to Employers Change Order No 2 in respect of a Data Centre DC2", and this was paid;

xi) Change Order 3, which was dated 4 April 2011 and also stated to be given in respect of Works Option 1 and pursuant to clause 12 of the Golden Contract, purported to require the Contractor to undertake the design, construction and commissioning of what became DC3 on Site B, not Site C;

xii) The UT correctly held that Change Order 2 and Change Order 3 had not been made pursuant to clause 12 of the Golden Contract; and

xiii) The sale and development agreements relating to DC2 and DC3 ("the SDAs"), executed on respectively 4 April 2011 and 5 April 2011, the parties to each of which included the Developer and the Contractor, provided for DC2 and DC3 to be constructed by the Contractor in accordance with "Shell Contracts" and "Fit Out Contracts" which, as the SDAs recorded, had been agreed between the Developer and the Contractor.

138. Having concluded that neither Change Order 2 nor Change Order 3 had been made pursuant to clause 12 of the Golden Contract, the UT said in paragraph 85 of its decision that "[i]t necessarily follows that the Change Orders resulted in a variation to the terms on which the parties contracted". However, the Developer and the Contractor both appear to have been proceeding on the (erroneous) assumption that the Change Orders had been validly given under clause 12 of the Golden Contract and, hence, that the Golden Contract was not otherwise being varied. In that connection, it is relevant to note the cases cited in paragraph 4-232 of *Chitty on Contracts*. Those show that, where parties' behaviour can be explained by reference to pre-existing rights (or what were believed to be pre-existing rights), that may prevent a contract arising. For example, in *Beesly v Hallwood Estates Ltd* [1960] 1 WLR 549 (affirmed on other grounds in the Court of Appeal: see [1961] Ch 105), Buckley J decided that no contract had been concluded because the relevant letters "were written with the intention of carrying out what were thought to be existing

obligations, not of creating any new obligation": see 558. In *The Aramis* [1989] 1 Lloyd's Rep 213, Stuart-Smith LJ said at 229-230:

> "What the court has to determine is whether that is evidence of a new contract between shipowner and holder of the bill of lading …. Since there is no evidence of any express agreement, it has to be inferred from the conduct of the parties. If their conduct is equally referable to and explicable by their existing rights and obligations, albeit such rights and obligations are not enforceable against each other, there is no material from which the court can draw the inference."

Bingham LJ, another member of the Court, said at 224:

> "it would, in my view, be contrary to principle to countenance the implication of a contract from conduct if the conduct relied upon is no more consistent with an intention to contract than with an intention not to contract."

Somewhat more recently, in *Glencore Grain Ltd v Flacker Shipping Ltd (The Happy Day)* [2002] EWCA Civ 1068, [2002] 2 All ER (Comm) 896, Potter LJ (with whom the other members of the Court agreed) said of a proposed contractual analysis, at paragraph 63:

> "The difficulty with such a formulation however is that the court is being asked to spell positive offer and acceptance out of conduct alone in a situation where the parties' obligations were governed by a formal written contract pursuant to which the owners were at all times purporting to act. There was thus no apparent bilateral intention to vary or re-negotiate the express terms of the charter, as opposed to an apparent willingness on the part of the charterer to treat as valid a notice appropriate in form and purportedly served in compliance with the terms of the charter …."

139. It has nonetheless been common ground between the parties that DC2 and DC3 were built pursuant to contracts between the Developer and the Contractor. Before us, Mr Ewart identified those contracts as the SDAs. Mr Williamson objected that it had not been suggested below that no contractual agreement had arisen from Change Orders 2 and 3 and submitted that agreement can be inferred from the Contractor's acceptance of payment and construction of DC2 and DC3. For my part, I am prepared to proceed on the basis that, one way or another, the Contractor became contractually obliged to undertake the works identified in Change Orders 2 and 3 for the sums specified in them independently of the SDAs.

140. Even so, I do not think those obligations were assumed by way of variation to the Golden Contract. They will rather, as it seems to me, have arisen from fresh and separate contracts, albeit possibly incorporating some of the terms found in the Golden Contract.

141. The Golden Contract allowed the Developer to commission one of the Works Options detailed in it or alternatively, once the Golden Contract had been varied by Variation Agreement One and Variation Agreement Two, one or other of two particular combinations of Works Options. The Developer exercised that right in 2009, opting for Works Options 1 and 3 by Change Order 1. Thereafter, the Developer can have had no entitlement to require the Contractor to build anything else; the Golden Contract will effectively have become spent except as regards the works for which the Developer had elected by Change Order 1. It is true that Change Order 1 stated that further Change Orders "may be issued in respect of the buildings within Works Option 3 or otherwise in accordance with the contract to the extent that they relate to that part of the land not affected by this Change Order", but that assertion cannot of itself have served to vary the Golden Contract or, in particular, to have enabled the Developer to instruct the Contractor to undertake other work, let alone to call on the Contractor to construct by reference to Works Option 1 (a) a building which would not fit the description of Works Option 1 given in the Golden Contract or be in the place specified in the Golden Contract (b) in circumstances where the Developer had already used its right to choose Works Option 1 and (c) when Change Order 1 had referred to the possibility of further Change Orders in respect of buildings "within Works Option 3", not Works Option 1. Yet Change Orders 2 and 3 purported to do so. They invoked Works Option 1 and, notwithstanding that "Works Option 1" had been defined to refer to "an industrial unit to accommodate the manufacture of an eight inch board on Site C" in accordance with the "Works Option 1 Employer's Requirements", provided for different buildings (viz. DC2 and DC3) elsewhere than on Site C.

142. It was of course open to the Developer and the Contractor to agree that the latter should undertake further work, including the construction of DC2 and DC3. In the absence of anything to the contrary, however, the natural inference would be that a contract to that effect would be free-standing rather than operating by way of variation to the Golden Contract, the Developer's rights to commission work under which had already been exhausted. I do not need to reach a concluded view on whether, had the Developer and Contractor so stated expressly in a contract, the Golden Contract could even in 2011 have been varied to provide for DC2 and DC3 to be built. However the Contractor came to be contractually bound to construct DC2 and DC3, it is clear that the contract(s) did not stipulate that the Golden Contract was being varied. In reality, the Developer and Contractor were proceeding on the basis that Change Orders were being given pursuant to the existing Golden Contract and will have seen no need to vary it in any other way. Nor, to my mind, is there any other evidence which could warrant the conclusion that there was a variation of the Golden Contract.

143. As I read the UT's decision, it saw the tax position as crucial. In paragraph 106 of its decision, it accepted the submission that "the parties' common desire to ensure that EZAs would be available to the purchaser of the building ultimately constructed is strong evidence of a common intention that the Change Orders would not result in rescission". In paragraph 107, it concluded that "the desire for construction expenditure to qualify for EZAs was a common goal shared by the Developer and the Contractor and is thus directly relevant to the objective ascertainment of their intentions". In paragraph 112, it said:

> "By the time of the Change Orders, all parties were clearly aware that the success of the composite transactions of which the Change Orders formed part depended on the expenditure being incurred 'under' the original Golden Contract. Therefore, they intended that the works set out in the Change Orders would be performed subject to the terms of the Golden Contract and not a new contract formed following the issue of the Change Orders."

144. I would not myself dismiss tax considerations as irrelevant. The UT was, I think, entitled to consider that the prospect of obtaining EZAs could bear on the inherent likelihood of the Developer and Contractor having intended to vary the Golden Contract (compare paragraph 136(vi) above). I do not think, however, that the tax position was, in the particular circumstances, of such significance as to entitle the UT to conclude that the Golden Contract had been varied.

145. The key problem with the UT's decision, as it appears to me, is that it takes no account of Change Order 1 or, hence, of the fact that the Developer had not only selected Works Option 1 already but exhausted its rights to require the Contractor to carry out any work. In all the circumstances, the mere fact that it might have been desirable from a tax perspective for DC2 and DC3 to be constructed pursuant to the Golden Contract is not, in my view, capable of justifying the conclusion that the Golden Contract was varied.

146. Mr Ewart's submissions were in part to the effect that the Golden Contract was rescinded. I have not been persuaded. In fact, the Golden Contract may well have had a continuing role as regards the works which were the subject of Change Order 1 and, if so, that would indicate that it had not been rescinded. As I see it, however, there is no necessity to choose between variation and rescission. The Developer and Contractor saw no need either to vary or to rescind the Golden Contract, and it seems to me that they did not do so. The correct inference is that they entered into fresh contractual arrangements which did not involve either variation or rescission of the Golden Contract. I thus agree with Lewison LJ that "DC2 was not constructed under a contract entered into within the ten year period" (paragraph 124 above) and also with Andrews LJ's conclusion, in paragraph 155 below, that "[s]ince the Developer was requiring the Contractor to carry out building work which was wholly outside the existing scope of the Golden Contract, for a consideration not mentioned in that contract, and on a part of the site not covered by the Option which it had already exercised, then if the Contractor agreed to do the work for that price, … the correct analysis is that they made a fresh contractual bargain". In short, the UT was, to my mind, mistaken in rejecting, in paragraphs 111-112 of its decision, the submission that the Change Orders "created a new contract that stood separate from the Golden Contract".

Lady Justice Andrews:

147. I respectfully agree with Lewison LJ that HMRC's appeal should be allowed, and with his analysis of the applicable legal principles and their application to the facts. I also agree that the adjournment of the LLPs' appeal is the appropriate disposal in all the circumstances, for the reasons he has adumbrated.

148. The key issue was whether the expenditure for which the allowance was claimed was incurred under the Golden Contract. In my judgment, if it was incurred under any contract at all, it was incurred under a new and different agreement and not under the Golden Contract entered into during the 10-year period when the site fell within an Enterprise Zone.

149. In reaching that conclusion, it is unnecessary to decide whether the Golden Contract was "rescinded" in the sense in which that term is used in cases such as *Morris v Baron*. Indeed, I regard that question as something of a red herring. Unlike *Morris v Baron* and *British and Beningtons*, the issue here is not whether the original terms of the contract can still be enforced in the light of a subsequent (unenforceable) agreement between the parties which contains different terms. It is whether the contracting parties varied the terms of the existing agreement or entered into a new and separate agreement. This was not a case of a stark choice between rescission, on the one hand, or variation, on the other, though at times it appeared to me that the LLPs were seeking to characterise it in that way. It was possible for the parties to make a new agreement which did not replace the old one. So whilst a finding that the parties intended to bring the original agreement to an end would lead inexorably to the conclusion that it was not varied but superseded, its continued existence would not resolve the issue.

150. The intentions of the Developer and the Contractor at the time of Change Order 2 (and Change Order 3) must be objectively ascertained from what they said and did at that time. The Developer's agent purported to give instructions under Clause 12 of the Golden Contract, which expressly referred to Works Option 1 (which had already been exercised) at a time when another building had been either substantially or fully erected on Site C, the only site to which Works Option 1 related. Each set of instructions required the Contractor to undertake the design, construction and commissioning of a new and different building, which necessarily had to be erected elsewhere than on Site C. They also purported to effect a unilateral change to the amount of the Contract Sum payable for the (proposed) additional works.

151. The Upper Tribunal correctly held that Clause 12 did not empower the Developer to give those instructions. The situation was therefore one in which one of the contracting parties (and probably both) mistakenly believed that they were performing the Golden Contract as validly amended by operation of its existing terms.

152. When considering whether in those circumstances it was to be inferred that the parties had agreed to vary the Golden Contract, the UT fell into error (at paras 106 and 107 of its first decision) by conflating the parties' desired objective of maintaining the tax advantages of the pre-existing arrangements with their objectively ascertained contractual intention. As Lewison LJ has explained at paragraph 118, they then compounded that error by considering whether the differences between the existing and new contractual terms "acted to call into question whether the common intention existed at all". Any such comparative exercise could only have been of value as an aid to determining what was the objectively ascertained intention of the parties, and not as a means of testing a conclusion already reached about it.

153. I *acknowledge* that there were very substantial differences between the Golden Contract and the works instructed under Change Orders 2 and 3. I also agree with Lewison LJ that in the light of the contemplated SDAs there was no reason to keep

the Golden Contract alive in order to ensure that the construction of DC2 and DC3 was carried out. On the other hand, the evidence was unclear about whether the Developer still had the ability to give instructions in relation to Works Option 3, or whether for example it had exercised (and exhausted) that option by serving the second so-called "Change Order 1" referred to by Newey LJ in paragraph 137(viii) above. In any event, I have a conceptual difficulty with the proposition that in circumstances where the parties were purporting to perform the original contract, there was an objectively evinced mutual intention to terminate it. However, that does not matter. As Lewison LJ has pointed out at paragraph 119, the professed intention of each Change Order was not to vary the Golden Contract but to give effect to it. Thus there was no evidential basis for finding an objectively evinced mutual intention to vary the Golden Contract in a manner that fell outside the scope of Clause 12 by, in effect, adding a new Works Option 7 and Works Option 8. The instructions to carry out the further work under Change Orders 2 and 3 cannot be characterised as offers to vary the contract in that way.

154. Applying the approach of Purchas LJ in the *Blue Circle* case, the employer could not have ordered the work required by it against the wishes of the Contractor as a variation under clause 12. Therefore, any agreement under which such work was carried out could not constitute a variation but had to be a separate agreement. Further support for that conclusion is to be found in the authorities referred to by Newey LJ in paragraph 138 above, which illustrate the difficulty of inferring an offer to vary the existing terms of a contract from circumstances in which the parties are doing no more than purporting to perform those terms or to give effect to them.

155. Since the Developer was requiring the Contractor to carry out building work which was wholly outside the existing scope of the Golden Contract, for a consideration not mentioned in that contract, and on a part of the site not covered by the Works Option which it had already exercised, then if the Contractor agreed to do the work for that price, in my judgment the correct analysis is that they made a fresh contractual bargain. For present purposes it matters not whether that bargain was under the SDAs, entered into a few days later (to which the Developer and Contractor were parties) or under a separate agreement formed by reason of the Contractor's acceptance of the price when tendered and performance of the work in due course. What matters is that the relevant expenditure was not incurred under the Golden Contract.

156. It follows that the LLPs were not entitled to any of the allowances that they claimed, and the question whether the UT was right or wrong to apportion the expenditure becomes academic.