



Variation or Rescission: A Question of Fact & Intention

How far is too far before a variation to an agreement becomes a new contract and/or a rescission of the original agreement? This was the question facing the Court of Appeal in the recent case of *Cobalt Data Centre 2 LLP & Anor v Revenue and Customs (the “LLPs” v “HMRC”)*.

The Background

In the period 1996-2006, the Government encouraged investment in the construction of industrial buildings in disadvantaged areas (“Enterprise Zones”/“EZ”), permitting generous tax allowances on construction expenses (EZ allowances/“EZAs”) pursuant to s.296 of Capital Allowances Act 2001 (“CAA”).

On 17 February 2006 (the day before the EZ at the site expired) Highbridge North Tyneside Developer One Ltd & Highbridge North Tyneside Contractor One Ltd entered into a JCT contract with contractor’s design (the “Golden Contract”). In an effort to preserve the ability to claim EZAs on future development of the site the Golden Contract featured 6 No. works options varying significantly in size and scope, to be selected by issuing a notice to proceed. In 2011 the LLPs purchased the benefit of the Golden Contract (the construction of two buildings which completed in 2012).

The Initial Proceedings

The LLPs claimed EZAs on the entire price paid, as the contract met the requirements of s.296 (expenditure incurred within 10 years of the site being included in the EZ). Conversely, HMRC argued that ‘Change Orders’ issued in 2011, said to be pursuant to Clause 12 of the Golden Contract, altered the scope of the works in the relevant option to such an extent they amounted to a new contract. As such, the new contract was not entered into

within 10 years of the site’s inclusion in the EZ and no EZAs were payable.

The Upper Tribunal (“UT”) found the Change Orders did not rescind or create a new contract, preserving the LLPs’ entitlement to EZAs on some but not all of the construction costs.

The Appeal

HMRC appealed on the basis that the LLPs had no entitlement to EZAs as (i) until the notice to proceed was issued, the Golden Contract was not a contract contemplated by s.298 of CAA; and (ii) the Change Orders to the selected work option were so different they amounted to a new contract made outside the 10-year period. The LLPs cross-appealed claiming entitlement to EZAs on the whole expenditure.

Was the Contract within s.298

Agreeing with the UT, the court held the legislation did not mandate any particular kind of contract and whether s.298 applied was to be determined by reference to when the contract was formed and whether later expenditure was under the same contract.

Was the expenditure under the same contract?

HMRC argued it was not because: (i) the effect of the Change Orders was so radical it rescinded rather than varied the Golden Contract, and formed a new contract outside the 10-year period; alternatively (ii) the Golden Contract was not rescinded, but nevertheless a new self-standing contract came into existence as a result of the Change Orders.

LJ Lewison confirmed (p53) “the extent of a contractual power of variation must be a question of interpretation of the contract in question.” By reference to a plethora of authorities including:

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Thorn v London Corp [1876], *Blue Circle Industries Plc v Holland Dredging Co (UK) Ltd* [1987]. *Sir Lindsay Parkinson & Co v Commissioners of Works and Public Buildings* [1949], *Abbey Developments Ltd v PP Brickwork Ltd* [2003] and *Supablast (Nationwide) Ltd v Story Rail Ltd* [2010]) and referring to (p.62) Wilmot-Smith on Construction Contracts (4th ed) (amongst others), the change ordered "cannot alter the essential characteristic of the contract itself"..."it is a matter of fact and degree as to whether the instruction for a variation goes beyond a change envisaged by the contract and instructs something over and above..." finding even a widely drawn variation clause has its limits.

Agreeing with the UT, the Court rejected the LLPs' argument that Clause 12 inferred a virtually unlimited power to make changes. As such, it was not essential to decide if the original contract was rescinded. *Blue Circle* confirmed it is possible for changes in the work to be referable to a new contract without necessarily discharging the original contract. The two may exist side by side.

Key Question:

The question of whether, in this instance, the parties made a new contract or varied an existing one would determine if the expenditure had been incurred under the same contract entered into during 10-year period. The focus must be on the new terms the parties agreed and the relevant intention.

LJ Lewison held the UT had erroneously applied the preferred test of "intention", as equating to the parties' desire to achieve a particular result (i.e the ability to claim EZAs). However, the parties' objective intention must be construed from what they said and did; in then asking if the facts were inconsistent with that desire, the UT erred in principle. It is not to say the expressed intention of the parties is irrelevant (*Antoniades v Villiers* [1988]);

but expressed intention is no more than one of the objective facts that must be considered.

Agreeing with HMRC, "to construct a materially different building on a wholly different site and at a substantially different price satisfies whatever is the right test to result in a new contract rather than a variation." (p 120). Again, whether that resulted in rescission did not matter.

A New Contract:

Consequently, LJ Lewison found (i) the right to instruct works under the Golden Contract had been exercised; (ii) the work in the Change Order was radically different; (iii) the work option of the Golden Contract was impossible; and (iv) further comprehensive terms were agreed. Accordingly, the construction was not under a contract within the first 10-year period. "If the parties did not rescind the Golden Contract (in the sense of abrogating it) the result of what they said or did was the making of a new contract" (p124).

Decision

Appeal allowed. Cross-appeal adjourned, with liberty to apply in the event the instant court's decision being reversed on appeal (p126-133).

Analysis

This is a reminder that the power to instruct variations has limits; and of the need to ensure that parties act in accordance with the terms agreed. Relying solely on what is desired and/or intended may lead to unintended (and potential costly) consequences.

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