[2018] UKUT 0431 (TCC)
Appeal number: UT/2017/0103

VALUE ADDED TAX – repayment of output tax – section 80(3) VATA 1994 – unjust enrichment – water and sewerage infrastructure charges set by regulators – whether regulators took into account the incidence of VAT in setting the charges – evidence before the FTT – whether that evidence was probative of the decision the regulators would have taken if they had known that infrastructure charges were outside the scope of VAT – approach to admission of new evidence by Upper Tribunal – Karoulla considered

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ANGLIAN WATER SERVICES LIMITED — **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS — **Respondent**

TRIBUNAL: MRS JUSTICE FALK
JUDGE JONATHAN CANNAN

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 8 – 10 October 2018

Mr James Rivett of counsel, instructed by Steve Leader, Solicitor, Anglian Water Services Limited, for the Appellant

Mr Peter Mantle of counsel, instructed by HM Revenue and Customs Solicitor's Office, for the Respondents

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DECISION

Introduction

1. This is an appeal against a decision of the First-tier Tribunal (Tax Chamber) (Judge Barbara Mosedale) [2017] UKFTT 386 (TC) released on 4 May 2017. The FTT dismissed an appeal by the appellant ("AWSL") against a decision of the respondents ("HMRC") to refuse a claim for repayment of overpaid output tax of some £12 million. The claim covered output tax overpaid in the period 1 April 1990 to 4 December 1996.

2. AWSL was appointed as a water and sewerage undertaker for the Anglian region in 1989, as part of the privatisation of the water industry. The claim for repayment was made pursuant to section 80 Value Added Tax Act 1994 ("VATA 1994"). It concerns VAT charged to customers in relation to certain infrastructure charges. HMRC accept that the supplies were outside the scope of VAT and as a consequence VAT was overpaid, however they refused the claim relying on the defence of unjust enrichment in section 80(3) VATA 1994. That section provides as follows:

> "It shall be a defence, in relation to a claim under this section by virtue of subsection (1) or (1A) above that the crediting of an amount would unjustly enrich the claimant."

3. It is well established that the burden is on HMRC to establish the defence of unjust enrichment – see *Baines & Ernst Ltd v HM Revenue & Customs* [2006] EWCA Civ 1040. As appears below, the Court of Appeal in *Baines & Ernst* set out certain principles to be applied in considering whether the defence of unjust enrichment is made out. Following a careful and comprehensive analysis the FTT found that HMRC had satisfied the burden and that repayment of the output tax would unjustly enrich AWSL.

4. AWSL appeals against the decision of the FTT on four grounds:

(1) The FTT failed properly to identify the principles in *Baines & Ernst*.

(2) The FTT failed properly to apply the principles in *Baines & Ernst*.

(3) The FTT reached conclusions and/or made findings of fact which no person acting judicially and properly instructed as to the relevant law could have reached (see *Edwards v Bairstow* [1956] AC 14).

(4) The decision of the FTT would have been different if a letter dated 6 September 1989 from HM Customs & Excise ("HMCE") to the Water Authorities Association ("WAA") had been before the FTT.

5. Ultimately the issue on this appeal is whether the FTT erred in law in concluding that HMRC had made out the defence of unjust enrichment.

6. The principles to be applied in relation to the defence of unjust enrichment are the subject of Ground 1 and we refer to them below in that context. By way of introduction we can simply say that the burden is on HMRC to establish that repayment

to the claimant of the tax it had wrongly paid would unjustly enrich the claimant. That will be the case where it is established that the claimant has actually passed on to its customers all or a specific part of the tax charge. It may not simply be assumed that tax has been passed on to customers. Even where the charge to tax has been passed on to customers there may still be no unjust enrichment if as a result the claimant suffered a fall in the volume of his sales caused by the higher price being charged.

7. Mr Rivett recognised that his submissions on Ground 2 effectively amounted to a challenge based on *Edwards v Bairstow* grounds. He argued that the FTT had reached a decision which was not open to it on the evidence as a result of failing properly to apply the principles in *Baines & Ernst*. We shall therefore deal with Grounds 2 and 3 together.

8. Ground 4 relies upon an application by AWSL to adduce new evidence on appeal, namely the letter dated 6 September 1989. The application is opposed by HMRC and we deal with it below under Ground 4.

The issue before the FTT

9. The FTT described the various regulated charges which water and sewerage undertakers were entitled to charge customers following privatisation. Those charges included infrastructure charges which undertakers were entitled to charge for new connections for "domestic purposes" for water and/or sewerage supplies[1]. Infrastructure charges were designed to meet the investment costs of providing additional capacity at treatment works, in reservoirs and in trunk mains. The FTT found that limits to those charges were first set by the Secretary of State for the Environment ("the Secretary of State") no later than 1 August 1989, and came into effect on 1 April 1990. Subsequently there was a reduction in the limits to infrastructure charges. With effect from 1 April 1995 new limits were set by the Office of Water Services ("Ofwat"), following a review that it conducted in 1994.

10. For the first five years following privatisation different limits were set for each water and sewerage undertaker with an overall maximum of £1,000 in respect of water infrastructure charges and £1,000 in respect of sewerage infrastructure charges. Undertakers could recover costs above that maximum through other charges including charges to existing customers. Six undertakers, not including AWSL, had their charges capped to the overall maximum of £1,000. In 1989 AWSL was permitted to charge a maximum water infrastructure charge of £479 and a maximum sewerage infrastructure charge of £597, subject to an annual RPI linked increase. With effect from 1 April 1995 the limits for all water and sewerage undertakers were set at the same level of £200

[1] "Domestic purposes" covers not only connections to residential properties but also industrial or commercial premises for domestic use, such as cooking, washing and toilet facilities (FTT decision at [21]).

each. It was not disputed that for practical purposes AWSL always set infrastructure charges at the maximum level permitted to it by the regulators.

11. It was common ground before the FTT that the limits set by the regulators, whether the Secretary of State or Ofwat, were exclusive of VAT. The FTT recorded this at [45] as follows:

> "45. Both parties accepted that the maximum charge rates set by the regulators were exclusive of VAT. I was not pointed to any document where this was stated to be the case: nevertheless, it was accepted that all the water companies (including AWSL) and the regulator had proceeded on the basis that the water companies were entitled to charge the maximum charge rates plus VAT, and, moreover, that the £1,000 overall maximum referred to in §42 was £1000 plus VAT."

12. The claim made by AWSL concerns output VAT which it accounted for on infrastructure charges made to its customers in the period 1 April 1990 to 4 December 1996. The FTT identified the issue before it at [17] – [27] of the decision. It summarised the issue as follows:

> "25. So the parties were agreed that in this appeal the question was whether (bearing in mind HMRC have the burden of proof) it can be proved that AWSL's net infrastructure charges were ***not*** reduced because of the incidence of VAT. Taking into account that AWSL always charged infrastructure charges at the maximum level permitted by the regulator (see §§47-50), both parties were therefore agreed that the only question of fact for the Tribunal was whether that maximum infrastructure charge set by the regulator was less than it would have been but for the imposition of standard rated VAT. In other words, did the regulator reduce the amount of the maximum infrastructure charge because of the incidence of VAT?"

13. The FTT set out various formulations of the issue in [25]. To the same effect, but in more straightforward terms, the FTT described the issue at [108] as follows:

> "HMRC must have sufficient evidence to convince me … that it was more likely than not that infrastructure charge levels were not affected by the incidence of VAT."

14. The FTT determined that issue both in relation to the prices set by the Secretary of State in 1989 and those set by Ofwat with effect from 1 April 1995. It considered the prices for water services and sewerage services separately because in its view different considerations applied. We understand that approximately 99.5% of AWSL's claim relates to VAT overpaid on supplies in the period 1 April 1990 to 31 March 1995 by reference to prices set by the Secretary of State.

The FTT's Findings of Fact

15. The FTT made various background findings of fact at [35] – [79], in particular concerning documentary material said to be relevant to the setting of infrastructure charges in 1989 and 1994, the proportion of customers likely to be able to recover VAT charged and the history of HMRC's position in relation to the VAT liability of water and sewerage supplies. We summarise below the findings of fact relevant for present purposes. The Tribunal also heard expert evidence from two economists, Dr Rubin on

behalf of HMRC and Dr Koboldt on behalf of AWSL. Their evidence addressed two areas:

(1) economic theory, including the law of supply and demand, and

(2) the economics of regulatory decision making, including the factors a regulator would take into account in setting maximum prices.

16. The Tribunal found at [106] that Dr Koboldt possessed more expertise than Dr Rubin when it came to regulatory decision making.

17. The FTT's principal findings of fact were set out at [115] to [189] of the decision. It first considered the evidence as to whether the regulators would have taken VAT into account when setting infrastructure charges, including expert evidence as to how the regulators would have approached the task. It then went on to consider evidence as to what the regulators did take into account. In the following paragraphs we summarise the FTT's findings.

18. The FTT considered the statutory context in which infrastructure charges were set, contained in the Water Act 1989 (see [117] – [124]). It identified that the primary obligation of regulators was to set infrastructure charges to cover the undertakers' costs, including a reasonable return on capital. Subject to that, a secondary consideration was protecting the interests of customers. Those interests themselves included an interest that the undertakers charged sufficient to cover their costs. There was a difference in opinion between the experts as to whether the regulators would have considered price to consumers as part of this exercise. Dr Rubin's view was that no consideration would have been given to price as the primary objective was to cover costs. Dr Koboldt's view was that the regulators would have looked at the actual price to consumers including the incidence of VAT as a check on whether the costs estimate was too generous. If the price was too high then the regulator would be more conservative in what was considered to be allowable as costs. The FTT considered that Dr Koboldt's opinion as an expert in regulatory economics carried more weight and accepted that the regulators would look at price to consumers. However, that was not sufficient on its own to satisfy the FTT that price to consumers would have affected the level of infrastructure charges.

19. The FTT found on the basis of the expert evidence that infrastructure charges would have been set so as to avoid cross-subsidisation, in the sense that existing customers should not pay towards the cost of connecting new customers (see [125] – [129]). However, the FTT rejected HMRC's submission that this meant the regulators would not take into account VAT when setting infrastructure charges because to do so would result in cross-subsidisation. It also rejected a submission by HMRC that reducing infrastructure charges to take into account the incidence of VAT would unduly favour customers who were unable to recover the VAT charged (see [130]).

20. The FTT considered the expert evidence as to economic theory and how that would affect the setting of infrastructure charges (see [131] to [138]). The evidence of Dr Rubin and Dr Koboldt mirrored what they had said in relation to the obligation on regulators to cover the undertakers' costs described above. Again, the FTT stated that it preferred Dr Koboldt's evidence, but recorded Dr Koboldt's acceptance that

consideration of the price to consumers did not necessarily mean that if no VAT was chargeable (which it described as the "counterfactual price") then the infrastructure charges would have been higher.

21. At this stage in the decision the FTT stated as follows:

> "137. The consideration of statutory duties and economic theory has not resolved the dispute: even though, because he is the regulatory expert, I prefer Dr Koboldt's evidence that the regulators would consider gross price when setting infrastructure levels, I do not accept that that necessarily means that the infrastructure charge levels were lower than they would otherwise have been. However, HMRC have not, by relying on these two points, satisfied me of their case on the balance of probability and so if I had nothing else to consider the appellant's appeal would succeed.
>
> 138. But I do have other factors which must be considered so I go on to consider the other factors, specific to the decisions at issue in this appeal, which the regulator may have considered, and also what evidence there is of what was actually considered. However, as the position in respect of the following issues was different in 1989 to 1994, I consider them separately…"

22. It seems to us that the FTT's reference to "gross price" in [137] reflected what it had previously referred to as the actual price to consumers. It included any VAT chargeable on the supply. It is clear from the FTT's subsequent findings that the FTT was not at this stage saying that the regulators did consider the incidence of VAT in setting infrastructure charges. There are various findings later in the decision which are prefaced by the words "if the regulator considered gross price relevant at all", including the FTT's ultimate conclusions at [191] to [194]. At this stage of the decision the FTT was only saying that as a matter of regulatory economic theory the regulators would be expected to consider the gross price to customers.

23. The FTT went on to consider whether the Secretary of State knew that infrastructure charges would be subject to VAT when setting charges with effect from 1 April 1990 (see [139] – [153]). At [143] it recorded agreement between the parties that the charges were set no later than 1 August 1989. It noted that both experts had assumed that the Secretary of State knew that infrastructure charges would be subject to VAT but found that this assumption was incorrect. The FTT went on to find that it was likely the Secretary of State would have taken steps to inform himself of whether VAT was chargeable and if so whether VAT was a necessarily a cost to customers who paid it, in other words whether any VAT chargeable to customers was recoverable by those customers. The FTT found that:

(1) it was more likely than not that, assuming he had considered VAT at all, the Secretary of State would have consulted HMCE to find out whether VAT would be chargeable and whether it was necessarily a cost to those who paid it;

(2) there was clear evidence that as at 29 August 1989, a month after the charges were set, HMCE considered that the VAT treatment of infrastructure charges would follow the VAT treatment of supplies of water and sewerage services;

(3) at that time such supplies were zero rated for VAT purposes, although it was known that supplies of water (as opposed to sewerage services) to industrial users in Standard Industrial Classifications ("SIC") 1-5 would be standard rated from 1 July 1990;

5 (4) it was an unanticipated and sudden change of mind by HMCE in September 1989, after the charges had been set, that led to infrastructure charges being treated as subject to VAT;

(5) it was therefore likely that HMCE would, if asked before the charges were set, have informed the Secretary of State that charges would have been zero rated, 10 with the exception of water supplied to SIC 1-5 industries from July 1990; and

(6) even if this was wrong and he had been unable to obtain a reliable answer, such that the incidence of VAT had been uncertain, the regulator was unlikely to take VAT into account in setting infrastructure charges.

24. Based on those findings, the FTT determined that the sewerage infrastructure 15 charges set in 1989 were not affected by the incidence of VAT. To that extent the FTT stated that the appeal was determined in favour of HMRC.

25. The FTT went on to make further findings relevant for the purposes of the other infrastructure charges, namely the 1989 water infrastructure charges and the charges set by Ofwat with effect from 1995.

20 26. The FTT found that in 1990-1996 a significant proportion of customers paying the infrastructure charge were likely to be able to recover it as input tax, although it could not say on the evidence what percentage would be able to do so. In those circumstances it found that the regulator would have been unlikely to take VAT into account in setting infrastructure charges. To do otherwise would have been inconsistent 25 with the regulators' primary duty of ensuring that the undertakers recovered their costs and would have handed a windfall to many customers. In so far as the regulators considered price, it was more likely that they would have looked at the price net of VAT even if they had thought VAT was payable (see [154] – [158]).

27. In relation to water infrastructure charges in 1989, the FTT found that the 30 Secretary of State would have expected a significant number of customers, albeit probably a minority, would not be expected to pay VAT, and a significant number of customers who were charged VAT would be expected to recover it. The FTT considered that the regulator would have approached VAT as a tax on final consumption. It did not accept Dr Koboldt's evidence that in those circumstances the 35 Secretary of State would have considered a smaller reduction in the price than he might otherwise have done. The FTT considered it more likely that he would not have reduced water infrastructure charges because of the incidence of VAT (see [159] – [163]).

28. HMRC submitted to the FTT that the nature of the £1,000 cap on infrastructure charges led to an inference that the cap was set taking into account affordability to 40 customers. The FTT accepted that such an inference could be drawn. Dr Rubin's opinion was that AWSL's infrastructure charges were likely to have been set without consideration of price because their charges were below the £1,000 cap. Dr Koboldt's

opinion was that the regulator might still consider the VAT inclusive price as a check on the costs estimate. The FTT preferred the view of Dr Rubin and found that the fact that AWSL's charges were below the limit of £1,000 indicated that a regulator would be unlikely to reconsider a cost estimate on the basis that the VAT inclusive price was too high.

29. The FTT then gave an update as to its conclusions thus far:

> "170 … In summary, my conclusion so far is that that [the Secretary of State] in 1989 when setting infrastructure charge rates
>
> *(a)* more likely than not did not reduce sewerage infrastructure charge rates because of the incidence of VAT. I take this view because on the basis that even though he may well have considered price relevant, the information likely to have been available to him at around the time the rates were set was that net price was to be the same as gross price (in other words, no VAT would be charged). In the event, this information would have been wrong but he could not have known that as at the time the rates were set.
>
> *(b)* more likely than not did not reduce water infrastructure charge rates because of the incidence of VAT. I take this view because even though he may well have considered gross price relevant, if he had thought it relevant, on the information likely to have been known to him at the time, he would have been aware that for many customers net price was effectively the same as gross price and that AWSL's infrastructure charge rates would be well below the maximum level of £1000 in any event. So that taking all these variables into account, it is more likely than not that the infrastructure charge rates were set without any reduction because of the incidence of VAT."

30. The FTT then went on to consider the decision by Ofwat in 1994 as to the level of charges with effect from 1 April 1995 (see [171] – [177]). The same factors were relevant for both water and sewerage infrastructure charges. The FTT noted that its conclusions in relation to the statutory context and economic theory applied equally to Ofwat. The material differences from 1989 were the VAT position as it was then understood and the fact that the £1,000 maximum did not apply. Ofwat set much reduced prices of £200 each for water and sewerage infrastructure charges and that was the maximum price which all water and sewerage undertakers including AWSL could charge their customers.

31. The FTT found that in 1994, Ofwat would have consulted HMCE and would have known that both water and sewerage infrastructure charges had been standard rated since 1 April 1990, but had been zero rated for new connections to domestic and qualifying buildings from 1 April 1994 onwards. It found that Ofwat would have known that a clear majority of AWSL's customers would not pay VAT on infrastructure charges and of those that did pay VAT, some would be able to recover it. The FTT found that in those circumstances, as with the Secretary of State, Ofwat would not have reduced charges to reflect the incidence of VAT.

32. Finally, the FTT considered evidence as to what the regulators actually did take into account in 1989 and 1994 (see [178] – [189]).

33. The FTT first referred to 1994 where the evidence available included a 1994 Ofwat paper called "*Future charges for water and sewerage: the outcome of the*

periodic review". The FTT noted that the paper contained no reference to VAT. There was a brief reference to affordability, but this was in the context of water charges generally and there was no suggestion that charge levels were reduced to make them affordable. The FTT did not accept Dr Koboldt's opinion that the absence of a reference to VAT was because it would have been one of many relevant factors and it would have been a minor factor. It concluded that the absence of a reference to VAT indicated that VAT was not considered in relation to price setting. The FTT also found some corroboration for that conclusion from the absence of any reference to VAT in two Monopolies and Mergers Commission ("MMC") reports where two undertakers challenged the rates set by Ofwat in 1994.

34. The FTT acknowledged that there was very little direct evidence as to what factors were taken into account in 1989. Some of the material was described as far too general to be of assistance. The FTT did refer to a 1991 Ofwat consultation paper, a 1992 National Audit Office report and Parker's "*The Official History of Privatisation*" which included a chapter on regulating the water industry. The FTT appeared to place some weight on the fact that these materials referred only to costs being taken into account by the Secretary of State when setting infrastructure charges and that the only taxes considered were direct taxes. However, it regarded these publications as being far too general to draw any conclusions from the publications themselves.

35. In relation to 1989 the FTT placed weight on the fact that the 1994 Ofwat report made no mention of VAT and found that if Ofwat was taking a different line to the Secretary of State then it would have said so. It also placed weight on the fact that in 1990 the WAA (referred to by the FTT as the Water Services Association) had persuaded HMCE to extend the range of infrastructure charges that would be standard rated. The FTT considered that if the incidence of VAT might lead to reduced infrastructure charges then the WAA would have been seeking to limit the extent to which they were treated as standard rated. The FTT also thought it suggestive that there was no reconsideration of the level of charges in 1990 after it became apparent that all infrastructure charges would be standard rated, and that net rates were set with no mention of VAT.

36. Overall the FTT considered that the direct evidence of what happened in 1989 was sufficient to raise a prima facie case that the Secretary of State did not take VAT into account when setting infrastructure charges, that this prima facie case had not been rebutted, and that if he did take affordability to consumers into account then it is likely that he only considered the net price without reference to VAT.

37. The FTT's conclusions in the light of all its findings were set out at [190] – [194]:

> "**Conclusions**
>
> 190. The appellant's case was that there was insufficient evidence to reach a conclusion on the speculative question of what the regulators would have done in 1989 and 1994. But it was not entirely speculation: the regulators had a statutory framework and would have taken into account economic theory; I had the benefit of an expert in economic regulation and evidence of what was known about VAT at the time and some direct evidence of whether they actually took VAT into account. I consider that there

was sufficient evidence for HMRC to make out their prima facie case that the maximum infrastructure charges were not affected by the incidence of VAT, and the appellant failed to rebut it.

Sewerage

5 191. 1989: I consider it much more likely than not that the level of infrastructure charges in 1989 would have been set at £597 (their actual level) irrespective of the incidence of VAT because as explained above it is more likely than not that, if the regulator considered gross price relevant at all, he would have known that at the time HMCE's view was that all sewerage infrastructure charges would be zero rated.

10 192. 1994: I consider it more likely than not that the level of infrastructure charges in 1994 would have been set at £200 irrespective of the incidence of VAT because (a) if the regulator considered VAT relevant at all, he would have known that most payers of sewerage infrastructure charges would not pay VAT and a significant number of those which did would be able to recover it and (b) in any event, the evidence is that in practice 15 Ofwat did not consider VAT relevant to setting infrastructure charge levels as it was not mentioned in the report or otherwise.

Water

193. 1989: I consider it more likely than not that the level of infrastructure charges in 1989 would have been set at £479 (their actual level) irrespective of the incidence of 20 VAT because as explained above it is more likely than not that, if the regulator considered price relevant at all, he would more likely have considered net price rather than gross price as he would have known that at the time HMCE's view was that only water infrastructure charges to industry would not be zero rated and so he ought to have considered that a significant percentage of payers would either not pay VAT at all 25 or would be able to recover it: this is a more finely balanced question than in respect of sewerage but I am satisfied that HMRC have made out the burden of proof on this because in practice the indications are that VAT was not considered relevant (§§187-188).

194. 1994: I consider it more likely than not that the level of water infrastructure 30 charges in 1994 would have been set at £200 irrespective of the incidence of VAT because (a) if the regulator considered VAT relevant at all, he would have known that most payers of water infrastructure charges would not pay VAT and a significant number of those which did would be able to recover it and (b) in any event, the evidence is that in practice Ofwat did not consider VAT relevant to setting infrastructure charge levels 35 as it was not mentioned in the report or otherwise."

The grounds of appeal

38. We shall consider the grounds of appeal in order.

Ground 1 – Failure to properly identify the principles in *Baines & Ernst*

39. The FTT succinctly set out the law in relation to the unjust enrichment defence at 40 [5] – [16]. It was entitled to be brief because there was no real issue between the parties as to the relevant law. The real issue between the parties before the FTT was whether

HMRC had satisfied the burden of establishing unjust enrichment on the evidence adduced. The FTT referred to case law in the CJEU as follows:

> "6. To a large extent the parties were agreed how [section 80(3)] should be interpreted. It should be interpreted in accordance with the case law of the CJEU. Both parties referred to *Lady & Kid* [2012] STC 854 at §§18-21. In that case the CJEU said that unjust enrichment of the taxpayer was the exception to the right of the taxpayer to repayment of overpaid taxes (§18) and that that exception was justified because otherwise the taxpayer would be paid twice over, once by its customer and once by HMRC (§19). The CJEU went on to say that the exception had to be interpreted narrowly (§20) and that even where the VAT was passed on to the customer, there might be no unjust enrichment in repaying the taxpayer because the taxpayer may have suffered as a result of 'a fall in the volume of his sales.'(§21).
>
> 7. I accept that that the reference to avoiding a narrow interpretation in §20 was explained in §21 as meaning that the court had to consider the taxpayer's loss in the round and not just the blinkered view of whether the VAT charge was passed on.
>
> 8. Much the same was said in the earlier case of *Weber's Wine World Handels-GmbH* C-147/01 at §95-102. Whether VAT has been passed on is a question of fact to be determined by the court, and even if it is shown that the VAT charge was wholly passed on, the taxable person may have suffered from a fall in volume of sales (§99). In §100 the CJEU said that the existence and extent of unjust enrichment could only be established following an economic analysis. Certainly both parties in this appeal relied on expert economic evidence.
>
> 9. I accept, as Mr Mantle said, and Mr Rivett did not suggest otherwise, that there are no presumptions or assumptions in favour of either party in resolving the issue in this appeal other than that the burden of proof lies on HMRC."

40. The FTT went on to refer to *Baines & Ernst* at [10] – [14] as authority for the proposition that the burden of proof to establish unjust enrichment lay on HMRC, that no presumptions were to be applied and that unless HMRC could prove that a particular amount of VAT was passed on to customers then AWSL was entitled to full repayment of its claim. The FTT quoted the following passages from *Baines & Ernst*:

> "[12]....the burden of proof lies on the Member State, and no presumptions are to be applied, including any assumption that because the tax has been included in the price, it has been borne by the customer." Per Lloyd LJ
>
> "[13] ....[HMRC] has to prove that the burden of the tax was passed on to customers in whole or in part and, if the latter, to what extent."

41. Mr Rivett on behalf of AWSL did not take issue with the FTT's analysis of the law. He did not suggest that the FTT had misstated the principles, or had failed to identify any material aspect of the case law. In those circumstances we cannot see that it can be said that the FTT failed properly to identify the principles to be applied in considering HMRC's defence of unjust enrichment. AWSL's real complaint is that the FTT failed properly to apply the principles, which is the subject of Grounds 2 and 3.

Grounds 2 and 3 – Failure properly to apply the principles in *Baines & Ernst*

42. Mr Rivett's submissions on Grounds 2 and 3 focussed on the FTT's approach to the evidence. He submitted that in finding for HMRC that the defence of unjust enrichment had been made out the FTT engaged in speculation. It was submitted that such speculation was impermissible both as a matter of general law and more specifically in relation to the issue of unjust enrichment under section 80(3) VATA 1994. Absent such speculation, he submitted that the only conclusion open to the FTT was that HMRC had not proved on the balance of probabilities that the regulators ignored the incidence of VAT when setting infrastructure charges.

43. AWSL's case is that there was no probative evidence at all before the FTT as to what matters were taken into account by the Secretary of State and Ofwat when the infrastructure charges were set. To reach a finding as to what was taken into account it would have been necessary for HMRC to adduce evidence from each regulator, or their successors, and/or policy documentation describing the policy to be applied in making the decisions and any guidance setting out the framework in which the decisions were to be made. Mr Rivett submitted that the setting of infrastructure charges was a deeply sophisticated decision and there was no evidence before the FTT which remotely touched upon what was relevant to the setting of those charges.

44. In his skeleton argument and oral submissions Mr Rivett identified the following findings where he said that the FTT engaged in unwarranted speculation, including Mr Rivett's references in square brackets to the relevant paragraph numbers of the FTT decision:

(1) The regulators would not have taken into account the gross cost of infrastructure charges to customers [158 and 162].

(2) The Secretary of State would have asked HMCE for its view as to the correct VAT treatment of infrastructure charges [142 and 174].

(3) The Secretary of State would not have asked anyone other than HMCE about the correct treatment of infrastructure charges [142].

(4) That the answer given by HMCE prior to 1 August 1989 would have been consistent with a view attributed to HMCE as at 29 August 1989 [144].

(5) Even if the regulators considered the infrastructure charges to be subject to VAT they would have ignored that fact because a significant number of customers would have been able to recover the VAT payable [190].

(6) The FTT's overall conclusion that there was sufficient evidence to conclude that the level of infrastructure charges was not affected by VAT [190].

45. Mr Mantle reminded us that the bar to a challenge on *Edwards v Bairstow* grounds is set very high. The approach to a challenge was described in *Georgiou v Customs and Excise Commissioners* [1996] STC 463 where Evans LJ said at p476:

> "There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. … It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure … to be misused in this way. Secondly, the nature of the factual

> inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled.
>
> It follows, in my judgment, that for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make. What is not permitted, in my view, is a roving selection of the evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong."

46. Against that background we must consider the extent to which the FTT was entitled to make findings of fact and draw inferences from the evidence before it. Mr Rivett submitted that as a matter of general principle, where a court or tribunal is required to reconstruct a decision which would have been made by a particular decision-maker it was not entitled to speculate. He relied on a number of authorities which were also referred to by the FTT at [108] to [113] of its decision.

47. *Alliance & Leicester Building Society v Paul Robinson & Co* (4 May 2000, unreported) concerned a claim by a building society against a firm of solicitors. There was a factual issue as to what the building society would have done if it had been told the true purpose of a loan. The Court of Appeal referred to limitations in the evidence of a decision-maker as to what he would have done where the situation was not covered by any policy or guidelines and was one which he had not previously experienced. Chadwick LJ stated at [31]:

> "31. …if, as was the present case, a witness is asked to consider a situation which was not covered by any policy or guidelines and which had not previously arisen in his experience, his evidence as to what he would have done in that situation may properly be regarded as speculative. He can do no more than speculate as to what he would have done in circumstances which he had never previously met."

48. The individual decision-makers had given evidence that faced with the hypothetical situation they would not have continued with the transaction. The trial judge rejected that evidence saying that it was wholly unconvincing, smacked of hindsight and justification and lacked all commercial reality. The Court of Appeal held that the judge was entitled to reach that conclusion having seen and heard the witnesses. We agree with the FTT's approach to this authority. The Court of Appeal was not saying that the evidence was inadmissible, just that the trial judge was entitled to give it little weight and to reject it in the particular circumstances of the case.

49. *Laker Vent Engineering Ltd v Templeton Insurance Ltd* [2009] EWCA Civ 62 was a similar case. It concerned a defence of non-disclosure raised by an insurance company, and the trial judge's finding that the insurer was not induced by the non-disclosure to renew a policy of insurance. The burden was on the insurer to establish that it had been so induced. There was no evidence before the judge from the individual

decision-makers. Nor was there any other factual evidence that they were induced by the non-disclosure to renew the policy. The Judge stated that he was "not prepared to speculate how Templeton's underwriters would have responded in the absence of any direct evidence from the underwriters concerned or even any evidence of Templeton's general practice" (CA decision at [54]). The Court of Appeal endorsed that finding at paragraphs [70] and [71] of its decision. Clearly in the absence of any evidence at all on the point, as the Court of Appeal stated, there was no basis on which the judge could have reached any other view. The issue in the present appeal is whether there was evidence to support the findings of the FTT.

50. Finally Mr Rivett relied on *E Surv Ltd v Goldsmith Williams Solicitors* [2015] EWCA Civ 1147 which concerned a negligent valuation following misrepresentations as to the date of the original purchase and as to the original purchase price paid by a borrower re-mortgaging a property. The negligent surveyors brought proceedings against the solicitors acting in the transaction for a contribution towards their liability to the lender. The solicitors had failed to inform the lender of the disparity in the date and purchase price. The trial judge found for the surveyors on the basis that the solicitors had been negligent in failing to advise the lender of the disparity which was a contributory cause of the lender's loss when the borrower defaulted.

51. There was a burden on the surveyors to establish that the solicitor's breach of duty was a cause of the lender's loss. To satisfy that burden the surveyors had to show that the lenders would have carried out checks on discrepancies in circumstances where the lender was already in possession of information on the mortgage application form strongly suggesting that the valuation of the property was excessive.

52. The Court of Appeal noted at [45] the absence of evidence from the underwriters making the decision for the lender or of any lending manual that might have indicated what action should be taken when such information comes into the possession of the lender. In those circumstances the Court of Appeal noted that the judge was "driven to speculate" what would have happened. Ultimately, the Court of Appeal allowed the appeal on the basis that the judge did not have evidence before him that enabled him to address the lender's apparent failure to act on information already available to it, and that in effect the judge had reversed the burden of proof.

53. It seems to us that references to speculation in these authorities and by AWSL in this case simply refer to conclusions which are not supported by the evidence. Ultimately, the test is that set out in *Edwards v Bairstow* and the proper approach is that set out in *Georgiou*. We accept what was said by the FTT at [112] of its decision in relation to the authorities relied upon by Mr Rivett:

> "112. … these cases are fact specific. The Tribunal is not prohibited from reaching a conclusion on what a person was likely to have done in a given set of circumstances that did not in fact occur, if there is sufficient reliable evidence to reach a conclusion on that matter."

54. We were also referred to what was said in relation to speculation in *Sanderson v Revenue & Customs Commissioners* [2016] EWCA Civ 19 at [42], however that was

in the specific context of discovery assessments and what the "notional officer" would have concluded. It does not assist in relation to the present issue.

55. Mr Rivett referred us to what was said by Moses LJ in *Marks & Spencer v Customs & Excise Commissioners* [1999] STC 205 at 241 in the context of unjust enrichment:

> "Lacunae in the evidence should not be considered to the detriment of the trader. It was, after all, the taxing authority which caused the problem in the first place. Thus, it seems to me, if, after considering all the evidence, there is uncertainty or absence of detail, that should not be held against the trader."

56. We do not consider that there is any basis to suggest that the FTT failed to adopt that approach. The real issue is whether there was probative evidence on which the FTT could base its findings of fact.

57. Mr Rivett also submitted that there was a particular rule regarding speculation applicable to the defence of unjust enrichment under section 80(3) VATA 1994. He relied on what was said by the Court of Appeal in *Baines & Ernst*. In that case the Court of Appeal found that there was no evidence before the Tribunal from which it could draw any inferences as to whether the burden of overpaid VAT had been passed on to the appellant's customers. Mr Rivett relied on various passages from the main judgment given by Lloyd LJ. To put these passages into context, "GP" was a competitor of Baines & Ernst, Mr Cochrane was a 40% shareholder in Baines & Ernst and responsible for finance and administration, and Mr Mantle was counsel for the respondent, HMRC:

> "15. Mr Mantle also submitted that the assessment of the hypothetical comparative situation must be made on the basis of all available evidence of any relevance and probative value. I agree. There is no scope for assumptions, either way, or for rules as to the weight of one type of evidence as distinct from another. The only relevant rule is that the burden of proof is on HMRC. In particular, it does not necessarily follow from the fact that a price is expressed as £X plus VAT, or £Y including VAT, that if VAT had not had to be charged, the price would have been £X, or £Y less the amount of the VAT."

> "43. Insofar as it relied on the Respondent having followed GP, the Tribunal ignored the need to consider what GP would have done in the hypothetical situation of no charge to VAT, and in particular the need to do so on the basis of evidence, rather than speculation. To say that, because GP charged 15% plus VAT in 1996, and (it seems) 15% when it was treated as exempt in 1999, and then 15% plus a monthly £8 in 2003 when it was again exempt, and because the Respondent copied GP's pricing in 1997, therefore one can infer that, if VAT had not been charged, GP would have charged a flat 15% in 1997 and therefore the Respondent would have done the same, seems to me to assume the answer to the question which should have been posed in terms, and answered by reference to evidence, namely what GP's pricing would have been in 1997 if it had been correctly treated as exempt. HMRC did not call any evidence from GP, perhaps because, as we were told, GP had also made a claim for the repayment of VAT. Nor did it call any other evidence, expert or otherwise, about this particular market, and conditions in it at any relevant time, from which the Tribunal could draw inferences as to what GP, the Respondent or anyone else would have done if VAT had not had to be charged and accounted for, at some given time."

> "47. …Since the burden of proof was on HMRC, the Tribunal's disbelief of Mr Cochrane opened the way for a finding that the Respondent would or might have charged less than 17.625% but was of no assistance at all as to what it would in fact have charged if its services had been treated as exempt during the claim period. That depended on other evidence. Mr Cochrane was not asked questions about this."

58. We do not consider that *Baines & Ernst* lays down any special rule about speculation in the context of VAT and unjust enrichment. It certainly illustrates that in that case the VAT Tribunal engaged in unwarranted speculation. The general principles are those stated by Lloyd LJ at [15]. A finding as to what the decision-maker did or would have done or what he took into account must be made on the basis of all probative evidence. There is no scope for assumptions or for rules as to the weight of one type of evidence as distinct from another. Beyond that, the only relevant rule is that the burden of proof is on HMRC. What is said in *Baines & Ernst* is entirely consistent with the three cases relied on by Mr Rivett to establish the general law position, and goes no further than that.

59. Mr Rivett identified three types of evidence which would have been relevant to the issue before the FTT:

(1) Direct evidence from the decision-maker.

(2) Documentary evidence recording the decision-making process or policy guidance followed by the decision-maker.

(3) Conceivably, expert evidence from someone who could speak with expertise as to what the decision-maker would do or from someone who makes those sorts of decision.

60. There was no evidence before the FTT from the decision-makers themselves, or their successors, no notes or contemporary documentation recording the decision-making process of setting infrastructure charges and no policy or other guidance describing the factors to be taken into account by the decision-makers. In the absence of such direct evidence Mr Rivett submitted that any conclusions the FTT reached were nothing more than speculation.

61. HMRC submitted that there was evidence to support the findings made by the FTT, including the inferences which the FTT drew as to what factors the regulators would have been likely to take into account in making the decisions, and what steps the Secretary of State would have taken to obtain information as to the incidence of VAT.

62. Clearly the FTT had to focus on the evidence before it, the relevance and probative value of that evidence and the weight to be attached to the different types of evidence. It had to make findings of fact based on that evidence and consider what inferences it could properly draw from those primary facts. There was no dispute that this was the approach the FTT was bound to take.

63. Mr Rivett submitted that the FTT took the wrong approach to the evidence and to the burden of proof. He submitted that the FTT struggled to reach a decision as to whether VAT was taken into account in setting the infrastructure charges, where the

only reasonable conclusion was that there was insufficient evidence to reach a decision. In contrast, Mr Mantle submitted that the FTT properly strove hard to reach a decision based on the evidence and that was the right approach. He referred us to *Stephens v Cannon* [2005] EWCA Civ 222 for the propositions described by Wilson J at [46]:

> "46. From these authorities I derive the following propositions:
>
> (a) The situation in which the court finds itself before it can despatch a disputed issue by resort to the burden of proof has to be exceptional.
>
> (b) Nevertheless the issue does not have to be of any particular type. A legitimate state of agnosticism can logically arise following enquiry into any type of disputed issue. It may be more likely to arise following an enquiry into, for example, the identity of the aggressor in an unwitnessed fight; but it can arise even after an enquiry, aided by good experts, into, for example, the cause of the sinking of a ship.
>
> (c) The exceptional situation which entitles the court to resort to the burden of proof is that, notwithstanding that it has striven to do so, it cannot reasonably make a finding in relation to a disputed issue.
>
> …"

There was no dispute about these propositions.

64. We turn now to consider the six specific criticisms made by Mr Rivett of the FTT decision.

65. The first criticism relates, as we understand it, to the FTT's approach to the expert evidence, and Mr Rivett's reference to "gross cost" is what the Tribunal referred to as the actual price paid by the consumer, or the gross price.

66. It is clear that the FTT accepted Dr Koboldt's evidence that the regulators would take into account the price to consumers, but took the view that that was not sufficient on its own to satisfy it that taking into account price to consumers would necessarily have affected the level of infrastructure charges. Mr Rivett submitted that in doing so, the FTT was effectively reversing the burden of proof. The FTT should have been asking whether there was anything to challenge Dr Koboldt's evidence, and there was nothing. We do not consider that the FTT was effectively reversing the burden of proof. It accepted Dr Koboldt's evidence but did not consider that evidence was determinative of the issue before it, namely whether the level of infrastructure charges was affected by the incidence of VAT. In our view it was entitled to take that approach, and it properly went on to look at the evidence as a whole. Indeed the FTT itself stated that if it had decided the appeal solely by reference to the statutory duties and the expert evidence about economic theory, then HMRC would not have established unjust enrichment (paragraph [137]).

67. It is necessary to continue reading the decision to see what evidence supported the FTT's subsequent findings that the regulators were not concerned with VAT in setting the infrastructure charges. Those findings are the subject of the following criticisms.

68. The second, third and fourth criticisms relate to how the Secretary of State would have informed himself as to the VAT treatment of infrastructure charges, and what he would have been told on or before 1 August 1989.

69. The FTT made key findings at [139] – [153] that the Secretary of State would have consulted HMCE prior to 1 August 1989 and would have been told that sewerage and water charges were zero rated, but that water charges to taxpayers in SIC 1-5 would be standard rated from 1 July 1990. It was an unanticipated and sudden change of mind by HMCE in September 1989, after the charges had been set, that led to infrastructure charges being treated as subject to VAT. The FTT also found that even if the incidence of VAT had been uncertain prior to 1 August 1989, in such circumstances the regulator would have been unlikely to take VAT into account in setting infrastructure charges.

70. Mr Rivett described these findings as speculation. He accepted that the regulator can be presumed to have done his job properly, but it could not be presumed that he would have spoken to HMCE or been given the answer that the FTT found he would have been given.

71. We accept that the matters being dealt with by the FTT in this regard only came into focus during the course of the hearing, following disclosure of correspondence by HMRC shortly before the hearing. Mr Rivett made submissions challenging the basis on which the FTT made these findings of fact. In particular he submitted that the FTT could not properly find on the evidence that the decision by the Secretary of State was made by 1 August 1989; that the Secretary of State would have consulted HMCE about the correct VAT treatment of infrastructure charges; or that the answer from HMCE would have been as set out above. Mr Rivett also pointed out that there was no evidence as to whether the regulator asked anyone else apart from HMCE or would have done so, for example the WAA, and if they did what the response might have been.

72. The basis on which the FTT found that the Secretary of State had set the infrastructure charges at some time before 1 August 1989 was an inference to that effect made by both experts (see [40]). That was the date on which responsibility for regulation passed to Ofwat, and it was common ground that the first infrastructure charges were set by the Secretary of State.

73. Mr Rivett accepted that both experts had inferred that the charges were set on or before 1 August 1989, but submitted that at the time the experts produced their reports there was no significance in the precise date. The date only became significant during the hearing and in light of disclosure by HMRC of the correspondence referred to above. In any event, Mr Rivett submitted that there was no evidence before the FTT as to the date on which the charges were set, save that an amendment to the Water Act 1989 to introduce infrastructure charges was first debated in the House of Lords on 22 May 1989 and the first reference to infrastructure charge limits in Hansard was 21 February 1990.

74. We accept that the date on which the infrastructure charges were set was not properly a matter for expert opinion. The FTT found that responsibility for regulation passed from the Secretary of State to Ofwat on 1 August 1989, and that the first

infrastructure charges had been set by the Secretary of State. We consider that this was evidence from which the FTT was entitled to infer that the infrastructure charges were likely to have been set on or before 1 August 1989.

75. The correspondence disclosed by HMRC was relevant to HMCE's view about the VAT treatment of infrastructure charges in 1989. We acknowledge that none of the individuals who were party to this correspondence gave evidence before the FTT.

76. The correspondence included notes of a meeting on 29 August 1989. The meeting was attended by representatives of Price Waterhouse, the WAA, Thames Water, Yorkshire Water and HMCE, including Mr Alan Ruston of HMCE. The notes were apparently prepared by Mr Alan Waterhouse, the representative of Yorkshire Water. The notes record that the meeting had been requested by the water authorities to seek clarification of issues raised in a paper circulated by the WAA on 19 June 1989 and a response from HMCE dated 3 July 1989. Neither of these documents was in evidence. There was discussion of various VAT issues in relation to water supplies, including at paragraph 6.4.8 of the notes the following:

> "6.4.8 Infrastructure Charges (Water Act 1989, Section 79) – will follow same liability as would a supply of water or sewerage service, ie if customer in SIC division 1 to 5, water infrastructure charge will be standard rated; other water infrastructure charges will be zero rated; sewerage infrastructure charges will always be zero rated."

77. On 4 September 1989 Mr Ruston wrote to Mr Waterhouse, having received a copy of the notes. He provided comments and further clarification of certain matters dealt with in the notes. The following paragraph is relevant for present purposes:

> "As to the issues raised in paragraph 6 we can confirm that the notes reflect our discussion, but we now feel that we have been somewhat precipitate. It has been put to us by others here that works of a civil engineering nature must be treated separately for VAT purposes from the supply of water. We are looking into the position and will confirm the various liabilities as soon as we can."

78. Both parties acknowledge that the evidence before the FTT was not a complete picture of the discussions as to the VAT liability of infrastructure charges in 1989. Indeed, following Mr Ruston's letter there was a letter dated 6 September 1989 from Mr Ruston to the WAA which was not before the FTT and which is the subject of Ground 4.

79. On 20 September 1989 Mr Ruston wrote again to Mr Waterhouse as follows:

> "When I wrote to you on 4 September I indicated that it would be necessary for us to review our position on the contents of paragraph 6 of the notes of our meeting held on 29 August 1989.
>
> This review has now been completed and, in summary, we have concluded that works of a civil engineering nature undertaken by water authorities and their successors from 1 April 1989 are standard rated …

Therefore, based on the information we have been given on the specific points covered in paragraph 6.4, the following items are standard rated for VAT purposes.

…

(e) infrastructure charges (to a developer); …"

80. Mr Rivett submitted that the only conclusion available to the FTT based on this evidence was that the position of HMCE as at 29 August 1989 was confused and unclear. He submitted that the evidence before the FTT was clearly incomplete and the FTT could not properly make any finding as to HMCE's position prior to that date, or that its position changed shortly after that date. If the Secretary of State had asked those "others" at HMCE referred to in the letter dated 4 September 1989 what the VAT position was then he would have been told that infrastructure charges were standard rated civil engineering works.

81. Mr Rivett submitted that even if the FTT was entitled to find that the Secretary of State would have contacted HMCE, it was wild speculation to find that they would have spoken to Mr Ruston or someone else who shared Mr Ruston's view on 29 August 1989 rather than someone else who might have expressed the view set out in the letter dated 20 September 1989.

82. We consider that the FTT was entitled to infer that, if VAT was considered at all, in all likelihood the Secretary of State would have contacted HMCE to establish the VAT status of infrastructure charges. Mr Rivett did not concede the point but he did not seek to forcefully argue otherwise. Further, there was no reason to think that the Secretary of State would have asked anyone else. We are also satisfied that there was evidence from which the FTT could find that prior to 29 August 1989 the Secretary of State would have been told that infrastructure charges would mostly be zero rated. The correspondence was clearly part of a previous dialogue and the VAT treatment described in the meeting notes was stated in categoric terms by a senior HMCE officer dealing with the water industry. Different tribunals might have reached different findings on these points, but we are not satisfied that no reasonable tribunal could have made the findings made by the FTT. The FTT's findings were the result of inferences drawn from primary facts and they did not amount to impermissible speculation. We also note, in response to a point made by Mr Rivett, that it would not be particularly surprising for HMCE's starting point to be zero rating rather than the more usual default assumption of standard rating, bearing in mind the general zero rating of water and sewerage charges. Overall, we consider that the inferences drawn were reasonable.

83. The fifth criticism concerns the FTT's finding that even if the regulators considered the infrastructure charges to be subject to VAT, they would have ignored VAT because a significant number of customers would have been able to recover the VAT.

84. The FTT found at [154] – [158] that in circumstances where a significant proportion of customers paying the infrastructure charge would either not be charged VAT or were likely to be able to recover any VAT charged as input tax, the regulator would have been unlikely to take VAT into account in setting infrastructure charges.

Mr Rivett submitted that there was no proper evidential basis to make any assumption as to the likely level of recovery by AWSL's customers at the time of the regulator's decision. Even if there were, it was speculative to find that the regulator would therefore put no weight at all on the gross price when setting the charges.

85. At [159] – [163] the FTT considered that the regulator would have approached VAT as a tax on final consumption intended to be borne by certain customers but not others. It did not accept Dr Koboldt's evidence that in those circumstances the Secretary of State would have considered a smaller reduction in the price than he might otherwise have done. The FTT considered it more likely that he would have looked at the price net of VAT. Mr Rivett submitted that this was wholly speculative and could not be reconciled with the fact that the FTT accepted Dr Koboldt's evidence that the regulators would look at price to consumers.

86. Subject to the point in the following paragraph, we do not accept Mr Rivett's submissions in relation to these criticisms. At [154] – [158] the FTT based its findings as to the customers who would bear the cost of VAT on evidence about AWSL's current customers. It recognised the limitations of the evidence before it and found that it was likely that a significant proportion of those customers who would be charged VAT would be able to recover it. For customers in that position any reduction in charges to reflect VAT would be a windfall, against the background of the regulator's primary duty to ensure that water undertakers' costs were covered. In our view the FTT was entitled to make these findings, and to treat them as probative that (if he actually considered VAT all) the Secretary of State was therefore less likely to take account of VAT (the "gross price") when setting the charges, on the basis that VAT was either not chargeable at all or, where it was, it would not be a cost for a significant percentage of customers.

87. We are less confident about the FTT's comments in relation to VAT being a tax on final consumption and therefore intended to be a cost to certain customers but not others. The FTT inferred at [163] that this was an additional factor that made it less likely that the Secretary of State would consider VAT when setting the charges. Whilst it is clearly the case that, as a matter of law, VAT is indeed a tax on final consumption and is intended to be irrecoverable in some cases, we are not persuaded that there was any basis to assume that the Secretary of State would have been familiar with VAT principles of that nature. However, we do not think that this was a material point in the context of the overall findings.

88. The FTT also relied on the existence of a £1,000 price cap in 1989, albeit by way of reinforcement of the conclusion it had reached at [163]. The FTT accepted Dr Rubin's evidence that the existence of such a price cap indicated that AWSL's infrastructure charges were likely to have been set without consideration of affordability because their charges were below that limit. Mr Rivett accepted that the price cap was set by reference to affordability, but submitted that it did not follow that the Secretary of State would not have adjusted charges below that amount by reference to the VAT inclusive price. We agree that it did not necessarily follow, but the FTT was entitled to infer that it was likely that the Secretary of State's consideration of

affordability was limited to the £1,000 cap and was not a factor for charges set below that level.

89. The sixth criticism addresses the FTT's overall finding that the regulators did not take VAT into account when setting the infrastructure charges. Mr Rivett criticised a number of findings which the FTT said supported that conclusion.

90. Mr Rivett submitted that even if there were some evidential basis for the findings described above, it remained speculative that the incidence of VAT did not affect the level at which the charges were set. There was expert evidence before the FTT from Dr Koboldt that this was a multi-factorial decision and there was no evidence as to how the regulators might have factored VAT treatment into the balance. Mr Rivett described this as a "killer blow", especially in circumstances where the decision under consideration was not a binary decision such as whether a mortgage would be approved or an insurance policy renewed, but a more subtle evaluative decision.

91. We accept that the decision in relation to infrastructure charges would have been a multi-factorial decision. However, we are not satisfied that the FTT failed to take that into account in considering what inferences it could properly draw from the facts it had found. The FTT was alive to the risk of impermissible speculation, but also of the need to strive to make a decision on the basis of the evidence before it. As the FTT noted at [190], it did have evidence before it, which it considered in detail.

92. In addition to the six criticisms, Mr Rivett also submitted that there was no direct evidence as to the factors the regulators took into account, and in particular whether they took VAT into account.

93. The FTT itself acknowledged that there was very little direct evidence of what was taken into account in 1989. Mr Rivett submits that in fact there was no direct evidence whatsoever as to the decision making process of the Secretary of State in 1989. We accept that the 1991 Ofwat consultation paper, the 1992 National Audit Office report and Parker's "*The Official History of Privatisation*" were not direct evidence as to the actual decision-making process. The question is whether the FTT was entitled to give that evidence any weight at all or whether it should have treated it as having no probative value.

94. We were taken to various passages in these documents. We accept that they post-date the decision in 1989 and in the context of setting infrastructure charges they are very general. The FTT recognised this at [186] and it is clear that whilst the FTT took into account this evidence it gave it little weight. In our view it was entitled to do so.

95. In relation to 1994, the FTT relied on the Ofwat report and by way of corroboration of that evidence the MMC reports. Mr Rivett criticised the reliance placed on the Ofwat report because it did not record the factors taken into account in setting infrastructure charges or provide any indication as to what effect there might have been if Ofwat had known that they were outside the scope of VAT. That is certainly correct but we consider that it was probative as to what was and was not taken into account, both in relation to 1994 and, because there was no reference to a change in approach,

to 1989. The FTT was entitled to take it into account, together with the MMC reports. It was also entitled to take into account, as it did at [188], that when rates were set they were set without any stated reference to VAT.

96. Grounds 2 and 3 of this appeal are not straightforward. Overall we consider that the FTT made findings on the basis of the evidence before it having appropriate regard to the burden of proof. In the light of its findings it drew inferences on the balance of probabilities as to what regard the regulators would have had to the incidence of VAT. That was the function of the FTT and we do not consider that the inferences it drew amounted to unwarranted speculation. They were supported by evidence and it was open to the FTT to draw those inferences.

Ground 4 – Additional Evidence

97. Ground 4 of the appeal was that the FTT's decision would have been different if it had been provided with a copy of a letter from HMCE dated 6 September 1989. AWSL submitted that the letter made it plain that the correspondence with HMCE relied on by the FTT was incomplete, such that there was no proper basis to make any finding as to HMCE's views in August 1989, and that insofar as the correspondence demonstrated anything it showed that both HMCE and the industry were uncertain about the correct VAT position.

98. In its permission decision dated 26 September 2017, the Upper Tribunal reserved the question of whether AWSL should be granted permission to advance this ground of appeal to the substantive hearing.

99. Both parties referred to the well known three part test for the admission of new evidence on appeal in *Ladd v Marshall* [1954] 1 WLR 1489, where Denning LJ (as he then was) said the following at page 1491:

> "…first, it must be shown that the evidence could not have been obtained with reasonable diligence for use at the trial; secondly, the evidence must be such that, if given, it would probably have an important influence on the result of the case, though it need not be decisive; thirdly, the evidence must be such as is presumably to be believed, or in other words, it must be apparently credible, though it need not be incontrovertible."

100. There have been a number of Upper Tribunal decisions that have considered the relevance of these criteria in the context of the specific power to admit fresh evidence in Rule 15(2) of the Upper Tribunal rules. The most recent of these was *Kyriakos Karoulla t/a Brockley's Rock v Revenue and Customs Commissioners* [2018] UKUT 0255 (TCC), which endorsed guidance provided in the earlier Upper Tribunal decision in *Bramley Ferry Supplies Ltd v Revenue and Customs Commissioners* [2017] UKUT 0214 (TCC) at [20] to [23]. That guidance was to the effect that whilst the *Ladd v Marshall* criteria should not be applied as strict rules, and the Tribunal's discretion needed to be exercised in accordance with the overriding objective to deal with cases fairly and justly, taking account of all the circumstances, the *Ladd v Marshall* criteria were of persuasive authority and should be borne in mind when exercising the discretion. We note that in the recent Court of Appeal decision in *Zipvit v Revenue and Customs Commissioners* [2018] EWCA Civ 1515, Henderson LJ also stated at [41]

that, in the context of the Civil Procedure Rules, the *Ladd v Marshall* conditions "do not place the court in a straitjacket, and the court must always seek to give effect to the overriding objective of doing justice in the individual case". In that case material was admitted even though the first of the three criteria was not met.

5 101. We did not understand either party to disagree with this approach. However, there was a significant disagreement over the circumstances in which it is open to the Upper Tribunal to consider fresh evidence on an appeal limited to a point of law, even if (whether under the *Ladd v Marshall* criteria or otherwise) it would have chosen to exercise its discretion to admit the evidence assuming it had the power to do so. The
10 full extent of this disagreement became apparent relatively late in the hearing and the submissions we received on it were relatively brief, bearing in mind that Ground 4 was not the main thrust of AWSL's case.

102. Mr Mantle submitted that, since the Upper Tribunal may only entertain an appeal on a point of law (section 11, Tribunals, Courts and Enforcement Act 2007 ("TCEA")),
15 it should only admit new evidence if either (1) that evidence was relevant to establishing that there was an error of law in the FTT's decision, or (2) (having found that there was an error of law) the Upper Tribunal had set aside the FTT's decision and had chosen to re-make it under section 12(2)(b)(ii) TCEA, in which case new evidence might be admitted to assist in re-making the decision. Mr Mantle submitted that in the present
20 case, unless the appellant could succeed on Grounds 1, 2 or 3 without reference to the additional evidence, there would be no relevant error of law. This was because the challenge to the FTT's findings was based on the evidence available to the FTT (or the lack of it). The FTT could not have erred in law in failing to take account of evidence that was not before it. Mr Mantle suggested that this submission could either be
25 expressed in terms of the Tribunal having no power to admit the evidence unless one of these requirements was met, or that it should not exercise its discretion unless one of them was met because it would not be doing so for a proper purpose. Alternatively the same result would arise from applying the second criterion in *Ladd v Marshall* and the overriding objective.

30 103. Mr Rivett submitted that this was too narrow an approach. It was not necessary to identify an error of law independently of the new evidence. Otherwise critical new evidence might be excluded unless it happened to be the case that a (possibly irrelevant) error of law could be identified. The proper constraint was the overriding objective, and the Tribunal could exercise its discretion to prevent abuse. New evidence could be
35 admitted even in the context of an *Edwards v Bairstow* challenge, on the basis that the conventional expression of the principle in terms of a tribunal "properly instructed as to the relevant law" should be read as extending to the factual dispute.

104. These submissions raise important issues. In particular, if Mr Mantle's submissions are correct then it is not clear to us on what basis the application to admit
40 new evidence considered in *Karoulla* should properly have succeeded. In that case the sole challenge in the appeal was under *Edwards v Bairstow*, and this was said to be critically dependent on the decision whether to admit new evidence (paragraph [18] of the decision). However, in some cases the approach suggested by Mr Mantle could lead to injustice: in *Karoulla* itself the evidence in question was in the possession of HMRC

and they had failed to produce it before the FTT, despite repeated requests by the taxpayer to return it. Although it might be that a different remedy would be available in that sort of situation in the power of the FTT to set aside its own decisions under rule 38 of the FTT rules (or conceivably in judicial review), the point is clearly not a straightforward one.

105. Nevertheless, Mr Mantle's submissions do reflect the important point that appeals to the Upper Tribunal may only be made on a point of law, and certainly reflect the "classic" formulation of the *Edwards v Bairstow* principle. We also note that in *Bramley Ferry Supplies* the Upper Tribunal took a similar approach, commenting at paragraph [14] that no error of law based on *Edwards v Bairstow* could be found by reference to evidence that was not before the judge.

106. We consider that we should only reach a conclusion on this important issue if it is necessary for our decision, and preferably on the basis of fuller submissions than we had the opportunity to receive. We do not consider that it is necessary because, whether or not we have power to admit the evidence or can properly exercise any such power, it is clear in our view that this is not a case where it should be exercised.

107. Looking at the *Ladd v Marshall* criteria, HMRC did not dispute that the third condition was met. It did dispute that the first and second were satisfied. On the first condition, we would have preferred Mr Rivett's submission that the 6 September letter could not have been obtained with reasonable diligence for use at the trial. The correspondence that was before the FTT was only provided shortly prior to the hearing, at a stage when HMRC had itself not yet appreciated its significance or decided to rely on it. The significance of the correspondence only started to become apparent from Mr Mantle's opening submissions on the first day of the hearing.

108. However, the second condition, that the evidence must be such that, if given, it would probably have an important influence on the result of the case, is clearly important. Neither party sought to argue that a discretion to admit new evidence should be exercised in accordance with the overriding objective even if this condition was not satisfied. In our view it is clearly not satisfied.

109. The letter in question is a letter dated 6 September 1989 from Mr Ruston of HMCE to a representative of the WAA, Peter Hall. It refers to Mr Ruston's letter to Alan Waterhouse commenting on the notes of the 29 August meeting (this must be a reference to the 4 September 1989 letter referred to above), and refers to that as "in particular stating that we had reservations on what we had told you on the contents of paragraph 6, and were looking the situation again". The main subject matter of the further letter is an expression of concern that Mr Ruston had been contacted by a representative of Coopers and Lybrand, who already had copies of the minutes and was asking about paragraph 6, and a request that Mr Hall send a copy of Mr Ruston's earlier letter amending and withdrawing HMCE's views on paragraph 6 to everyone who received the draft minutes, on the basis that "it is most important that people do not get incorrect information based on preliminary thinking".

110. It is plain that the FTT itself recognised that the correspondence with HMCE was incomplete. This is stated in terms at paragraph [70] of the decision. In our view the 6 September letter does not add anything material to the 4 September letter, and does nothing to undermine the FTT's conclusion that there was a change of mind after the meeting at the end of August 1989. We consider the point to be sufficiently clear that, even putting to one side (as we do) Mr Mantle's submission that Ground 4 cannot be advanced as an independent ground of appeal in any event, there would be no real prospect of it succeeding. We accordingly refuse permission to appeal on Ground 4.

Decision

111. For the reasons given above we dismiss the appeal.

MRS JUSTICE FALK
JUDGE JONATHAN CANNAN

RELEASE DATE: 27 DECEMBER 2018