

6-19-2018

Humbly Grove Energy Limited v. O'Dwyer (Valuation Officer)

Valuation Tribunal For England

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VALUATION TRIBUNAL FOR ENGLAND



Non-domestic rating appeals; 2010 rating list; Gas Pipeline and Premises; Gas Storage Facility and Premises; the relationship with the Oil Facility; comparing Humbly Grove to other Gas Storage Facilities; choice of valuation method; receipts and expenditure valuation (R&E); the contractor's basis valuation; assets and valuation. Decision: Appeals Allowed.

RE: Gas Pipeline Humbly Grove to Barton Stacey, Lasham, Alton, Hants, GU34 5SY

Gas Storage Facility, The Avenue, Weston Common, Lasham, Alton, Hants, GU34 5SY

APPEAL NUMBERS: 170525388407/537N10; 170525388401/537N10 & 170528616548/537N10

BETWEEN: Humbly Grove Energy Limited Appellant
and Tom O'Dwyer (Valuation Officer) Respondent

PANEL: Mr A Jack (Chairman)
Mr B Pinfield

SITTING AT: VTS Offices, 2nd Floor, 120 Leman Street, London, E1 8EU

ON: 14 March 2018. The panel reconvened on 27 April 2018 to conclude its deliberations.

APPEARANCES: Mr D Kolinsky QC for the Appellant
Expert Witnesses: Mr A Moors; Mr K Norman
Witnesses: Mr N Rambhai and Mr N Wakefield

Mr H Flanagan for the Respondent
Expert Witness: Mr T O'Dwyer

Summary of decisions

1. Appeal number: 170525388407/537N10 – Appeal dismissed.

2. Appeal number: 170525388401/537N10 – Appeal against the rateable value (RV) in the list is allowed to a RV £3,225,000 with effect from 1 April 2010.
3. Appeal number: 170528616548/537N10 – (merged hereditaments) Appeal against the RV in the list is allowed to a RV £4,150,000 with effect from 1 April 2015.

Introduction

4. The appeals arose following proposals dated 27 March 2015 (Appeal Nos. 170525388407/537N10 and 170525388401/537N10) and 22 February 2017 (Appeal No. 170528616548/537N10) made by Gerald Eve on behalf of the appellant ratepayer, Humbly Grove Energy Limited, seeking a reduction and a merger in the 2010 rating list entries for the subject hereditaments. Agreement between the Valuation Officer (VO) and the appellant in respect of these proposals had not been possible and the issues were therefore referred to the Valuation Tribunal for England as appeals under Regulation 13 of the Non-Domestic Rating (Alteration of Lists and Appeals) (England) Regulations 2009 SI 2268.
5. Under current legislation, by virtue of The Non-Domestic Rating (Alteration of List and Appeals) (England) (Amendment) Regulations 2015 SI 424, the effective date for proposals received after 1 April 2015 will, in most cases, be restricted to 1 April 2015.
6. The hearing of this complex case took place on 14 March 2018. The Appellant was represented by Mr Kolinsky QC, the Respondent by Mr Flanagan. Oral evidence ended at 4:30pm. The parties agreed to provide closing submissions in writing. In making our decision we have taken into account:
 - i. The parties' statements of case;
 - ii. The statement of agreed facts and issues;
 - iii. The two bundles of witness statements, expert reports, supporting documents;
 - iv. The parties' skeleton arguments;
 - v. The oral evidence; and
 - vi. The parties' written closing submissions.

Issues

7. The issue in this appeal (170525388401/537N10) is the valuation of the Humbly Grove gas storage facility, which is a partially depleted oil reservoir used for gas storage with associated buildings, plant and machinery. The Rateable Value of Humbly Grove gas storage facility in the 2010 Rating List is £4,860,000. The Appellant seeks a reduction in rateable value to £3,225,000. The effective date for this appeal is 1 April 2010.
8. The dispute between the parties concerns the appropriate method to be adopted when valuing Humbly Grove i.e. whether the receipts and expenditure method or the contractor's basis should be used.

Statutory Provisions

9. The Local Government Finance Act 1988 (LGFA), Schedule 6, paragraph 2(1) is as follows:

(1) The rateable value of a non-domestic hereditament none of which consists of domestic property and none of which is exempt from local non-domestic rating shall be taken to be an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year on these three assumptions—

(a) the first assumption is that the tenancy begins on the day by reference to which the determination is to be made;

(b) the second assumption is that immediately before the tenancy begins the hereditament is in a state of reasonable repair, but excluding from this assumption any repairs which a reasonable landlord would consider uneconomic;

(c) the third assumption is that the tenant undertakes to pay all usual tenant's rates and taxes and to bear the cost of the repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command the rent mentioned above.

10. The AVD is 1 April 2008. The rateable value of the gas storage facility is therefore equal to the rent at which it is estimated that it might reasonably be expected to be let from year to year, assuming that the tenancy began on 1 April 2008.

11. Schedule 6, paragraph 2(6), LGFA requires the matters listed in paragraph 2(7) to be taken as they were on the material day. The matters listed in paragraph 2(7) are as follows:

(a) matters affecting the physical state or physical enjoyment of the hereditament,

(b) the mode or category of occupation of the hereditament,

(c) the quantity of minerals or other substances in or extracted from the hereditament,

(cc) the quantity of refuse or waste material which is brought onto and permanently deposited on the hereditament,

(d) matters affecting the physical state of the locality in which the hereditament is situated or which, though not affecting the physical state of the locality, are nonetheless physically manifest there, and

(e) the use or occupation of other premises situated in the locality of the hereditament.

12. The material day is 1 April 2010.

Method of Valuation

13. The parties agree that there is insufficient evidence of rentals of comparable properties to use the rentals method of valuation, because gas storage facilities are not normally (if ever) let.

14. The Valuation Officer considers that the appropriate valuation method in this case is the contractor's basis. The Appellant argues that the receipts and expenditure method should be used.
15. The Joint Professional Institutions' Rating Valuation Forum have produced a guidance note entitled *The Receipts and Expenditure Method of Valuation for Non-Domestic Rating*. It defines the receipts and expenditure method as "A method to ascertain the rental value of a property, for the purposes of rating, by reference to the receipts and expenditure, adjusted as necessary, of an undertaking carried on at that property". The notes say that "Gross Receipts should be determined by taking into account all income reasonably able to be derived from occupation of the property" (paragraph 4.2(a)). Costs and expenses are then deducted, and the balance divided into the tenant's share (the tenant's reward for their enterprise) and the landlord's share (i.e. the rent which the tenant would be willing to pay). This is a method of assessing what the *hypothetical* tenant would be willing to pay, although unless there is some reason to think that the actual occupier is more or less successful than the reasonably competent hypothetical tenant, it will be the actual occupier's accounts which are usually taken as representative of the gross receipts which the hereditament is capable of yielding and of the expenditure likely to be incurred in achieving them (*Hughes (VO) v York Museums and Gallery Trust* [2017] RA 302, paragraph 122).
16. The Joint Professional Institutions' Rating Valuation Forum have produced a guidance note entitled *The Contactor's Basis of Valuation for Rating Purposes*. This states that this method is used in the case of properties which are not normally let, which by their nature do not lend themselves to valuation with other classes where rental evidence does exist, "and which are not of the type where a valuation by reference to the accounts of the undertaking would be appropriate" (paragraph 1.2). *Hughes v York* states that "The contractor's basis is often described as a method of last resort and ought not to be employed where there is material on which to base a comparative or receipts and expenditure valuation" (paragraph 131).
17. There are five stages to a valuation on the contractor's basis:
1. Estimate the replacement costs of the hereditament.
 2. Adjust the replacement costs to reflect any deficiencies in the actual property as compared with the replacement property.
 3. Value the land.
 4. Decapitalise the sum of stage 2 and stage 3 using the statutory decapitalisation rate (which is 5% for the 2010 List).
 5. Stand back and make any further adjustments considered appropriate.
18. We will address the issue of which method of valuation is appropriate in this particular case after reviewing the evidence.

Appellant's Evidence

Mr Moors

19. Mr. Moors is the Managing Director of Humbly Grove Energy Limited, which owns the Humbly Grove Storage Facility. He provided evidence of the history of Humbly Grove as follows. During 2004 and 2005 the then oil field at Humbly Grove was redeveloped as a gas storage facility. It has two underground reservoirs, each of

which is used for both oil production and for gas storage. One (called Rhaetic) is a sandstone reservoir, the other (named Great Oolite) is a limestone reservoir. Gas is pumped into the reservoirs from the national grid when prices are low and extracted when prices are high.

20. There are two types of underground gas storage facilities in the UK. The first type are depleted hydrocarbon reservoirs, which are used to store gas following the extraction of hydrocarbons, either oil or gas. Humbly Grove has depleted oil reservoirs and can be used to store gas following the extraction of oil. Another facility which is often referred to in this case is Hatfield Moors, Mr. Moors explained that this has a depleted gas reservoir into which gas can be pumped as a result of the earlier extraction of gas. (The only other depleted hydrocarbon reservoir – called Rough – is offshore.) The second type are salt caverns, which are created by removing salt to create an underground hole, much like an underground tank, in which gas can be stored. Depleted hydrocarbon reservoirs are permeable and porous rock formations in which gas is stored not in a cavern or ‘tank’ but in the space between grains or granules of the rock. Mr. Moors explained the difference to us using the analogy of blowing through a straw filled with sand and blowing through an empty straw.
21. The physical differences between depleted hydrocarbon reservoirs and salt caverns give rise to significant differences in their performance as gas storage facilities. It takes much longer to get gas in and out of porous rock than an underground ‘tank’ (perhaps months in the first case, days in the second). As a result, Humbly Grove has limited scope to pump out gas when the price of gas is high as a result of market (rather than seasonal) fluctuations, as compared with a salt cavern reservoir. A further disadvantage of depleted reservoirs is that when gas is extracted it contains impurities and contaminants such as crude oil and sand, which need to be removed before the gas can be put into the national grid, whereas the only contaminants needing to be removed from gas extracted from a salt cavern are water and salt.
22. Mr. Moors also explained the differences between Humbly Grove (with its two depleted oil reservoirs) and Hatfield Moors (which has a depleted gas reservoir). In particular, the extracted gas contains more contaminants at Humbly Grove (including oil and sand) than at Hatfield Moors. As a result, Humbly Grove requires far more treatment facilities, giving rise to greater capital and operational costs, and is subject to more regulatory requirements than Hatfield Moors.
23. Mr. Moors also spoke to the document in the Appellant’s bundle entitled “Contract Timeline”, regarding various gas storage contracts under which the owner and operator of Humbly Grove gas storage facility agreed to store gas at Humbly Grove for the owners of that gas. When Humbly Grove was originally developed as a gas storage facility it was owned and operated by Star Energy HG Gas Storage Ltd.¹ Star Energy HG Gas Storage Ltd entered into various contracts with Vitol SA at various points in time beginning in 2004, under which Vitol SA was entitled to the exclusive use of the gas storage facility for the storage of its gas. In particular, the terms of the contract were renegotiated during 2008 and 2009 and on 17 June 2009 a Second Supplemental Agreement relating to the original gas storage agreement of April 2004 was signed. This is referred to as ‘GSA2’ (short for Gas Supplementary Agreement 2) and was effective from 1 April 2010. Under GSA2 Vitol SA were entitled to store gas at Humbly Grove and Star Energy HG Gas Storage Ltd was

¹ Star Energy HG Gas Storage Ltd was renamed as Humbly Grove Energy Ltd in 2011.

entitled to receive in return a fixed base price and an amount which would vary. The variable amount was a mechanism by which Star Energy HG Gas Storage Ltd would receive a share of seasonal and volatility gains without having to share in any seasonal and volatility losses ('the gain share mechanism'). Mr. Moors' evidence to us was that the negotiations of GSA2 were free, that this was an arms-length transaction.

24. Mr Moors states in his rebuttal statement that the only hydrocarbon sold commercially is crude oil, and that the crude oil revenues form part of the oil production business which is separately assessed for business rates.
25. Mr Moors accepted in cross-examination that the gas storage facility was constructed not only to store gas, but also to boost oil production from the oil facility next door which is also owned by Humbly Grove Energy Ltd. He accepted that there are three benefits to the oil facility. (1) Increased oil production which is caused by the increased gas pressure. (2) The compression system which is part of the gas plant can be used to churn gas (cycling gas from the reservoir) to increase oil production. (3) The liquids which are produced with the gas include oil, which is recovered for sale.
26. Mr Moors was also cross-examined about the difference in revenue streams at Humbly Grove and at Hatfield Moors. His report says that the purpose of the store at Humbly Grove is to provide a revenue stream from a warehousing facility for third party access (the third party storing and trading gas). The purpose of the store at Hatfield Moors is to provide a revenue stream from a warehousing facility for third party access but also from the operator's own storage and trading of gas. There is one revenue stream in the former case, but two revenue streams in the latter. Mr Moors stated that the structures of the businesses are totally different. At Hatfield Moors the operator of the storage facility not only stores gas for others but also stores and trades their own gas.

Mr Wakefield

27. Mr. Wakefield has been the Financial Controller at Humbly Grove since 2007. He provided accounts of Star Energy HG Gas Storage Limited, the principal activity of which is the provision of gas storage facilities. He stated that both revenue and costs are apportioned between oil and gas for tax purposes. He provided a calculation of the amount that would have been due under the gain share mechanism had it applied from April 2008. He also says in his witness statement that the actual construction costs of Humbly Grove storage facilities, pipeline and wells were £100,810,000.
28. Mr. Wakefield was cross-examined about the apportionment of each of the three benefits to oil production from gas storage numbered (1), (2) and (3) above. He stated that it is the costs of churning to enhance oil production that are included in the accounts of the oil production field. The costs of putting gas in the reservoir for the purpose of storing it are not. Apportionment is based on the purpose that the activity was carried out for. The purpose of putting gas into the gas storage field is gas storage, so there is in this case no apportionment to the accounts of the oil business even if it also enhances oil production. With respect to the oil which is extracted with gas, the cost of extracting gas is apportioned wholly to the gas business.

Mr Rambhai

29. Mr. Rambhai is the Head of Legal and Compliance, Company Secretary and Acting Head of Risk at PETRONAS Energy Trading Limited ('PETL'). He gave evidence regarding the 2011 transaction in which PETL acquired the gas storage contracts at Humbly Grove from Vitol SA in March 2011 for £33 million. As a result, PETL were entitled to store gas at Humbly Grove for the remaining four years of the contract until May 2015. He stated that Humbly Grove Energy Ltd is the operator of the storage facility and, unlike Vitol SA or PETL, it does not have the personnel, systems or capital to exploit the value of the asset from a trading perspective. He stated that the £33 million paid by PETL was based on a highly optimistic view of the gas market taken by PETL's then CEO, which was contrary to the view taken by other participants in the gas storage market in 2011.
30. Mr. Rambhai was cross-examined about PETL's accounts for 2014. The gas storage agreement is given a net book value of £23,315,000 at 31 December 2014. It was put to Mr. Rambhai that the producers of the accounts thought that the asset still had a significant value, of over £5 million a year. He replied that the accounts would have reflected the view of the then CEO who had acquired the asset, and who would have convinced external auditors of his view of the asset's value.
31. Mr. Rambhai also highlighted the difference between a gas trading enterprise and the Appellant in terms of capital. He stated that a company trading gas requires large amounts of capital to operate. PETL itself borrows £250-300 million as working capital in order to buy and sell gas, with the aim of making more profit than the cost of borrowing.

Mr Norman

32. Mr. Norman gave expert valuation evidence. He has some 28 years' experience of advising oil, gas and energy companies in respect of the rating assessments of their properties.
33. Mr. Norman considers that the Humbly Grove installation has not been "constructed" but developed from the extraction of oil over a long period of time to create a storage reservoir.
34. He considers that the receipts and expenditure method is appropriate as the value of Humbly Grove gas storage facility is directly related to its potential profitability for a hypothetical occupier. It is necessary to ascertain the rent for the hereditament which would have been agreed on 1 April 2008 having regard to future economic prospects. The hypothetical tenant will consider previous years' financial performance and his own projections for future years in deriving anticipated income and operating costs.
35. Mr Norman considers that there is sufficient information from accounts and breakdowns of those accounts to undertake a receipts and expenditure valuation. His valuation does not however simply rely on the actual receipts and expenditure of Humbly Grove Energy Ltd. The initial gas storage agreement with Vitol which was in effect at AVD was for a fixed operating charge plus a capacity charge. GSA2 was however negotiated in 2008 and is likely to most accurately reflect what would have been agreed between a hypothetical landlord and tenant at the valuation date, as it was an arms-length transaction. Under GSA2 the base price increased and the gain share mechanism was introduced. Although GSA2 was not actually in effect at AVD,

and did not take effect until 2011, Mr Norman has produced a receipts and expenditure valuation based on actual financial information but with the revenue recalculated as if GSA2 had been in effect. His valuation therefore takes account of the higher base price and the gains share mechanism under GSA2. It also includes an assessment of the theoretical income that would have been received under GSA2 had it been in effect in 2008-2009 and following years. His valuation reflects his judgment of the extent to which the hypothetical tenant would have applied some value to the potential gain share income in determining his rental bid, notwithstanding that by April 2008 seasonal spreads and volatility were on a long term structural decline. He considers however that the full extent of the collapse in spreads was unlikely to have been anticipated at AVD.

36. Mr Norman's valuation does not take account of the 2011 transaction in which PETL acquired the remaining four years of the contract from Vitol for £33 million. His reasons include: (i) it is some 3 years after AVD; (ii) it is the acquisition of a contract which facilitated trading operations reflecting very different capital requirements; (iii) it reflected the perception of one particular company; (iv) it conflicts with the evidence of the GSA2 negotiations in 2008 – 2009; and (v) subsequent performance of the contract suggests that the price bears no relationship to the underlying market value.
37. Mr Norman's conclusion is that the ratable value of the hereditament - including the pipeline, whose valuation has since been agreed at £925,000 - is £4,150,000.
38. Mr Norman considered the Respondent's criticism that his valuation does not include all the profits of trading gas was not fair. If the hypothetical tenant was set up for trading, it would need expertise, capital, and would bear a far greater risk. Humbly Grove Energy Ltd had however been able to negotiate a share of the trading profits. He was also asked about the Respondent's criticism that not all of the benefits to the adjoining oil production facility which result from the gas storage facility were reflected in his receipts and expenditure valuation. He replied that the oil facility is a separate hereditament. The increase to oil production has been included in the assessment of the oil facility. He says in his rebuttal report that the oil producing field at Humbly Grove is subject to a separate rating assessment which as a mineral producing hereditament is subject to annual review to reflect changes in annual output. An increase in oil production is reflected in the assessment of that hereditament and these benefits should not be double counted.
39. He said in cross-examination that this valuation did not simply value the business of the actual tenant at AVD. He considers that his valuation is based on the most reliable – and best evidenced – hypothetical tenant model.

Respondent's evidence

Mr O'Dwyer

40. Mr O'Dwyer gave expert valuation evidence. He has valued the UK's underground gas storage facilities for 15 years. His valuation uses the contractor's method.
41. The size of the reservoir at Humbly Grove has been agreed at 282,760,000 cubic metres and his revised valuation of the hereditament - including the pipeline - in the light of this is £6,410,000. This is based on a stage 1 cost of £0.41 per cubic metre of working gas for the reservoir.

42. This is consistent with the stage 1 cost adopted for the reservoir at Hatfield Moor. This is a depleted gas field used as a gas storage facility. The gas storage reservoir was given a stage 1 cost of £0.41 per cubic metre. An appeal against this valuation by its owner Scottish Power was withdrawn by Mr Norman.
43. The stage 1 cost is also supported by AVD market evidence from Caythorpe. His analysis of the Caythorpe project is set out in his expert report. In 2008 Centrica purchased the redundant gas field at Caythorpe for £70 million in order to develop and operate a gas storage facility. The project did not ultimately proceed. However, Mr O'Dwyer's analysis of the project indicates a stage 1 cost of £0.65 per cubic metre on the working gas volume. This was on the basis that the anticipated working gas volume was 4.9 billion cubic feet, or 138.76 million cubic metres. The analysis includes 6 new wells at a cost of £3 million each, which is based on costs at Humbly Grove. (Mr O'Dwyer's analysis is accompanied by a document which neither party has referred us to, namely a request for information relating to Humbly Grove, and information from Star Energy Group Plc relating to the overall project costs of two Rhaetic wells. The overall project cost in the period ending October 2009 was in excess of £7 million.)
44. Accompanying his report is a Centrica news release dated 22 September 2008 which says that Caythorpe would have "a capacity of up to 7.5 billion cubic feet (bcf)". There is also part of another document from Centrica which gives the "Working gas (bcf)" at Caythorpe as being 4.9. It is this figure Mr O'Dwyer uses in his Caythorpe analysis.
45. In his oral evidence he said that in 2014 he reviewed all gas storage facilities in the UK. He attended a meeting with Centrica, with the gentleman behind the 2008 Caythorpe proposal. His analysis of the Caythorpe transaction is based on the information provided at that meeting.
46. His analysis of the Caythorpe project is that the costs would have been £0.65 per cubic metre, which indicates that £0.41 for the subject property is not unreasonable.
47. The agreed assessment on the seasonal cavity storage facility at Hornsea also underpins his opinion. This facility was developed in the 1970s from salt strata. The stage 1 cost was £0.80 per cubic metre, against which the stage 1 cost of £0.41 used in valuing Humbly Grove is not excessive.
48. Mr O'Dwyer also makes a 12.5% stage 5 ('stand back and look') allowance on the gas storage assets to reflect the characteristics of Humbly Grove which require additional assets and incur additional operating costs. He accepts that there are value significant differences between Humbly Grove and Hatfield Moor – the main difference is the use of an oil reservoir at Humbly Grove, which gives rise to additional costs - and he has reflected these by way of his stage 5 allowance. He has considered all the pluses and minuses, and this is what underpins his allowance of 12.5%.
49. He considers that it is realistic to use the contactor's basis notwithstanding the point that this is a natural facility. The appeal property was developed two years before AVD. Land with an appropriate geological facility can be acquired and then developed. There was demand for these facilities at AVD and these facilities were being created. He notes in his rebuttal report that Mr Wakefield has given

construction costs of £100.81 million and that Mr Norman has used these costs in his sense check. The only element missing is the value of the land with appropriate rights.

50. Mr O'Dwyer does not consider a receipts and expenditure method of valuation to be appropriate in this case. The receipts and expenditure method requires you to include *all* of the revenue from the hereditament. The Appellant's valuation does not include Vitol's revenues. It does not include the valuable oil that is recovered with the gas, the revenues for which are reflected in the valuation next door. And it does not include the increased oil production, although the main purpose of the gas storage facility was to boost oil production. Further, costs are included in the valuation of the gas storage facility which relate to the revenues next door.
51. He referred to the Market and Revenue Graphs in his report which show seasonal spread prices from 2004 – 2012. Like Humbly Grove, Rough is a seasonal facility. Its revenues closely align with seasonal spread prices. In contrast, the revenues at Humbly Grove are not closely aligned with seasonal prices, indicating that the revenue streams at Humbly Grove were not market sensitive.
52. The Appellant's valuation does not include the market trading risk revenues taken by Vitol. The 2011 transaction had a price of £33 million. This sum represented the value of 4 years rights to exclusively use the storage from March 2011. In his expert report Mr O'Dwyer suggested that this indicated an annual value of £8,250,000 for this right as at March 2011. In his rebuttal report Mr O'Dwyer takes as his starting point the value put on these rights in the 2014 PETL accounts, which is £23,315,000. This still indicates an annual value of £5,828,750, a value well above that of GSA2 to Humbly Grove.
53. Mr O'Dwyer was cross-examined about his analysis of the Caythorpe project. He considered that what he was told by Centrica was correct. When the VOA had approached Centrica, they were fully aware of the review of the valuation of all gas storage facilities and of the implications of the information they were giving him.
54. Mr O'Dwyer was cross-examined about paragraphs 95b and c of his expert report. These state that Humbly Grove has advantages over Hatfield Moor: (i) valuable hydrocarbons are recovered with the gas at Humbly Grove and (ii) the adjoining oil plant benefits directly from enhanced oil production as a result of the gas storage facility at Humbly Grove. He agreed in cross-examination that his 12.5% stage 5 allowance takes account of advantages to the oil facility and that the benefits to the oil facility are already counted in the oil facility assessment. He accepted that it is incorrect to double count, and that there is an element of double counting in his assessment. He therefore accepted that the stage 5 allowance of 12.5% would need to be increased.
55. The panel asked what increase to the 12.5% stage 5 allowance should be made if we were to find that his valuation involved double counting. Mr O'Dwyer answered that a 2.5% - 5% increase would be appropriate.
56. In response to a question from the panel, Mr O'Dwyer said that if we found that the correct stage 1 cost for Caythorpe were £0.33 per cubic metre (which is the figure Mr Norman arrives at in his analysis of the Caythorpe transaction) there would also need to be a reduction to about £0.25 per cubic metre in the case of Humbly Grove.

Decision and reasons

57. Gas storage facilities have to be valued and where there is no evidence for R&E valuations valuers must do their best. Mr Norman accepted in cross-examination that the value in the 2010 list for Hatfield Moor is done on the contractor's basis.
58. The Respondent says that all the other seven gas storage facilities in the 2010 rating list were valued using the contractor's basis. The Appellant accepts that the contractor's basis is appropriate for fast cycle facilities where there is evidence of construction costs at or around AVD and, because they were not yet operating, there is not the evidence on which an R&E valuation could be based. Mr Norman gave evidence that an appeal against the RV of Hatfield Grove was withdrawn because his clients in that case were unable to provide the necessary information to undertake an R&E valuation. In this case, however, he has provided a reasoned R&E valuation based upon actual accounts and GSA2. The question for us is the valuation of this particular property on the basis of the detailed and extensive evidence before us.
59. There is a hierarchy of methods and the R&E method should be considered before the contractor's basis.

The Appellant's R&E valuation

60. The Appellant argues that its valuation is well evidenced. The gas storage facility was let out for profit at AVD. The gas agreement in place at AVD gave Vitol SA exclusive rights to use of the facility to store gas. Further, GSA2 was negotiated at arm's length around AVD. Mr Norman's valuation takes into account the accounts of Humbly Grove Energy Ltd and breakdowns of those accounts. However, it is based on an assessment of what revenues would have been received had the gain share mechanism had been in place.
61. The Respondent argues that the Appellant's valuation is fundamentally flawed for a number of reasons and we consider them in turn.
- (i) Failure to Account for Trading Profit
62. The Respondent argues that the Appellant's R&E valuation does not include the receipts from trading gas which will be recorded in Vitol SA's accounts. It includes the gain share mechanism, but that is only a *share* of the revenue which a trader would receive. This is contrary to the Rating Valuation Forums R&E guidance which requires an R&E valuation to take into account all income reasonably able to be derived from occupation of the property (paragraphs 4.2(a) and 5.12).
63. We consider that this criticism is not well founded. What can reasonably be derived from *the occupation of a gas storage facility* is the receipts which can be obtained by operating a gas storage facility. Since one can operate a gas storage facility without trading in gas we do not consider that the receipts which can reasonably be derived from the occupation of Humbly Grove must include all of the receipts of a gas trader.
64. Further, we see no reason to suppose that the hypothetical tenant would be a trader rather than a warehouse. As the Respondent points out, Hatfield Moors is owned and operated by Scottish Power who both operate a warehouse and trade gas. There is a different business model at Humbly Grove, which is designed to exploit

the value of Humbly Grove as a seasonal gas storage facility, but without the additional capital that would be necessary to trade gas and without the potential downside risks that a trader takes. We accept Mr Rambhai's evidence that a trading company is a different kind of entity requiring very large amounts of capital. As the Respondent says, it would be a mistake to simply assume that the hypothetical tenant must be the actual tenant at AVD. But on the basis of the evidence before us, there is no reason to think that the hypothetical tenant would seek to exploit the value of HG by trading gas, rather than by operating a warehouse but seeking to share in the gain. It is not only gas traders who exploit the ability of a gas storage facility to gain from seasonal spreads. Mr Norman's valuation is not based on the assumption of a hypothetical tenant who is unable to exploit the essential value of the hereditament: it is based on a hypothetical tenant with a perfectly sensible business model designed to ensure that it covers its costs and shares in the gain, but does need the substantial capital required for trading and does not involve taking on the risk of market downsides.

(ii) Failure to Account for Increased Oil Production

65. The Respondent argues that the Appellant's R&E valuation fails to take into account that fact that the gas storage facility boosts oil production and extends the life of the oil field. The revenue derived from increased oil production is not included in the Appellant's R&E valuation. Further, it would be reasonable for the hypothetical tenant of the gas storage facility to anticipate revenue from the oil production operator reflecting some of his gains by way of reduced costs derived from the gas storage operations. The Respondent submits that this is contrary to the Rating Valuation Forums R&E guidance, which states that "Some receipts may be gained from activities carried on outside the property" (paragraph 5.23).
66. We find that it is clear – and is indeed agreed between the parties - that the gas storage facility was constructed to boost oil production. However it is also clear that an increase in oil production is reflected in the assessment of the oil producing field (a point which is confirmed by the Respondent's closing submissions, which makes plain that an onshore oil field's assessment increases with every barrel of oil produced annually). So to the extent that the oil field produces more oil or produces oil for longer, that is already reflected in the assessment of the oil field. It is no flaw in the Appellant's R&E valuation that it does not include increased oil production since, if it did, that would be double counting. That is indeed a point explicitly recognised by the R&E guidance. Paragraph 5.23 needs to be read in full: it says that it may be appropriate to take receipts gained from activities carried on outside the property into account but also says "Care should be taken to ensure that receipts derived from the occupation of other separately assessed properties are not included in this consideration". We find that the criticism of the Appellant's valuation that it fails to take into account revenue derived from increased oil production is entirely misconceived.
67. The Respondent also argues that the costs of the oil plant are reduced by the gas facility. Mr Wakefield's evidence is that the costs of churning are apportioned to the oil facility, but the cost of putting gas into the reservoir for the purpose of storing it is not. So the Respondent's submission comes to this: the hypothetical tenant of the gas storage facility would be able to extract a price from the oil plant for saving the oil plant from having to repressurise the reservoir. There is however no evidence before us – either that a price could be extracted, or of what that price might be – to support it.

68. We find this criticism of the Appellant's valuation to be without merit.

(iii) The Vitol Agreements are unreliable

69. The Respondent argues that the Appellant's reliance on the Vitol agreements is not satisfactory because they are not market sensitive. The revenues from Humbly Grove do not fluctuate with seasonal spread prices.

70. We do not accept this argument because revenues under GSA2, had it been in effect at AVD, would have increased when there were gains. The Respondent argues that this price sensitivity would have been limited because the base price was fixed and are not market sensitive at all. But for the reasons already given above we think it is reasonable for the Appellant's valuation to be based on the base price as well as the gain share element. It is not unreasonable to assume that the hypothetical tenant would have adopted a business method which would ensure that it covered its costs, yielded a share of gains, but did not expose it to the risk of trading losses or require very significant additional capital. And as Mr Norman's rebuttal report shows, the estimated revenues which would have been received had GSA2 been in place do fall with the market.

The Respondent's Contractor's Valuation

71. The Respondent argues that Mr O'Dwyer's adoption of £0.41 per cubic metre is robust and reasonable. It is supported by: (i) the valuation for Hatfield Moor; (ii) the evidence of Caythorpe; and (iii) the stage 1 cost adopted at Hornsea. Mr O'Dwyer conceded in cross-examination that Hornsea was a very secondary basis for his valuation. The primary basis was Caythorpe and Hatfield Moors.

Hatfield Moor

72. Mr O'Dwyer says that the adoption of a stage 1 cost of £0.41 is consistent with the stage 1 cost of £0.41 adopted at Hatfield Moor, a depleted gas reservoir. The VO submits that this is an important comparable with a settled value in the list, to which regard can and should be had. The Appellant accepts that the Hatfield Moors settlement is admissible as evidence of value but argues that we should not attach a great deal of weight to it. Since the appeal regarding Hatfield Moor was withdrawn, the evidence underlying that assessment has not been tested.

73. We take into account the fact that Hatfield Moor – the only other onshore depleted field storage facility on the 2010 list – has a settled value in the list, one based on a stage 1 cost of £0.41. However, as the Appellant says, since the appeal in that case was withdrawn (on the basis that the evidence necessary for an R&E valuation was not available), the VO's basis for that assessment was not been tested.

Caythorpe

74. Mr O'Dwyer's analysis of the Caythorpe project is that it would have had a cost of £0.65 per cubic metre. The purchase of Caythorpe took place in September 2008. So this is, the VO submits, important market evidence of a depleted field gas storage facility very close to AVD.

75. There is a distinction between the total volume of gas which a gas storage facility can store and the working volume. The working volume is the amount of gas which can be injected and extracted to be sold. But since a certain amount of gas – cushion gas – which must remain in the facility at all times, the working volume is less than the total volume. The parties agree that it is working volume that is relevant for the purposes of valuing a reservoir.
76. The parties are agreed that the Caythorpe transaction has to be analysed using the volume of working gas that Centrica had in its proposals when acquiring the site.
77. The Respondent's evidence is that Mr O'Dwyer had a meeting with Centrica in 2014, which was attended by the person behind the 2008 proposal. Centrica were well aware of the implications of the information they were giving Mr O'Dwyer.
78. Mr O'Dwyer produces two documents from Centrica in support of his analysis. The first is a Centrica press release on the day of the transaction which says Centrica would have a capacity of up to 7.5 billion cubic feet. The second gives the working gas at Caythorpe as 4.9 billion cubic feet. The parties agree that this is an extract from a 2013 Centrica strategy update, and we accept the Respondent's point that this document was therefore well after the transaction.
79. The Appellant also produces various documents. Warwick Energy obtained planning permission for Caythorpe before selling it to Centrica. Their press release made on the same day as the sale to Centrica said that "The proposed *working volume* of the storage facility is expected to be 7.5 billion standard cubic feet" (emphasis added). Caythorpe Gas Storage Limited intended to convert Caythorpe to a gas storage facility. The annual report for 2010 says that the converted facility would have a capacity up to 7.5 billion cubic feet, whereas their annual report for 2011 stated that the converted facility would have a capacity up to 5.4 billion cubic feet. We accept the Appellant's argument that the accounts show that the assessment of capacity at Caythorpe reduced after the date of the acquisition. We consider that the press release shows that Warwick Energy, who sold Caythorpe to Centrica, were clear at the time of the transaction that the working volume of the facility would be 7.5 billion cubic feet.
80. Mr Moors explained in his evidence that "working volume" and "capacity" are in his experience expression that are used interchangeably with respect to gas storage facilities. Taking the evidence as a whole, we are not satisfied that the Appellant is right to read the Centrica press release on the day of the transaction as relating only to total volume and not working volume.
81. We accept that Mr O'Dwyer has acted in good faith in relying on what he was told by Centrica at the meeting in 2014. But we are faced with a conflict between Mr O'Dwyer's understanding and recollection of a meeting which took place some four years ago and the documents produced by the Respondent, some of which were contemporaneous with the transaction. We find it more likely than not that at the time of the transaction in 2008, Centrica considered that the working volume of the facility would be 7.5 billion cubic feet. Certainly, in the light of all this evidence taken together, we consider that Mr O'Dwyer's recollection and understanding of a conversation he had four years ago (which is, we are clear, entirely honest) is not a firm foundation for one of the primary bases of his valuation of Humbly Grove.

82. Mr Norman's evidence in his rebuttal report regarding Hornsea is that it is a purpose-built cavity gas storage facility developed in the late 1970's. There is no material difference in the cavities themselves from modern fast cycle facilities. The facilities are in any event very different to Humbly Grove which is a depleted oil reservoir. We are therefore unable to see how the stage 1 costs of Hornsea provide support to Mr O'Dwyer's assessment of the stage 1 costs at Humbly Grove.

83. What we come to is this. Hatfield Moor – the only other onshore depleted field storage facility on the 2010 list – has a settled value in the list, one based on a stage 1 cost of £0.41. However, the basis for that single assessment has not been tested. And the evidence before us does not explain whether that assessment was based on the above reasoning about Caythorpe and Hornsea, or whether it was supported by other considerations. So taking account of the all the relevant evidence before us and on the basis of our findings above, we consider that the VO's stage 1 costs in this case are not well evidenced.

84. Mr O'Dwyer also provides two check valuations in support of his valuation.

Sense check 1: the 2011 transaction

85. The first is based on PETL's acquisition in 2011 of the exclusive right to store gas at Humbly Grove for 4 years. Mr O'Dwyer accepts the Appellant's evidence that the £33 million paid was an overpayment but notes that the 2014 PETL accounts valued the rights at £23,315,000 as at December 2014. He argues that dividing this sum by four indicates that these rights had an annual value of £5,828,750 in addition to those which Mr Norman has taken into account in his valuation. The VO submits that this shows that his valuation is not excessive.

86. The Appellant submits that once the VO has accepted that the £33 million was an overbid, the accounting treatment of the transaction in the accounts which followed should not be taken to be independent corroboration of value. Mr Rambhai's evidence was that the accounting treatment would have been overseen by the same individual who had been responsible for the overbid. Further, it is misconceived to argue that some variant of this transaction needs to be added to the Appellant's R&E valuation to properly reflect the totality of the revenue to be derived from the appeal hereditament.

87. We consider that evidence subsequent to AVD can be relevant to value at AVD (as Mr Norman accepted in cross-examination).

88. With respect to the value shown in the accounts, we are not satisfied that Mr O'Dwyer's logic of dividing the sum in the 2014 accounts by four years can be right. By December 2014, three of the four years would already have expired. The 2014 and 2015 accounts both give an estimated asset life of 23 years, which again suggests that something has gone wrong with Mr O'Dwyer's reasoning.

89. Further, Mr O'Dwyer accepts that the £33 million was an overpayment and we see no reason to suppose that this evidence about an overpayment in 2011 resulting from a contrarian, unusual and highly optimistic view of the market can provide good evidence of what the hypothetical tenant would have paid in 2008. Nor can it provide a justification for the Respondent's valuation.

Sense check 2: submission regarding the 2017 list

90. The second is based on a submission from a number of gas storage providers to the VOA in respect of the draft 2017 rating list. This argues that there should be “discounts from the agreed 2010 list basis on facilities of between 80% and 94%” and was signed by the Appellant. Mr O’Dwyer argues on the basis of the arguments in this letter that his valuation is not excessive. We consider that this argument does not assist with the issues in this case. Firstly, the 2010 list has not been agreed in the case of Humbly Grove – it is the subject matter of this appeal. Secondly, we consider that the Appellant has produced a well argued and well evidenced R&E valuation and we do not see that there is anything in this letter that could outweigh the evidence supporting that valuation.

Conclusion

91. We do not consider ourselves bound in this case to follow the method used in the case of Hatfield Moor. In the case of Hatfield Moor, as the email withdrawing the appeal makes clear, the appellant did not have the information necessary to put forward an R&E valuation. In the case which we have to decide evidence has been put forward in support of an R&E valuation.

92. In sum, on the basis of the totality of the evidence before us we consider the Appellant’s valuation to be well evidenced. There is a hierarchy of methods and Mr O’Dwyer and Mr Norman agree that where an R&E valuation is possible it should be used in preference to a valuation based on the contractor’s basis. We have rejected the Respondent’s argument that there are fundamental flaws in the Appellant’s R&E valuation which mean that it cannot be used in this case. We accept in full the Appellant’s submissions summarised at paragraph 60 above as to why its valuation is well evidenced. In contrast, on the basis of our assessment of the VO’s state 1 costs we find that the Respondent’s contractor’s basis valuation is not well evidenced. Given our findings above, it is not necessary to make findings on the other issues in dispute between the parties e.g. whether the conceptual difference between ‘construction’ and ‘development’ means that a contractor’s basis valuation cannot be carried out as a matter of principle in the case of a depleted field facility.

93. Our findings also mean that we do not need to make findings in respect of two issues which the Respondent sought to reopen in closing submissions. (1) As we have noted above, Mr O’Dwyer accepted in cross examination that his stage 5 adjustment involved an element of double counting as it took account of the benefits to the oil facility which were also taken into account in the separate assessment of the oil field. The Respondent’s closing submissions seek to retract that concession. On the basis of the reasons given above we do not need to make findings about whether the 12.5% adjustment involves an element of double counting. (2) The Respondent’s closing also made points about the rival analyses of Caythorpe which were not explored before us in evidence. Mr Norman provides an analysis of the Caythorpe transaction which is limited to contract price and volume. Mr O’Dwyer’s analysis of the Caythorpe project also takes into account development costs and professional fees. However, we have found in favour of the Appellant without needing consider these differences.

Disposal

94. Appeal (170525388401/537N10) is allowed. RV £3,225,000 effective 1 April 2010.

95. The parties are agreed that the rateable value of the gas pipeline should remain £925,000, and appeal 170525388407/537N10 is therefore dismissed.

96. The parties are agreed that the gas storage installation and gas pipeline should be merged into a single hereditament with effect from 1 April 2015 and appeal 170528616548/537N10 is therefore allowed. RV of £4,150,000 (i.e. £3,225,000 + £925,000) effective 1 April 2015.

Order(s)

97. Under the provisions of Regulation 38 (4) and (9) of The Valuation Tribunal for England (Council Tax and Rating Appeals) (Procedure) Regulations 2009 the VTE orders the Valuation Officer to alter the List within two weeks of the date of this order to show Humbly Grove Gas Storage Facility, The Avenue, Weston Common, Lasham, Alton, Hants, GU34 5SY, at a Rateable Value of £3,225,000 with effect from 1 April 2010 (Appeal No. 170525388401/537N10).

98. Under the provisions of Regulation 38 (4) and (9) of The Valuation Tribunal for England (Council Tax and Rating Appeals) (Procedure) Regulations 2009 the VTE orders the Valuation Officer to alter the List within two weeks of the date of this order to show Gas Processing Facility, Pipeline and Premises, The Avenue, Weston Common, Lasham, Alton, Hants, GU34 5SY, at a Rateable Value of £4,150,000 with effect from 1 April 2015 (Appeal No. 170528616548/537N10).

Date: 19 June 2018

Appeal numbers: 170525388407/537N10; 170525388401/537N10 & 170528616548/537N10