

SCOTTISH LAND COURT

Application SLC 233/08 – Order of 2 June 2010

R W Morrison-Low

v

The Executors of the late T H Paterson

(Lord McGhie, D J Houston, J A Smith)

Agricultural Holdings – Rent – Variation of rent – Open market – Scarcity – Single Farm Payment – “Naked acres” – Current economic conditions – Marriage value – Potato lets – Sub-letting – Approach to comparables – Potential earning capacity – Budgets – Return on tenant’s capital – Net profit – Expert witnesses – Expert court – Agricultural Holdings (Scotland) Act 1991, Sec 13

The landlord sought determination of rent for the farm of Moonzie, near Cupar, for the period from 4 December 2008. The lease had been running on tacit relocation from 4 December each year following its creation by implication following the original tenant’s death on 4 December 1973. The rent current at the time of the application was £22,000 having been agreed with effect from 4 December 2004 following an application to the Court. In the application the landlord sought an increase to £32,000 and the tenant contended for a reduction to £10,266.74. It was apparent that the main reason for the difference between them related to the issue of proper treatment of SFP. However, various other issues of principle and of detail arose and are dealt with in the judgment. Calculation of the award – in the sum of £20800 – is set out in Appendix 1 and some practical findings are summarised at [203]

HELD: The main finding of the Court was that although an incoming tenant could be taken to come with an SFP entitlement appropriate to the farm and some allowance had to be made for SFP by reference to “naked acres” and the effect that receipt of such income support would have on a tenant’s attitude to profit sharing, SFP was not properly to be regarded as part of the earnings of the farm.

The Court dealt with certain other items of general application: A requirement to disregard scarcity does not imply an assumption of a complete equality of farms for let and persons seeking such farms. The willing tenant is not to be assumed to be a complete newcomer. He can be assumed to be taking over a farm operating on the same hypothetical basis as he is assumed to adopt and to have a full knowledge and understanding of the farm and its operation. The tenant would not be able to sub-let land to a potato grower but would be able to make an arrangement at much the same rate of return as if there was no issue over sub-letting. The hypothetical tenant would have sufficient capital of his own to provide necessary equipment but would be expected to borrow to cover his annual variable costs. The cost of such borrowing is a proper outlay in calculating farm earnings. The statutory reference to current economic conditions did not imply an instruction to base rent on a budgeted assessment at the date of assessment. However, rent would not normally exceed the predicted net income. The question of return on tenant’s capital is part of the assessment of how much of the potential earnings of

the farm a tenant would be prepared to allocate to rent. In doing this, the tenant would have regard to the whole package of benefits available from the lease as well as to farm income support from the State.

Applying these principles and having regard to its findings on matters of detail, the Court determined rent at £20,800.

The Note appended to the Court's Order is as follows:—

Introduction

- [1] This is an application by the landlord for determination of the rent payable in respect of Moonzie Farm near Cupar from 4 December 2008. The rent current at the time of application was £22,000 having been agreed by the parties in respect of the period from 4 December 2004, after some procedure in this court. In the present application the landlord contended for a figure of £32,000, and the tenant for £10,266.74.
- [2] As will appear, the main reason for the different figures was the dispute between parties over the role of the Single Farm Payment ("SFP"). A number of other matters had been in dispute. The Court convened a discussion with legal advisors. Following this, parties requested that a Member of the Court convene a meeting of the expert advisers. This meeting took place on 4 March 2010. We understand that, following that meeting, a series of informal meetings took place between two of the advisers and various matters were agreed.

Representation

- [3] We heard evidence and submissions at Edinburgh, with the hearing of evidence running from 8 to 18 March and submissions being heard on 23 and 24 March 2010. Mr Lewis Kermack, solicitor, appeared for Mr Richard Walter Morrison-Low, the landlord. Sir Crispin Agnew of Lochnew, QC, appeared for the tenants, the executors of Thomas Herbert Paterson.

Authorities etc

Statutory material

Agricultural Holdings (Scotland) Act 1949
Agricultural Holdings (Scotland) Act 1991
Agricultural Holdings (Scotland) Act 2003
Agricultural Holdings Act 1986

Authorities

Aberdeen Endowments Trust v Will 1985 SLT (Land Ct) 23
Broadland Properties Estates Ltd v Mann 1994 SLT (Land Ct) 7
Buccleuch Estates Ltd and Kennedy 1986 SLCR 1
Bulmer v Bollinger [1974] Ch.401
Cairngorm Chairlift Co Ltd v Assessor for Highland Region. 1995 SLT (Lands Tr) 35
Crown Estate Commissioners v Gunn 1961 SLCR App 173
Dunbar and Anderson 1985 SLCR 1
Earl of Seafield v Stewart 1985 SLT (Land Ct) 35
FR Evans (Leeds) Ltd v English Electric Co Ltd (1978) 36 P & CR 185
Ishak v Thowfeek [1968] 1 WLR 1718
Pease and Ors. v McMillan and Ors [2009] EWCA Civ 258
Kilmarnock Estates v Barr 1969 SLT (Land Ct) 10
Kinnaird Trust and Boyne 1985 SLCR 19

Little v McEwan 1965 SLT (Land Ct) 3
MacFarlane v Falfield Investments Ltd 1998 SC 14
Mackenzie v Bocardo SA 1986 SLCR 53
McGill v Bury Management Ltd 1986 SLCR 32
McKinley v Hutchison's Trustee 1935 SLT 62
Messrs R & M Whiteford v Trustees for Cowhill Trust July 2009 SLC/174/08
Moll v McGregor 1991 SLCR 1
Morrison-Low v Paterson 1985 SC (HL) 49
Morrison-Low v Paterson 1998 SLT 564
Morrison-Low v Paterson 2000 SLT 624
Murray Threipland's Trust v Cunningham Feb 2000 (Div Ct) SLC/159/98
NCB v Wilson 1987 SLCR 15
Shand v Trs of Late Major S F Christie 1987 SLCR 29
Southesk Farms v Amber Agriculture Ltd January 2003 Arbiter F R Barraclough
Strachan v Robertson-Coupar 1989 SC 130
Sutherland Estates v Sutherland 1998 SLT (Land Ct) 37
Telfer's Executors v The Buccleuch Estates Ltd 2006 SLCR (Vol 1) 131
Towns v Anderson 1989 SLT (Land Ct) 17
Trustees of J W Childers (Deceased) Will Trust v Anker 1997 73 P&CR 458
Western Heritable Co Ltd v Husband 1983 SC (HL) 60

Textbooks etc

Crofting Law, Sir Crispin Agnew of Lochnaw Bt QC
The Law of Agricultural Holdings in Scotland, 3rd Edition, Lord Gill
Agricultural Holdings, 14th edition, Muir Watt and Moss
 Explanatory Notes to Section 63 of Agricultural Holdings (Scotland) Act 2003
 Fraser R Barraclough "A Practical Guide to Rent Review of Agricultural Holdings in Scotland"
 2002
 Scammell & Densham, *Law of Agricultural Holdings*, 9th Ed.
 Concise OED – "Scarce"
 Oxford Companion to Law by D M Walker "Agistment"
 Encyclopaedia of Legal Styles – Vol 7, No.146 (Potato Joint Venture)
 SPICe Briefing 7 March 2003 – 2003 Bill at Stage 2

EC Regulations and cases

ECJ INFORMATION NOTE on references from national courts for a preliminary ruling –
 (2009/C 297/01)
 Council Regulation (EC) No 1782/2003
 C-470/08 *Kornelis van Dijk v Gemeente Kampen*, 21 January 2010
 C-434/08 *Harms v Heidinga* Feb 2010
 C-38/94 *R v Minister of Agriculture, Fisheries and Food ex parte Country Landowners Association* [1995] ECR I-3875

- [4] The relevant provisions of section 13 of the 1991 Act as amended by section 63 of the 2003 Act are in the following terms:

"13. — (1) Subject to subsection (8) below, the landlord or the tenant of an agricultural holding may, whether the tenancy was created before or after the commencement of this Act, have determined by the Land Court the question what rent should be payable in respect of the holding as from the next day after the date of the notice on which the tenancy could have been terminated by notice to quit (or notice of intention to quit) given on that date.

(2) In relation to such a question, the LandCourt shall determine, in accordance with subsections (3) to (7A) below the rent properly payable in respect of the holding as from the "next day" mentioned in subsection (1) above.

(3) For the purposes of this section the rent properly payable in respect of a holding shall normally be the rent at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing landlord to a willing tenant, disregarding —

(a) any effect on rent of the fact that the tenant is in occupation of the holding; and

(b) any distortion in rent due to a scarcity of lets,

but having regard to the matters referred to in subsection (4) below.

(4) For the purposes of determining the rent payable under subsection (3) above, the Land Court shall have regard to the following —

(a) information about rents of other agricultural holdings (including when fixed) and any factors affecting those rents (or any of them) except any distortion due to a scarcity of lets; and

(b) the current economic conditions in the relevant sector of agriculture.

(5) The Land Court shall not take into account any increase in the rental value of the holding which is due to improvements —

(a) so far as —

(i) they have been executed wholly or partly at the expense of the tenant (whether or not that expense has been or will be reimbursed by a grant out of moneys provided by Parliament) without equivalent allowance or benefit having been made or given by the landlord in consideration of their execution; and

(ii) they have not been executed under an obligation imposed on the tenant by the terms of his lease;

(b) which have been executed by the landlord, in so far as the landlord has received or will receive grants out of moneys provided by Parliament in respect of the execution thereof,

nor fix the rent at a higher amount than would have been properly payable if those improvements had not been so executed.”

[5] No issues were raised requiring consideration of subsections (6) to (9).

[6] It may be noted that, in the material which follows, we use the expression “the subjects” to refer to the holding in respect of which rent is to be determined. This will normally refer to Moonzie but in discussion of some aspects of valuation practice the meaning will be clear from the context.

Inspection

[7] We carried out an unaccompanied inspection of the farm on 22 February 2010. Although we did not attempt to examine the interior of any of the residential accommodation we were able to familiarise ourselves with the subjects. Having regard to the nature of the issues in dispute and the agreements reached we are satisfied that we had adequate evidence of the physical characteristics of the subjects without any need for further inspection.

Background and brief description of Moonzie

- [8] The tenants are the executors of Thomas Herbert Paterson who died on 4 December 1973. He was tenant of the subjects under a written lease. However, no formal steps were taken by the executors to succeed to the tenancy because neither they nor the landlord appreciated the need for such steps. The executors were allowed to continue to occupy the farm and paid rent for it. For the reasons more fully set out in the decision of the House of Lords in 1985 in *Morrison-Low v Paterson's Executors*, a valid new lease was deemed to have been established by inference. The terms of this lease are, therefore, governed by common law and by the provisions of the relevant legislation. The parties had entered into certain Minutes of Agreement but these were of limited scope and the one current at the assessment date, 4 December 2008, insofar as relevant, related only to rent and to the cottages on the farm, as discussed further below.
- [9] Moonzie Farm is situated approximately 4 miles north west of Cupar. It extends to 192 hectares or thereby and includes some 61 hectares of Class 3(1) and some 90 hectares of Class 3(2) land in terms of the Land Capability for Agriculture classification by the Macaulay Land Use Research Institute. The land is designated as non Less Favoured Area (non LFA). It lies between 60 and 135 metres above sea level with the farmhouse and steading situated fairly centrally near the top of Moonzie Hill. The land slopes both gently and, in places, quite steeply from Moonzie Hill. The property is adequately serviced by both public roads and farm tracks.
- [10] The holding, in December 2008, was operated principally as an arable farm with cereal cropping, rotational potatoes and permanent pasture. Crops of winter wheat, winter oil seed rape and spring barley were grown. Hay was harvested and sold from the permanent pasture with no livestock being kept. The fencing was in poor condition. Potatoes were grown in most of the fields although some thin, steep or stony areas were excluded. The farm has no irrigation and no obvious access to water for that purpose. The tenants were also involved in contracting work off the farm, using the subjects as a base.
- [11] The fields to the south of the farm buildings tend to face in a southerly direction, the fields to west in a westerly direction and to the north they have both a northerly and a southerly aspect as the land falls from Moonzie Hill and then rises again towards the summit of Colluthie Hill which is just to the north of the farm.
- [12] The farm has a substantial, attractively positioned, farmhouse with a southerly and easterly aspect. It has 3 cottages all stone built and accessed from the public road which leads to the farm and the former Moonzie Church. A range of mainly traditional and some modern farm buildings make up the farm steading. The traditional buildings have limits to their utility due to low roofs and narrow access doors. The most modern is an enclosed steel framed general purpose shed provided by the landlord. It has a concrete floor and brick walls which allow grain to be held. Temporary storage occurs at harvest here and in other buildings. Various buildings have been provided by the tenant.
- [13] As the parties were agreed about the rental implications of the fixed equipment provision and the main aspects bearing on the potential earning capacity of the holding it is unnecessary to provide further detail.

Witnesses

- [14] There were few factual issues in dispute and we make reference to the evidence bearing on disputed issues in the discussion below. We had to consider a large number of documentary productions but it is unnecessary, for present purposes, to set out any of the detail of them. The expert witnesses for the landlord were Mr Siddle and Mr Addison-Scott and for the tenants, Mr Hall and Mr Henderson. Each provided a written report and we do not attempt to summarise the detail of what they said. However, we provide brief summaries to indicate the broad scope of their evidence and the evidence given by the other witnesses.

- [15] David John Lothian Siddle BSc (Hons) Agric (42) is an agricultural consultant. He is a partner in Andersons Northern, farm business consultants, and is based in Penicuik. He was instructed by the landlord and Mr Addison-Scott to prepare a budget showing the potential earning capacity of Moonzie Farm as assessed at 4 December 2008. He visited the farm and the budget was prepared and submitted by him. He had also been involved in preparation of other budgets for Mr Addison-Scott and these had been used to help determine the level of rent sought by the latter in relation to a range of other farms. In preparation of the budget for Moonzie he had relied on certain assumptions specified by Mr Addison-Scott, relating, for example to the tenant's ability to sub-let land for potatoes, treatment of cottage lets, and in relation to fixed equipment.
- [16] Mr Siddle used to work with Peter Hall at Laurence Gould. He had discussions with Mr Hall shortly before the hearing and during the course of the hearing which led to agreement on a range of matters. This led to some changes in his original budget. The most important disputed area addressed in his evidence was the proper treatment of fertiliser costs. He had included a full allowance for SFP as part of the farm income in all his budgets.
- [17] Christopher Barr Addison-Scott MRICS (51) is a partner in CKD Galbraith at Cupar. He himself has a farm near Moonzie. He was instructed by Richard Morrison-Low and advised him on rent review before the notice was served. He had long experience of farm rent reviews. He was involved with 40 to 50 rent reviews in 2008 and the company handled 50 to 60 rent reviews at that time. He had settled all except this one. His negotiations had sometimes been direct with tenants and sometimes with their agents. He had calculated the rent for Moonzie based on the budget and the knowledge he had from the other farm rents he had agreed.
- [18] Michael Graham John Reid MRICS (41) is another partner in CKD Galbraith in Cupar. He was led to give evidence of rent reviews at Skelpie and Waltonhill and at Cults farms in the Cupar area. He explained in evidence how he had conducted the reviews with the tenants and what issues had been considered. The aim had been to fix a rent under the provisions of section 13. He had relied on the sample budgets and the firm's experience. He said he had been able to agree the rents without difficulty.
- [19] Jonathan Robert Mitchell Henson MRICS (43) is a director of Savills and head of their Rural Department in Scotland, based in Perth. He acted for Wemyss Estate in Fife. He gave evidence in relation to the rent agreed at Little Raith Farm which had been a comparable relied on by the respondents. He and the tenant had looked at the farm on a field by field basis. An analysis was made of each field and this was tallied up to form the basis of the farm rent. Other issues were added in or taken account of in calculating the final agreed rent. There were some good arable fields and the rent was effectively £65 an acre. He said the discussion had been very amicable.
- [20] He gave evidence of the steps taken by Wemyss Estate in relation to rent review in 2008. This had followed a good year in 2007 and had also been influenced by a high open market rent obtained at The Peel. Although he had thought that his proposed figures were realistic, the Wemyss landlords had come to take the view that because of adverse conditions in 2008, it was not appropriate to seek any increase in that year. They had, indeed, voluntarily decided to discount rents in that year by 15%. As we did not hear further detail of these tenancies we cannot take anything from this material although it did tend to indicate that one landlord, at least, took the view that conditions at the end of 2008 were not favourable to tenants. Mr Henson gave evidence on various points of detail including matters which were eventually agreed such as cottage letting. He said that because of the price of potash and phosphates in December 2008, several farmers decided to take a break from application of these fertilisers.
- [21] Richard Walter Morrison-Low (50) is the landlord of Moonzie. He farms, in hand, an adjacent farm at Kilmaron. This extends to 600 acres and is operated on a similar rotation to Moonzie. He had little knowledge of Moonzie before the 1970s but since then he has considered the rent to be low and has tried to get regular rent reviews to get the rent to catch up. In 2004 he did not get the market rent he wanted. He started the present review in 2007. He attempted to discuss matters

with the tenants but when he received no reply to correspondence he engaged Mr Addison-Scott to take over. He had no objection to sub-letting for potatoes. He dealt in some detail with matters relating to the cottages and also gave evidence in relation to fertiliser use and the state of agriculture in December 2008.

- [22] Peter William Hall MSc Animal Production BSc (Hons) Agriculture (40) is a director of Laurence Gould Partnership based in Dunfermline. He is an agricultural consultant involved in a wide range of farming businesses across Scotland and North East England. He is experienced in preparation of budgets and cash flows. He prepared a budget for Moonzie after discussion with Mr Henderson. Based on these discussions, he made certain assumptions in relation to matters such as sub-letting of ground for potatoes, fixed equipment provision and cottage lets. His budget had been revised following a meeting with David Siddle. Most figures were agreed. The main difference was fertiliser where the only dispute was on the rates of application to be included.
- [23] Angus Cameron MacCall (59) is tenant of Culmaily Farm, Golspie, Sutherland He is Chairman of the Scottish Tenant Farmers Association (STFA). His role as Chairman is to support tenant farmers' interests. He was questioned about a wide range of matters relating to the way a tenant farmer would approach the negotiation of rent. He explained that the cost of going to the Court played a big part in a tenant's thinking. Tenants were prepared to pay a higher level of rent than they would otherwise have done, simply to avoid the risk of being taken to court. He explained that there was an insurance scheme available to tenants. It covered their liability in expenses up to £50,000 subject to certain conditions. In cross-examination he said that tenants not only paid more than they thought appropriate simply to avoid risk of litigation but paid more than they could really afford. They lived in hope that things would improve. The legal expenses cover only applied where a case reached the stage of final determination by the Court. If there was any settlement or agreement, the policy did not operate. He was asked to comment on the terms of various articles he had written over the years, critical of landlords in general in their approach to rent review. He confirmed that he had strong views on that matter which had not changed. He gave some general evidence about farms. He said there were about 4,500 to 5,000 "1991 Act" tenancies, with some 700 under limited partnership arrangements; 300–400 limited duration tenancies; and some 700 short limited duration tenancies. Some tenants had more than one holding. He gave some general evidence about the economic outlook in 2008. He thought it had been poor for arable farmers.
- [24] Hamish Lean (48) is a solicitor and partner in Stronachs, Aberdeen. He is the agricultural law Partner and is accredited by the Law Society of Scotland as an Agricultural Law Specialist. He is a member of the Scottish Agricultural Arbiters and Valuers Association, the Agricultural Law Group, a professional member of NFUS, and a member of SRPBA and STFA. He operates the legal helpline for STFA and has done so for the past three to four years. He has extensive experience of farm tenancies. However, it has only been since 2007 that he has been involved in rent reviews and he has advised in relation to about 15 to 20 of these, including those at Wardmill and Baggerton. His advice generally was to reach agreement and, specifically, that in order to avoid risk of Court expenses, it would be prudent to settle at a higher figure than the tenant might find comfortable. He had advised all his clients of his view that SFP should not be included as part of the farm income in assessment of rent but that that there were various doubtful questions of law in relation to this and other aspects of section 13. He assumed landlords would have received similar advice. He accepted that they, too, would be reluctant to incur the cost of litigation if they could avoid it, but thought they had the advantage of deeper pockets. Some clients had settled at a level they did not expect to be able to afford simply hoping all would turn out well but unwilling to risk expenses.
- [25] Edward Cameron Henderson MRICS BSc (Hons) Agriculture (44) is a partner in Hendersons, Chartered Surveyors, which is a family partnership. He has worked on landlord and tenant issues, professional valuations, and compulsory purchase with utility companies. In 2008 he was consulted by several tenants about rent reviews. He had been involved in six formal processes. He had advised on another 12 to 20. He had been consulted by the present tenants in the previous

case in 2004. He had inspected the holding, the buildings, the fixed equipment and the land and had prepared two reports.

- [26] He gave evidence on his budget and on his reports. He gave his opinion of the problems relating to the tenants' comparable units which had all been withdrawn at various stages. He explained the methodology of detailed analysis of comparable units so as to allow them to be compared to Moonzie. He referred to the decision of the arbiter in the *Southesk* case. He thought he had followed similar methodology in giving equal weighting to the budget and to the comparables. In his view, the allowance in relation to SFP should be no more than the naked acre value of £6.00 to £6.50 per acre. His evidence covered the range of disputed matters, including his views on the difficulties of contractual arrangements, other than let, for potato growing, and on fertiliser costs and application rates.

Detail of Comparables

- [27] The landlord initially gave notice of five specified comparables and added two in response to proposed comparables referred to by the tenants. Six of the comparables related to rents fixed by agreement with sitting tenants. The other, at Birkhill, was an open market let on a short limited duration tenancy (SLDT). We provide further details of these comparables in Appendix II. There was no attempt by the landlord to provide any detailed analysis of the comparables in order to derive a figure for Moonzie. He relied on evidence of Mr Addison-Scott's expert assessment, based on his over-all experience of negotiation of rents with sitting tenants in 2008.
- [28] We heard that Mr Addison-Scott had approached his negotiations by obtaining a budget from Mr Siddle for each of a range of sample holdings. He had had about half a dozen examples. He had been able to agree rents based broadly on these budgets. His approach was to explain these budgets to other tenants and invite their comment on their own specific circumstances. There had been full discussions. The aim was to obtain a rent assessed as it would be under section 13. He said he had never thought to include any element of marriage value. He had not had regard to any other holdings or other land operated by individual tenants. Each rent was assessed solely in relation to the individual farm. There was, he said, no indication of any special relationship with the landlord influencing tenants. Indeed, some discussions had been fairly robust.
- [29] He used the information from all these agreed figures to derive a rate per acre for different classes, or grades, of land. He then applied these figures to the different classes of land at Moonzie. He had selected his specific comparables on the basis of their similarity to Moonzie and we accepted them as reasonably comparable. However, he had not adopted a method of making specific allowance to offset different features such as different standards of provision of equipment or different repairing obligations. He was, accordingly, unable to explain the detail of his comparative calculations. But he stressed that he had used his professional judgment based on wide experience of the varying circumstances of the different rents he had agreed. An important part of his evidence was his professional view that the SFP was simply to be regarded as one of the earnings of the farm. All other rents had been settled on that basis as far as he was concerned. That had been explicit in his budgets. No tenant or agent acting for any tenant had sought to suggest to him that SFP should be excluded or treated in any different way.
- [30] We have no doubt that, in practice, an assessment based on wide experience and understanding of the material in question may be quite reliable. But, in court it is expected that an expert witness will be able to explain his method in detail. At the end of the hearing it was not disputed that, for the purpose of expenses, Mr Addison-Scott could be treated as an "expert witness". But, it seemed to us that his role in this case was largely as a witness to fact. It would, accordingly, be inappropriate to attach any personal criticism to him for the content of his evidence. It is sufficient to say that an expert witness requires to be able to explain his methodology to allow it to be understood and tested.

- [31] Although we had no positive evidence of how Mr Addison-Scott carried out the exercise of comparing the detail of Moonzie with the detail of the other 50 tenancies, we did hear his attitude to Mr Henderson's approach. He initially expressed himself as being unable to understand it. We found this comment surprising. The method followed by Mr Henderson in seeking to adjust the figures for other farms in a way which would allow them to be compared with Moonzie seemed to us to be a standard way of going about the exercise of assessment based on comparables. But, we came to understand that Mr Addison-Scott probably meant to do no more than express his view of the basis of assumptions which Mr Henderson appeared to have had to make in reaching his figures. He said they were not founded in reality. If Mr Addison-Scott's comments were intended to suggest that he, himself, had used some different method, it was a method he was unable to explain fully to us.
- [32] Because of our conclusions in relation to SFP, discussed below, we are satisfied that none of the settled 1991 Act comparables is capable of providing a proper basis for assessment of open market rent at Moonzie and it is unnecessary to say more about the detailed figures. We discuss below the evidence of the open market SLDT let at Birkhill.
- [33] The tenants had specified three comparables in their written pleadings. However, reference to all of these was withdrawn. There was some dispute between the parties as to the circumstances in which the tenants had withdrawn their comparables. It appeared that the individual tenants of these other farms had withdrawn their permission. However, although we recognise that, as a practical matter, a party to a rent review would not wish to upset another tenant by referring to their holding without consent, such consent is not necessary. Withdrawal of consent is not, of itself, an adequate reason for abandoning a comparable. For the present tenants it was suggested that the other landlords had, in some way, put pressure on their tenants to withdraw consent. What interest such landlords had to interfere in this way was not explained. But, in any event, we see no purpose to be served by attempting to reach a view on the conflicting evidence about individual tenants' reasons. The tenants' comparables can simply be ignored.
- [34] We did hear evidence of an open market let on some form of limited duration tenancy at "The Peel" which was, apparently, a farm on Dupplin Estates, near Perth. However, there had been no intimation of this in the pleadings of either party and the main use made of it was to help explain the attitude of landlords to rent review at the end of 2007. A figure of £170 per acre had apparently been agreed. We heard that the new tenant was a potato grower and merchant. But, as we heard only patchy detail and, in particular, no detail of the concluded lease, its duration, or of any agreed provisions for rent review, we can attach no weight to the figure discussed.
- [35] Mr Henderson had analysed each of the landlord's comparables and adjusted them to allow for factors which he said altered and, generally, reduced the comparable base rent, expressed as a rate per acre. As we have found it unnecessary to attempt detailed analysis of the comparables, it is unnecessary to deal with all Mr Henderson's proposed adjustments. It may be said that we do not doubt the general soundness of his method but we are satisfied that it is only appropriate where there is evidence that the factors identified have indeed been included in the original figure. It is sufficient to look at a few examples. Mr Henderson made an adjustment of 15% in relation to Skelpie and Waltonhill Farms based on marriage value of farm units through economies of scale. He pointed out that there were two holdings and an opportunity to spread the cost between them. Part of his allowance was based on the fact that the tenant also farmed Kinloch. However, the evidence of Mr Reid was that he and the tenant had agreed rent assuming the two units were to be treated as one and that Kinloch had played no part in the discussion. There may be little doubt that the tenant derived an advantage from economies of scale in being able to run Skelpie and Waltonhill along with Kinloch. But if the landlord and tenant had agreed a rent for the combined unit without any suggestion that Kinloch should be included, we do not accept that a deduction of 15% can properly be made. At Skelpie and Waltonhill, Mr Henderson deducted £2000 from the rent as an allowance for sub-let of two cottages. However, the landlord's evidence was that the parties had agreed that any possible rental income from the cottages, which were in poor repair, should not be included. Here again, if the landlord had

agreed that it should not be included, it is inappropriate to make a deduction on the basis of an assumption that it was in fact included.

- [36] By contrast, at Wardmill and at Baggerton, the sub-let of cottages at £1000 had been included by the landlord and we have no doubt that Mr Henderson was correct in these cases to take it out as part of his attempt to find a base rate per acre equivalent for use in assessment of Moonzie. However, at Cults, he deducted £2000 in respect of sub-let of a shed when the parties had excluded that because the shed was a tenant's improvement. We do not consider this an appropriate deduction.
- [37] In each of the cases where Mr Henderson made a deduction of an element which had not been included in the first place, we can see some force in the underlying argument that if a tenant is able to derive a financial return from his use of the farm, that may be a factor which tends to influence the level of rent he is prepared to agree. However, a tenant with the benefit of income which the landlord is prepared to exclude would be unlikely to include the whole amount in his calculations. In each of the sitting tenant cases, the tenants knew that they were attempting to identify the rent which would be fixed, failing agreement, by the Court in terms of section 13. There was no need for them to include allowances for the factors referred to and no positive evidence that they did.
- [38] It is appropriate, in light of the criticism of Mr Henderson's approach, to say a little more about his method in more general terms. We have no doubt that in the process of comparison there will nearly always have to be adjustment to strip out special features included in the rent agreed for any specific holding. Unless there is a comparator which is very similar to the subjects, the process of attempting to identify a base figure is a reasonable method to adopt in most circumstances. It may be added that because of the issue of economy of scale, we consider that attempts to identify a simple base figure per acre without reference to size of holding, may be misleading, but, as we have been unable to rely on comparables in this case, that point was not significant in our deliberations. We return, below, to the question of marriage value. But we have no doubt that if it has been included in a comparable – as it now frequently would be in an open market let – allowance must be made for it in attempting to identify the appropriate comparable base rate. It may well be appropriate to identify and exclude other special features such as the tenant's ability to use the subjects as a base for other activities. It might also be appropriate in some circumstances to make an allowance for the tenant's other sources of income.
- [39] It is also necessary to make some adjustment for the terms of the tenancy. Where there is a post lease agreement, the tenant will usually have undertaken additional liabilities in relation to renewal of fixed equipment. This would tend to lower the rent. Failing agreement, assessment of an appropriate allowance under this head would require close examination of the nature of equipment on each comparable. In the present case, the allowances suggested by the various witnesses ranged from 8 to 15%. Mention was made of the report in *Telfer v Buccleuch Estates* where reference was to an allowance of 20%. The precise figure would always depend on the nature of the agreement and the amount, condition, and standard of the fixed equipment. Deductions or additions under this head may be appropriate and we accept that this is a matter for assessment by an expert valuer.
- [40] It is appropriate to comment briefly on the proposed adjustments for "goodwill". While there are undoubtedly circumstances in which this element plays a part which may lead to a need to make some adjustment of rent, we would caution against any approach which simply assumes that because the landlord and tenant have a good relationship the tenant will be prepared to pay a higher rent. The reverse might as easily be said. We consider that allowance for goodwill should be limited to specific circumstances where there is evidence of it as a positive factor with a material influence on the rent. That will normally be where the tenant has an expectation of some provision being made by the landlord which is dependent on his goodwill and where the tenant may allow for that in the negotiation. We did not find persuasive some attempts made in the

present case to define goodwill by reference to the difference between an assessed rent and the actual level at which parties settled.

- [41] Where there is an open market rent, it may be necessary to draw inferences from limited information as to the factors which influenced a particular offer. For example, if the successful bidder is a neighbouring farmer, it may be assumed that some allowance should be made for an element of marriage value. But, where rent has been agreed for the purposes of section 13, we are satisfied that the approach must be based on an assumption that irrelevant factors have not been included. It is only appropriate to discount or adjust where there is evidence that specific factors had been taken into account in assessing the rent.

Submissions

- [42] Mr Kermack and Sir Crispin each provided detailed written submissions and it is unnecessary to set out the full detail of the arguments advanced. The nature of the conflicting contentions will appear from our discussion of the individual issues.

Discussion

- [43] The provisions of section 13 setting out how the Land Court is to determine rent may tend to convey the impression that the Court is required to carry out the whole exercise of fixing the proper rent simply on application by one or other party. Plainly that is not so. When Parliament appoints a court to do something it must normally be understood that it is to do so in its capacity as a court. In other words, it is to reach a determination after considering the evidence placed before it by the parties and hearing the competing submissions. The fact that the Land Court functions as an “expert court” does not change the essence of this. We are able to apply an expert understanding to the evidence presented but not free to rely on other material known to us unless it is consistent with that evidence. An expert court is free to take a different view of the effect of evidence from that contended for by any of the parties; in other words we can apply our own judgment and discretion to aspects of the evidence which require such judgment. But we are not free to contradict evidence by reference to material known to us from other sources unless that material has been explicitly referred to in course of the hearing and an appropriate opportunity given for comment on it. It may be added that while the aim of the Land Court is always to reach a sensible workable result, our prime duty as a court is to apply the law as enacted by Parliament.
- [44] We consider that the proper approach to be taken by the Court has some affinity with that to be taken by an arbiter. This was discussed in *Earl of Seafield v Stewart* at page 40. The Court accepted that the agricultural Members of the Land Court were in much the same position as an arbiter. The Court pointed out that an arbiter was appointed because of his special expertise and went on: “He may use this not only when judging the evidence but, above all, when inspecting the holding and any comparables proffered. For he has, in the end of the day, to determine the rent properly payable in terms of the statute and cannot hide behind the concept of onus of proof. He may indeed even have to exercise investigatory powers to obtain proper evidence or, in the event of a dearth of evidence, to introduce his own comparative evidence...”.
- [45] Some such dicta relating to investigatory powers must be treated with caution when applied to a court and, in any event, it is important to have regard to the further observations of the Court in that case. “Nevertheless, an arbiter must act judicially in accordance with the rules of natural justice which entails that he must divulge to parties for their comment at or before the hearing any specific facts or specific comparables on which he expects to base his rental determination. He must not use such evidence or information behind parties’ backs ... The basic requirement of natural justice in such circumstances is divulgement.”
- [46] We do not consider that it is the proper function of a court to “exercise investigatory powers”. While there may be circumstances in which it is sensible and appropriate for an expert court to make certain enquiries, it will always be essential for any material discovered to be fully

disclosed to the parties. In an adversarial system we think it clear that it is for the parties to present the evidence to the court. A difficulty may arise when our consideration of the matter after the hearing discloses areas where, as expert assessors, we might have wished further information. We are required to determine a rent. We may be able to fill gaps from our own expertise where it is consistent with evidence already before us but the scope for this is plainly limited and if any significant new material was to be relied on we would need to provide an opportunity for further comment.

- [47] As is widely recognised, the cost of litigation over rent is often likely to be out of proportion to the sums in issue in any particular case. It is perhaps appropriate to comment explicitly on suggestions that the Court should simply reach a sensible figure without the need for formal procedure. The idea that we should simply examine matters ourselves is superficially tempting but is wholly inconsistent with the role of a court. There can be no doubt that when Parliament gave the jurisdiction to the Court it must have intended normal court procedures to apply.
- [48] There is, however, no reason why parties should not agree that a simpler course be taken in any case. The 2003 Act removed the formal shackles of arbitration procedure and now allows parties to choose an informal method of fixing rent if they agree to do so. They could leave the matter to an agreed expert valuer. They could agree that the Court should fix rent on the basis of written submissions and inspection. Even if there are issues which require determination by a court, parties should always make every effort to agree or compromise as much of the detailed material as possible. It is perhaps worth making the point that there is a distinction between agreement and compromise. This is often lost sight of. Two experts in discussion may be unable to agree a particular point. Each may see it as black or white. If they are correct, the court's decision will be black or white. One side will win; the other will lose. Compromise means that rather than risk total loss – with a possible additional liability in expenses – some middle figure is simply accepted. It was an unfortunate feature of the present case that the attempts to negotiate and agree aspects of detail did not take place until after the Court took positive steps to encourage this approach. It should be obvious in every case that even when parties are well apart on proposed rents, the more matters of detail they can agree or compromise, the less money they will need to spend on litigation. But the Court cannot compel such agreements and we usually make the assumption that the parties will see the need to attempt this for themselves.
- [49] Although the present case is likely to prove an example of the expense of court procedure being well in excess of the sums involved in the short term between the individual parties, it is also an example of the justification for parties having a right to go to a court for a decision where agreement cannot be reached. Parties are entitled to have a court determine their commercial disputes. That is particularly important where there are issues of principle to be determined. It is plainly right that an opportunity is available for them to be examined fully in open court.

Section 13(2) and (3)(a) – disregard of tenant's occupation

- [50] In terms of section 13(2) the rent which the Court requires to determine “shall normally be the rent at which ... the holding might reasonably be expected to be let in the open market by a willing landlord to a willing tenant”. Although the word “normally” is still included, the section now makes no provision for any alternative basis of assessment. It was not disputed that the aim of the Court was to find the open market figure taking account of the various statutory “disregards”.
- [51] We did not hear much by way of analysis of the first main disregard. In terms of subsection (3)(a) we require to disregard the fact that the tenant is in occupation of the holding. It was not disputed that, in broad terms, this meant that we have to assume a tenant taking over a farm with vacant possession. We return to the question of whether the present tenants can be assumed to be a potential willing tenant on the open market in the context of consideration of the significance of SFP.

- [52] Mr Kermack did advance an argument in his pleadings to the effect that the use of the terms “landlord” and “tenant” meant that we had to assume that the relationship of landlord and tenant existed. He used it to support the contention that it was only the fact of current occupation which fell to be disregarded. We think there is no substance in this argument. We are satisfied that the use of the word “willing” points to an intention to refer to the desire of a prospective tenant to become tenant. Accordingly, use of the terms “landlord” and “tenant” cannot be taken to imply an existing relationship. The instruction to disregard the tenant’s occupation means that all the personal circumstances of the current occupation must be disregarded. Accordingly, it is neither necessary, nor appropriate, to assume that the incomer is taking over the farm as it exists December 2008. We must assess the potential of the farm as provided by the landlord and we have no reason to proceed on the basis of any assumption other than that it was being operated to the best of that potential at the time.

Section 13(3)(b) – disregard of scarcity

- [53] More was made of the proper approach to subsection (3)(b) which requires us to disregard “any distortion in rent due to a scarcity of lets”. As the two main approaches relied on by each side related to rents agreed with sitting tenants and evidence derived from assessed budgets, the issue of scarcity was not at the heart of the dispute in this case – as it might have been, for example, had there been direct evidence of open market transactions. However, it did arise in relation to the question of whether we were to assess the rent on the basis of a willing tenant negotiating a rent or a tenant trying to outbid all others in a competitive situation and the submission that such tenant would be prepared to treat income from SFP as something to be shared with the landlord. The essential proposition for the tenants was that we had to assume an equilibrium of supply and demand; by which was meant a situation where there were always as many farms available as there were tenants to take them.
- [54] Plainly our task is to consider and apply the language used in the legislation, but we are entitled to have regard to the fact that the language of section 13, as amended by the 2003 Act, is not significantly different from the pre-existing legislation. The reference to disregarding any distortion due to scarcity of lets cannot be thought to point to any intention to make a radical change by comparison with the earlier legislation where the substantive provision, read short, was to have regard to a market which was not affected by distortion, by scarcity of lets or by other factors. The exclusion of the reference to other factors by the 2003 Act simply focuses attention on distortion due to the scarcity of lets, it does not change that concept. We think it follows that the proper approach to section 13(3)(b) requires to be broadly on the lines taken by the Court in relation to the provisions as they stood before the 2003 Act.
- [55] In *Aberdeen Endowments Trust v Will*, the Court said:

“It will be seen, therefore, that open market value still remains the underlying Scottish criterion. It now, however, requires to be discounted to allow for any enhancement of rental values due to a scarcity of farms available for letting or to any other factors. If, however, there is sufficient open market evidence in an undistorted or reasonably balanced market, then full open market value....still prevails. Whether there exists sufficient open market evidence and a reasonably balanced market, must be a matter of judgment for the arbiter or this court to make. A reasonably balanced market, however, does not suppose an exact equality of supply and demand which can rarely, if ever, exist in practice. If such a complete hypothesis had been intended, this could easily have been legislated for along the lines already adopted in the Rent and Rating Acts.

The new provisions ... are thus designed to remove any enhancement in rental value due to a distorted market which sometimes resulted in levels of rent being determined by arbiters greatly in excess of going rates under agreements reached between other sitting tenants and landlords and possibly beyond the viability of the holdings themselves. Hence the aim, more easily expressed than calculable, of trying to remove any element of distortion due to scarcity of lets or other factors.” : (p25).

- [56] In *Earl of Seafield v Stewart*, the Court gave express consideration to the difficulty faced by an arbiter or valuer in making appropriate allowances. The Court said: "...an agricultural arbiter, when making a percentage discount for scarcity or other factors or an addition for inflation, may often have difficulty in going beyond the simple statement that he has made a stated percentage deduction or addition to represent such factors. It may be difficult however to explain why that percentage was chosen as opposed to any other. This is a matter of judgement. It is nevertheless necessary for the arbiter to state what he has done." : (p40). The Court referred to the observations of Lord Keith of Kinkel in the *Western Heritable* case. In relation to the making of a percentage discount, Lord Keith observed: "We are here concerned not with any rule of law but with an exercise of the valuer's professional skill." : (p75). In the present case, the Court is not sitting as a valuer but, like an arbiter, may have to make an expert assessment on the basis of the evidence before it.
- [57] It is unnecessary to reach any concluded view as to how any discount or adjustment should be assessed because the issue does not arise in this case. It is sufficient to say that it is very clear that the existing practice of the Court has been to take a practical approach. There is no question of the Court having approached section 13(3)(a) by attempting to assume an equal number of vacant farms and prospective tenants.
- [58] The argument for an exact equality of prospective tenants and available holdings was based on the decision in the *Western Heritable Investment Company* case. However, the provisions under consideration there were very different from the provisions of section 13. The dicta were aimed at the proper construction of the statutory provisions applicable to domestic dwellinghouses. Because of the excess of demand over supply, the open market had forced tenants to pay much more than they could afford. In order to provide suitable protection for the tenants, as a matter of policy, it was necessary to provide a test other than one based on the open market. In these circumstances, it is not surprising to find that the statutory provision in question – section 42 of the Rent (Scotland) Act 1971 – made no mention of open market. The aim was to find a "fair rent" and that was to be on the basis of an assumption spelled out in clear terms. It was an assumption "that the number of persons seeking to become tenants of similar dwellinghouses in the locality ... is not substantially greater than the number of such dwellinghouses in the locality which are available for letting on such terms". The Court construed that provision as requiring an assumption that the market was in a state of equilibrium in respect that the number of comparable houses available for letting was not substantially exceeded by the number of persons seeking to become tenants.
- [59] We are not persuaded that the dicta in that case provide any guide to the task of identifying "distortion" due to scarcity of lets. Dicta have to be read in context and the context was the construction of a very specific legislative provision. For completeness, we comment on two matters which might be potentially misleading. In the first place we note an observation by Lord Keith (p 74) where he mentions a "fair market rent". His comment relates to a passage in the opinion of Lord Dunpark where the reference is, in fact, to a "free market rent". Having regard to that context, it would seem that the reference to "fair" was a typing error. In any event, we are satisfied that it does not reflect an intention to introduce a concept significantly different from an open market rent. We also note the view of Lord Brightman that when the Act says that it is to be assumed that the number of persons seeking a house is "not substantially greater than the number of houses", this means that the number of persons seeking a house is to be assumed to be exactly the same as the number of houses available. That would be the effect of his definition of "equilibrium": (p 77). It must be said, with respect, that we find some difficulty in accepting that construction of the provision in question. An assumption of exact equality would, no doubt, exclude any element of competition whereas even a slight excess demand would maintain competition as a relevant element. However, as we do not regard the dicta as applicable to the provisions of section 13, nothing turns on this point.
- [60] It may be added that, as it seems to us, an assumed equality of supply and demand would radically alter the whole basis of land and rental values. In an open market, price is determined by the

conflict of supply and demand. The effect is that a balance, or equilibrium, of supply and demand is brought about by the mechanism of market price. In colloquial terms there is a market for everything if the price is right. In an economist's terms it may make little sense to talk about an assumed equality of supply and demand. In a commercial context, it can be assumed that there would always be a demand for a viable business opportunity. Accordingly, an assumed equality would, in effect, require an assumption of an unlimited supply. But in construing an Act of Parliament a more robust approach may be required. Exclusion of scarcity may be intended only to mean that there are as many farms available as the number of people actively seeking tenancies at the current time. That number will, no doubt, have been constrained by existing rental levels but such a concept might perhaps allow a rational approach to valuation if section 13(3)(b) did fall to be read as if it meant much the same as the provision under discussion in the *Western Heritable* case.

- [61] The issue arose in relation to discussion of marriage value and it provides an example of the artificiality of the concept of an exact equality of supply and demand. It was not disputed that, in the real world, we might reasonably assume that a number of neighbours or other farmers would be interested in acquiring Moonzie to acquire the benefit of being able to spread costs over a wider scale of operations. They would be prepared to pay a rent based on their commercial calculations as to savings made from more efficient use of their equipment and other resources. However, the argument based on equality of supply and demand led to the contention that if any given number of farmers wanted Moonzie we had to assume that a similar number of similar farms would be available. It was accepted that they would not have to be identical. They could not be in precisely the same location. So each of these hypothetical additional farms might, hypothetically, attract interest from its own neighbours who might, or might not, be interested in Moonzie. But then we would have to assume additional farms to match the interests of the additional prospective tenants. It was said to follow that there would be no place for a calculation of "marriage value". Adjacent farmers would not need to outbid other people wanting land. There would be ample land for all. As it seems to us, the same argument could be applied to any letting. The exercise of calculating a rent based on a hypothesis of assumed equality would not be one for practical valuers. It could not realistically be calculated by reference to the open market.
- [62] We are satisfied that our approach is properly guided by the settled approach of the Court in taking the evidence of open market rentals as a start point rather than seeking to assess a rent based on an artificial "equilibrium". We recognise that it is unnecessary to seek to support that by reference to policy. It is enough to say that in relation to commercial subjects such as a farm, it is clear that there is no policy consideration directly comparable with the policy underlying the Rent Acts. If there had been a policy to apply a "fair rent" rather than a market one that could have been expressed and guidance might have been given in relation to productive or earning capacity. But we find, in the Act, no such guidance. The requirement for the intervention of the Court in the rental process arises because the normal open market mechanism for fixing rents is not available when a tenant has security of tenure. In assessing the appropriate rent there is no need to shield him from the normal open market. But there is a need for protection from artificially high rents because of the risk that they would go "beyond the viability of the holding": *Aberdeen Endowment Trust, supra*. There would be little point in security of tenure if it came at a price the tenant could not pay. The reference to the open market as the test does not point to a policy of giving the tenant a favourable rent. Implicit in the concept of "distortion" is the idea that there exists, or might exist, some other, more "genuine" value which can be identified. If there was clear evidence of a market rent based on a reasonable number of comparable examples, there would be no need for any such disregard.
- [63] An example of an approach to assessment based on the potential earnings or profitability of the holding was available in the provisions of the English legislation dealing with rent: Agricultural Holdings Act 1986. It is clear that the Scottish Parliament did not opt for a similar approach. The choice of the open market as the basis of assessment cannot have been accidental.

- [64] It might be assumed that in a rational open market, a tenant would not offer a rent which went beyond the earning capacity of the holding: *C. E. C. v Gunn*. In the circumstances of the present case that is an important and helpful guide. However, it may be noted for completeness, that it is only accurate if earning capacity is viewed over a reasonable period. If there was an open market in farm tenancies under the 1991 Act, the benefits of security and a mechanism for controlled rent would be something for which tenants might well have been prepared to pay a premium for reasons not directly connected with scarcity. A tenant might well accept a rent in excess of the immediate productive capacity of the holding if he expected the real value of earnings to overtake the rent before it fell to be reviewed.
- [65] The only open market transaction relied on in the present case was Birkhill which did not relate to a “1991 Act” tenancy. Although information derived from the freely negotiated rents of sitting tenants might on occasion appear to be tainted by scarcity – as, for example, in *Kinnaird Trust and Boyne* – evidence of going rates under agreements reached between other sitting tenants and landlords will not normally be at risk of such distortion: *Aberdeen Endowment Trust*. It was agreed that no element of scarcity arose in that context, in the present case.
- [66] It was in connection with the alternative basis of assessment, advanced on the basis of the snapshot budgets, that the parties appeared to focus their dispute over the issue of “scarcity”. Mr Kermack suggested that the proper approach to the budgets was to have regard to the element of competition. A conservative budget simply would not “win” the tenancy. Sir Crispin contended that as there had to be an assumed equivalence of demand and supply there was no place for competition. Rent fell to be assessed on the basis of a deal freely negotiated between the willing landlord and one willing tenant.
- [67] For reasons set out above, we do not accept the approach contended for by the tenants but, in any event, we do not consider that the precise implications of the concept of “scarcity” have any useful bearing on the matter. The implication of an open market test is that the landlord is entitled to the highest figure which would be obtained in a normal market. That was discussed by the Court in *C.E.C. v Gunn* by placing some emphasis on the element of competition. However, we do not consider that reference to the element of competition, as such, is of major importance in relation to our assessment. Lease differs from outright sale in that the landlord retains an interest in the subjects. As explained in that case, he will not simply take the highest offer but will have regard to the long term interests of the holding. He will consider the basis upon which the offer is made. There is, accordingly, no justification for assumption of any irrational competitive impulse. We are to make an assessment. If the snapshot budget was to be the basis of the rent, we would have to make a realistic assessment and determine what rent the successful candidate would have had to offer to beat other offers. We must assume rational parties. We consider that, although the element of competition is not to be ignored, the exercise we have to carry out is closer to the concept of a figure freely negotiated between a willing landlord and a willing tenant than that of trying to guess the rent which might be offered by an eager competitor intoxicated by the atmosphere of the auction ring.
- [68] Mr Kermack’s main point was that a prospective tenant, who was prepared to make an offer treating the SFP as earnings of the farm, would inevitably beat one who had no SFP or one who was not prepared to offer it to the landlord. It followed, he said, that we had to assume that the successful tenant on the open market was one who not only had SFP entitlement but was prepared to treat it as farm income. However, it might equally be said that any prospective tenant who had an additional source of income which he was prepared to treat as farm income would be successful if his additional source of income was large enough. The determination of what is to be treated as part of the potential earning capacity of the farm is a matter for the Court.

Section 13(4)(a) The relevance of different types of tenancy

- [69] The provisions of section 13(4)(a) direct the Court to have regard to information about rents of other agricultural holdings. We are to have regard to the dates when rents were fixed and to any

other factors affecting those rents. There is a further provision which appears to direct the Court to disregard information about scarcity but it was not disputed that this appeared to have been inserted simply to avoid any possibility of double discount. It was not suggested that this provision had any separate significance.

- [70] The dispute in relation to subsection 4(a) related to the scope of the term “agricultural holdings”. For the tenants it was contended that it related only to a holding under the provisions of the 1991 Act. The argument was based on the proposition that where an Act gives a definition by reference to a definition given in a specific section of the Act, that definition can only apply to subjects that are governed by that Act. We do not accept this as sound. It was not supported by reference to principle or authority. Sir Crispin also attempted to support his contention by reference to the contrast between section 13 and the terms of section 9 of the 2003 Act. Under that section, which relates to review of rents of limited duration tenancies, the Court is directed to have regard to information about rents of “other agricultural tenancies”. It was suggested that this meant that the reference in the amended 1991 Act to “holdings” must have been intended to have a more limited meaning than “tenancies”.
- [71] We recognise that where there is a change in language there may be assumed to be an intention to provide a different meaning. But this is not a weighty presumption and, in any event, it does not, in itself, provide a guide to what that different meaning might be. “Agricultural holding” is defined by section 1 as being the “aggregate of agricultural land comprised in a lease”. In terms of section 84 a “lease” includes a letting of land for a term of years. There is nothing in section 13 to qualify that definition. It is plainly wide enough to cover a lease of limited duration.
- [72] We agree with Mr Kermack’s contention that if support for this construction is required it can be found in the fact that Parliament must have recognised that new lettings in terms of the 1991 Act would be few and far between. The intention of the 2003 Act was to replace them by limited duration tenancies. The risk of an arrangement for use of land being found to be governed by the 1991 Act was excluded by the provisions of section 1(2) of the 2003 Act and, in any event, accidental creation of a 1991 Act tenancy would not provide an example of a freely negotiated open market rent. Further, the heading of said section 1 is: “Application of the 1991 Act to agricultural holdings”. This tends to show that holdings governed by the terms of the 1991 Act were seen by Parliament as no more than one class of “agricultural holding”. This view is supported by the terms of section 1(4) of the 2003 Act which was the Act which amended section 13. We see no reason why Parliament would have intended to restrict the evidence available to the Court. We do not accept that it would have done so by way of an indirect inference of the nature contended for by the tenants in this case.
- [73] In short, we are satisfied that regard can be had to information about rents of any land held on a limited duration tenancy, including a short limited duration tenancy. We must simply have regard to the implications of the different terms and conditions in the same way as we have to have regard to different terms of any lease relied on by way of comparison.
- [74] Sir Crispin contended that the word “comparable” should be limited to an open market let of a 1991 Act tenancy. However, we think that the term “comparable” in this context can sensibly be used to refer to any transaction which is capable of analysis to provide relevant information relating to the proper rent of the subjects by a process of comparison. Even where the circumstances of such a transaction are quite different it may properly be regarded as a “comparable” if it is possible to identify and allow for the differences. If that cannot be done, the term “comparable” would not be appropriate although information from such a transaction might still be available as a factor to take into account.
- [75] Although it is clear that it would be rare to find an open market let on 1991 Act terms, we heard that a number of farms had been let on limited duration tenancies. The evidence was of between 300 and 400 such tenancies. As Mr Kermack pointed out, these must all have been since 2003 when this type was first introduced and this evidence does not support any finding of a scarcity of

lets. We are aware that many such tenancies were agreed as part of compromise settlements between existing landlords and tenants and Mr Kermack did not suggest that all would be open market. However, we accept that many would be new tenancies. Mr Kermack instanced Birkhill and The Peel as examples in the present case.

Section 13(4)(b) – Current economic conditions

[76] Under section 13(4)(b) the obligation to have regard to “current economic conditions” is part of the overall exercise of trying to determine the open market rent. Although both parties appeared to accept that a “snapshot” budget as at the date of assessment would provide a proper reflection of current economic conditions, we are not persuaded that the language used is capable of supporting the weight given to such budgets in the present case. The exercise of seeking to derive the rent from a formula based on an allowance for comparable evidence on the one hand and a figure derived from such a budget on the other, while attractive in giving an appearance of precision, is not, in our view, justified by the Act.

[77] At first sight, a requirement to have regard to “current economic conditions” seems to be no more than a reminder of the need to allow for any changes in economic conditions between the date when any rent relied on as a comparator was fixed and the date of assessment. Any valuer making an assessment on the basis of a comparison would have to have regard to the date when the rent was fixed in the comparator and to any relevant changes since that date. Change in the economic conditions in the relevant sector would simply be one of the changes to be taken into account. In *Shand v Major Christie’s Trs* the Court accepted that this would be the obvious meaning and said that although it was an unnecessary provision, it “at least did no harm”. However, the Court went on to recognise that the provision in the former legislation stood as a separate instruction to the Court or arbiter. Clearly the present provision also stands as a distinct and deliberate provision although it is not couched in terms indicative of an intention that it should provide a distinct method of assessing a rental figure. In *Shand* it was said that: “...it must be a decision taken after consideration of the evidence, as to how [the sub-section] should be applied to the practical valuation.” The point is, perhaps, most clearly illustrated by considering a contemporaneous comparator. If a rent was fixed by agreement at or near the valuation date, the current economic conditions in the relevant sector would have been taken into account by the parties. There would be an obvious element of double counting if any further allowance was made. It must always be a question of circumstances.

[78] As discussed above in relation to “scarcity” we are satisfied that the change in the lay-out of the provisions does not demonstrate an intention to change the meaning of the words used. The same expression was considered in a variety of cases under the previous legislation. In *Aberdeen Endowments Trust*, the Court said that the expression meant “the general trend in economic conditions which are known at the time of the hearing.” : (p32). In *NCB v Wilson* (p28), the Court accepted that it was proper to have regard to prices and costs as part of the assessment of economic conditions but looked at these in a very broad way as demonstrating trends rather than as the basis of a full calculation. In the present case, Sir Crispin suggested that by “current economic conditions” was meant “the economic conditions applicable at the time of offering for rent and how these conditions would affect an offer to be made by an incoming tenant for the next three years”. He made the point that it was not concerned with conditions beyond that period.

[79] Reference was made to a Ministerial Statement made to a Parliamentary Committee. The relevant passage was in the following terms:

“Amendment 62 would give greater weight to economic factors, which I understand tenants want. In that regard let me make it clear that we would expect new section 13(4) of the 1991 Act to be interpreted so that no less weight is given to “current economic conditions in the relevant sector of agriculture” simply because it is listed as (b), after “information about rents of other agricultural holdings”.”

Evidence of ministerial statements is admissible where the language of the statute is ambiguous, where the ministerial statement has been made to Parliament prior to the passing of the provision in question and where it is in itself clear and unambiguous: *Pepper v Hart*. We do not find that the meaning of the statement by the Minister was clear. It is not clear what ambiguity it might be said to resolve. It has been suggested that it meant that both sub-sections should have equal weight. We see the force of the proposition that one provision should not be subordinate to another simply because it is listed second. But it would be hard to treat that as meaning that each provision should have equal weight in each case. A simple reference to “current economic conditions” could not, of itself, provide a figure for rent. This might also be true of the provisions of sub-section (4)(a). The weight to be given to the information about other rents will vary from case to case, depending on the nature of that information. If it is to be given equal weight with “economic conditions” in each case this would require all pieces of information to be given equal value which cannot have been intended.

- [80] We are satisfied that if Parliament had intended to refer to an assessment based on a precise budget it would have seen the need to use language more specific than a reference to current economic conditions and a need to show the intention to make a change from the Court’s established approach to that term. The provisions of the corresponding English legislation would have provided an example of how that might be expressed and, perhaps, also illustrated the difficulties inherent in any prescriptive provision on such lines. In the present case, the parties’ submissions on figures came close to making an assumption that the words “current economic conditions” were equivalent to “the figure derived from a budget based on expected costs and returns as viewed at the date of assessment”. Such a construction might have allowed a sensible meaning to be given to the Minister’s statement but we are not persuaded that there is adequate justification for construing the language of the statute in such a precise way. Reference to a budget does not, as such, provide a figure for rent.
- [81] For avoidance of doubt, it should be added that matters were not expressed to us in such explicit terms. We think that the problem arose largely from the way things were laid out in the written reports. For example, Mr Hall’s budget was labelled “Budget for 2009”. When the point was raised by the Court, the witnesses did not dispute that it was appropriate to look further forward. In respect of certain elements, such as income from agri-environmental schemes, it was agreed that it was appropriate to take a figure based on average of expected earnings over three years. We do not know to what extent a similar approach informed any of the agreed figures.
- [82] In any event, we have no doubt that analysis of the potential earning capacity of the holding is of fundamental importance whether it is justified under the express terms of the statute or simply a matter to which we are entitled to have regard. This would follow the practical approach taken by Mr Barraclough as arbiter in *Southesk Farms v Amber Agriculture Ltd*. He considered the very wide range of information provided for him in that case, such as statistics and publications bearing generally on economic conditions in farming. He accepted that a farm budget could be relied upon as part of that evidence but took it as falling into the category of being a valid source of information outwith the express statutory categories. The essential point is that we accept that the open market rent would not be one which was beyond the capacity of the holding: *C.E.C. v Gunn*. Regard must therefore be had to a budget of some sort. The difficulty which appeared to us to arise from treating the expression “current economic conditions” as if it actually meant a figure derived from a single budget at the date of assessment, was that too much concern appeared to be focussed on that date. Farming is a long term activity. We cannot accept that the effect of section 13(4)(b) is to compel us to assess rents on the basis of a budget prepared simply as a snapshot on that date. The chosen date might have been a comparatively high point. The matter hardly requires illustration but the evidence relating to fertiliser does provide a good example. There was clear evidence that cost tended to follow the prices obtained for grain but lagged behind these prices. Assessment based on a single date would inevitably mean that any such pattern, however well established, would be ignored. We are satisfied that the broader

approach of using the evidence of current economic conditions simply as an important factor in assessment is consistent with authority and with the approach a tenant would take in practice.

- [83] As will be seen, we have found ourselves unable to derive any real assistance from the various comparables advanced in the present case. In that situation, an assessment based on potential earning capacity is the only rational method open to us. As an expert court we have a broad awareness of conditions in the relevant sector of agriculture in the years preceding the assessment. Although it is clear that, by comparison with preceding years, 4 December 2008 was a fairly low point, we accept that the effect of subsection (4)(b) means that figures available at that date will be an important starting point. Any variation of them would require to be based on an informed view as to the evidence which would reasonably be assumed to be available to the incoming tenant, including evidence of informed judgments by others in the industry such as market predictions.
- [84] Mr Henderson, Mr Hall and Mr MacCall all gave evidence of general economic conditions at the end of 2008. The outlook for arable agriculture could be summarised as “gloomy”. Reference was made to several newspaper or magazine articles discussing particular factors supporting that view. Mr Kermack made the point that newspapers and magazines contained such a wealth of varying material that it would always be possible to find opinions supporting one side or another. It is, perhaps, enough to say that we heard little or no positive evidence from the landlord’s side suggestive of any particularly optimistic outlook in late 2008 and the relatively gloomy outlook spoken to by these witnesses reflects our own awareness of conditions at the end of that year.
- [85] We, accordingly, consider that it is appropriate to accept the figures agreed by the witnesses as the basis of their budget. It was not disputed that the founding basis of their figures was the state of knowledge in the late Autumn of 2008. We discuss below our approach to the figures which were in dispute. We have attempted to assess them on the basis of the position of an experienced practical farmer viewing a three year period.

Single Farm Payment

- [86] It is clear that the issue of SFP is of critical importance not only to this case but to the level of rents across the whole tenanted sector in Scotland. There can be little doubt that, if not all, then the vast majority of tenants who have negotiated rents since 2005 have been prepared to treat their income from this source as part of the farm income to be shared with the landlord as rent. Where SFP is included in a budget it is typically found to be at a level which makes it the dominant element in the “profit” of the whole enterprise. If such payments are not to be included, there will inevitably be a significant fall in rents.
- [87] However, land values are always to some extent at the mercy of change of policy. Planning policy is, perhaps, the most obvious example, but it is plain that changes in an agricultural support regime may have an effect on values. In *R v Ministry of Agriculture, Fisheries and Food, ex parte, Country Landowners Association* it was acknowledged that the allocation to tenant-producers of quotas which were freely transferable had an adverse impact on the capital value of the land. Plainly, the adverse impact would come from the drop in rental value. The question in that case was whether there was any obligation to compensate for such loss. That issue does not arise in the present case.
- [88] We shall come to look in more detail at the legal basis of SFP, but we start by considering the matter from a practical point of view based on the undisputed evidence of its main features.
- [89] The essential features of the SFP scheme as matters stood on 4 December 2008 were not in dispute. SFP entitlements had been allocated to occupiers of land who had been in receipt of various forms of subsidy during the “reference period” which was from 2000 to 2002. It was not disputed that the subsidies received at that time were properly regarded as part of the farm income. The entitlement was calculated by reference to the total subsidies received during the

reference period. A person holding entitlement required to have occupancy of matching hectares of farm land for a period of at least 10 months in the relevant year in order to qualify for payment. The scheme was due to run until 2012. Persons holding entitlement would, therefore, normally expect to receive an income each year until then as long as they were able to obtain rights to occupy the necessary matching hectares. A farmer whose entitlement was based on a holding such as Moonzie might expect to receive at least £35,000 each year. The so-called “parish average” was agreed to be £233 per hectare. It may be noted, for completeness, that such figure would not necessarily be applicable to every hectare but nothing was said to turn on this detail.

- [90] Any tenant of Moonzie would be able to use hectares at Moonzie to match his entitlement and meet the necessary conditions for payment. However, he could meet it by leasing other land. There was a ready Scottish market in “naked acres”. These were typically stretches of hill land, often of little agricultural value, and they could be rented for about £6.50 per acre. Payment under the scheme was also subject to various conditions but in relation to the type of land involved in naked acres, compliance was not regarded as an onerous requirement.
- [91] A person holding entitlement could sell it. There was a ready market although numbers were comparatively low. A typical price in December 2008 would be about two and a half times the expected annual payment. An incoming tenant could buy entitlement.
- [92] It was not disputed that the effect of SFP was to decouple subsidy from production. Mr Kermack agreed that it was properly described as “income support” for farmers.
- [93] In the context of section 13 there are two distinct issues to be addressed. In the first place is the question of whether the willing tenant is to be taken to hold a suitable level of SFP entitlement. The second is whether the payment stream flowing from it should be regarded, in whole or in part, as part of the earnings of the holding.
- [94] Mr Kermack contended that the successful tenant had to be taken to be efficient, experienced and adequately resourced: *C.E.C. v Gunn*. It followed, he said, that such person would have sufficient entitlements of sufficient value to secure an appropriate yield of payment from the holding.
- [95] An alternative line of argument was that section 13 did not require the Court to disregard the sitting tenant as a potential tenant. Although the holding was to be taken to be vacant, the present tenants could be considered as a potential tenant on the open market. They would come adequately resourced with resources which well fitted the holding. They would be likely to be the successful offeror. They would have a SFP entitlement. The position was also said to be analogous to that in *Broadland Properties v Mann*. Mr Kermack suggested that the allocated milk quota would not have been allocated to a completely new tenant notionally coming in on the valuation date but was held by the sitting tenant. The Court had concluded that it was an item on which he should be rented.
- [96] Where there is security of tenure some provision for assessment of rent is required to deal with the fact that security prevents the open market from being available as a mechanism. We consider that section 13 need not be read as going further than necessary to achieve such an alternative mechanism. In that context, a requirement to “disregard any effect on rent of the fact that the tenant is in occupation” or words to that effect, is plainly necessary. A unit offered on the open market with a sitting tenant would inevitably attract a lower rent than one offered with vacant possession. This provision does not, however, require us to ignore that tenant altogether. We accept that the existing tenant may be taken to be a potential tenant on the open market: *FR Evans (Leeds) Ltd v English Electric Co Ltd*.
- [97] We accept that the basis of allocation of SFP allows a finding that all, or virtually all, existing farmers are likely to have a SFP entitlement broadly matching their holdings. With some hesitation we have concluded that it is therefore reasonable to accept that the hypothetical

incomer should be taken to have an entitlement, either because the successful offer would come from an existing farmer moving to Moonzie or from the existing tenant. Although the implications of the availability of SFP raise difficult questions which we shall go on to discuss, it is clear that, all else being equal, a potential tenant with entitlement to SFP would be able to pay a higher rent than one without and would accordingly be likely to be successful on the open market.

- [98] In any event, we consider that in the context of section 13 and the purpose it is to serve, it is not appropriate to make any assumption that the incomer is coming new to farming. We accept that rent should be assessed on the basis discussed in *C.E.C. v Gunn*. “A landlord will want as tenant an efficient, experienced and financially sound farmer who will make the best use of the land. It may reasonably be expected that in the open market the great majority of offers will be made by efficient and experienced farmers of adequate resources”: (p 173). We accept that such a tenant should be taken to have an appropriate level of SFP to allow him, as farmer, to enjoy the support which other tenant farmers have.
- [99] We turn to the separate question of whether the income from the SFP is to be treated as part of the income stream derived from the holding. Mr Kermack contended that the Court had to draw a distinction between the entitlement or right to receive the subsidy in each year, and the payments actually received in any particular year. The purpose of the scheme was, he said, to provide income support for farmers. That income was available to pay rent.
- [100] He submitted that both tenant farmers and owner occupiers did, as a matter of fact, apply the annual income as part of the income stream “derived from the holding”. However, it must be said that we are not satisfied that there is any sound basis for this assertion. We are not aware of any practical context in which an owner occupier could be said to “apply” the income as “income derived from the holding”. They will, no doubt, regard it as trading income or income from their farming business. It will be treated in that way for tax purposes.
- [101] Similarly, as a matter of routine accounting practice, tenants no doubt apply the income from the SFP as income of their farming business. But they would only require to give active consideration to the question of whether it derived from “the holding” in the context of rent assessment. A comparison might be made with income attributable to a dairy business. If the whole dairy equipment had been provided as a tenant’s improvement, the question of whether the income was “applied” as income “from the holding” or as income due to the improvements, would normally arise only in relation to rent review.
- [102] Mr Kermack made various other broad submissions in support of the view that subsidies should be regarded as part of the income of the farm. He referred to the decision in *Murray Threipland* and we understood him to suggest that the Court there had treated the income from the Sheep Annual Premium quota as part of the income stream and a return for the use of the land. The quota rights had been bought in that case. They were, in no sense, derived from the land. He accepted that the actual cash flow came from the production of sheep but said this was not the same as coming from the land.
- [103] We do not accept that sheep quota cases are directly comparable. The effect of the quota was to determine the potential limits of entitlement. The payment itself was, however, based on the stock actually held. There would be no payment of subsidy if the land was not available for use for keeping the stock. We have no doubt that the value from keeping sheep is properly to be taken to be a fruit of the use of the land. In the *Murray Threipland* case, the value of the quota, as such, was treated, not as part of the income stream from the farm, but as an item of tenant’s capital. An appropriate deduction was made in respect of the return on that capital.
- [104] Reference was also made to the question of milk quota. The whole background to the schemes for milk quota was summarised by the Court in the *Broadland Properties* case as reported in 1994 SLT (Land Ct) 7. We need not repeat that material. The practical significance of quota was

that it provided a cap on the permissible production of milk. The direct return to the farmer was derived from the productive capacity of the holding but the higher the quota the more milk he was able to produce and sell. In that case the tenant held both allocated milk quota and transferred milk quota and had, himself, borne the cost of the transferred quota. There was no dispute that the latter fell to be ignored in terms of the relevant legislation. However, the arbiter had determined that the allocated quota would not have been awarded but for improvements carried out by the tenant. But for these improvements there would have been no dairying and, accordingly, no allocated quota. He considered that any value attributable to that quota fell to be disregarded. The Court held that the matter turned on the correct construction of section 16 of the Agriculture Act 1986. That made specific provision differentiating “allocated quota” and “transferred quota”. As the statutory provision provided expressly that transferred quota was to be disregarded it followed that allocated quota had to be included.

- [105] The decision in that report is not in point. The Court expressly declined to express any view as to the correct treatment of milk quota in the assessment of rent. It was clear that the allocated quota related to the holding itself. The tenant was entitled to compensation from the landlord on leaving the holding. His successor would obtain right to the quota. The relevant statutory provisions were quite distinct from the provisions relating to the SFP where the entitlement is clearly that of the tenant and is not tied to any particular land.
- [106] The subsequent stages of the case were not reported although a brief summary can be found in Mr Barraclough’s book: at Appendix 4. We have thought it proper to look at the full material. However, we think that this simply emphasises the view that the Court initially took. Allocated milk quota was something attached to the holding and, accordingly, one of the factors to be taken into account. The holding was to be viewed as having “the landlords’ provision of land, building, and allocated milk quota but no specific milk or dairying facilities”. The Court found that the quantity of quota available imposed a restriction on the potential level of dairying activity which could be carried out. The farm could not be regarded as a full dairy farm. Rent would be lower to allow for this. Appropriate allowance could be made by comparison with other holdings. However, all of these considerations related to a situation where the quota was tied to the holding. We are not persuaded that the treatment of milk quota has any bearing on the issue currently before us.
- [107] Mr Kermack also submitted that it was “no more objectionable” for a tenant to include the income stream from SFP “in any assessment of the productive earning capacity of the holding” than that an owner should use such income to pay interest to a heritable creditor. We do not consider this a relevant comparison. Assessment of earning capacity is a wholly different concept from deciding how a sum of money is to be applied. The quantum of interest due is not affected by the source of payment. A more accurate comparison is that a tenant is entitled to use money derived from his entitlement to SFP to pay his rent in the same way as he can use it to pay any other creditor. That is quite different from saying that it is to be treated as being a payment on which he is to be rented.
- [108] We accept that, in attempting to find the notional rent, it is appropriate to have in mind the concept of a willing landlord and willing tenant negotiating a figure. This is consistent with the language of section 13. We are satisfied that we have to assume a rational process. The reliance placed by Mr Kermack on the element of competition risked being a cover for an element of irrationality. We heard that farmers were perennial optimists at heart. We accept that evidence – although it must be said that we are aware of many whose public image is of deep pessimism. We agree that, in light of that optimism, it is inappropriate to take a conservative attitude to figures. It is not irrational to take an optimistic view of the future. The willing tenant would be likely to do so.
- [109] In adopting a rational approach, we consider that an appropriate starting point is to look at the position of the prospective tenant and landlord at the start of their negotiations. The landlord is able to offer the use of land and, of course, the fixed equipment forming part of that land.

Essentially the parties have to determine the value to the tenant of the use of that land for his business. No matter what the landlord might say about how much other people might be prepared to pay for similar land, the rational tenant's concern must be to assess what he can make from his use of the land in question.

- [110] He might already own a farm and machinery and be able to calculate the value of his use of the new holding in that context. If all his fixed costs had already been covered by his existing holding he might approach matters by assessing his potential gross margins and accepting that it was worth giving the landlord the major share. But it can scarcely be imagined that he would agree a rent in excess of the gross margin. He might be able to afford to do so in the sense that his overall farm business would be profitable but, paying a rent in excess of the expected gross margin of the new holding would lead to a lower income than he would have had without it.
- [111] Similarly, if the prospective tenant had money in the bank, he would not rationally be prepared to use it in conjunction with the farm if he could make more overall income from using it elsewhere. He might, however, invest it in the farm if some other benefits were perceived.
- [112] We see no justification for treating the tenant's entitlement to SFP in any different way. If, at the start of the negotiation, the tenant possesses an entitlement, it must be assumed that he will be aware of all the options open to him. If he was a neighbouring farmer seeking to add to his farmable land, he would, no doubt, treat the flow of income coming from the SFP as coming from an existing asset. There would be no question in his mind of taking that income into account in assessing the potential of the new holding. If, however, he was someone who had acquired the entitlement but had no other land he would consider the options open. He could realise the income flow by applying his entitlements to the new holding; he could sell the entitlement and use the capital to fund the purchase of equipment; he could sell it and apply the proceedings to some other business or investment; he could release the income by leasing naked acres.
- [113] We heard evidence that the capital value of the entitlement at the time was seen to be about two and half times the annual flow of income from the scheme. It is probable that a tenant would assume that the best return would come from keeping the entitlement rather than selling. Most active farmers clearly took that view. We need not give further consideration to the detailed implications of selling the entitlement. However, it seems beyond dispute that if the incoming tenant had sold his entitlement and was deriving an income from investment of the proceeds in stocks and shares, or the like, that income would play no part in his assessment of the potential earning capacity of the use of the landlord's land.
- [114] In practical terms the choice to be discussed with the landlord would be between using the new holding as the basis of his claim or renting naked acres. It would be obvious that the holding had a direct value based on the saving of the need to incur the trouble and expense of renting such naked acres. The tenant would freely concede that this was a benefit he would derive from use of the land. He would, no doubt, allow something in excess of the cost of naked acres to obtain this benefit.
- [115] Mr Kermack's argument would seem to involve the landlord then saying, in reply, something to the effect that this was an inefficient way of working. It would be a complete waste to rent naked acres when the tenant would have a new holding available to release the income. The tenant would no doubt agree that it was inefficient in one sense but point out that, as a skilled experienced farmer he realised that the only relevant measure of efficiency was the effect of different courses of action on his bottom line. If he could get the holding for the same rent as the naked acres it would be better to make the payment to the landlord. It would be worth paying a little more for convenience. But, if a reasonable figure was not agreed, he would seek to maximise his income by taking the cheaper option. He would apply the SFP entitlement to the naked acres. In that event, the entitlement and flow of income deriving from it would come right out of the equation. The tenant would no doubt go on to point out that it was in every sense more

efficient from the landlord's viewpoint to accept a return based on an equivalence with the naked acres rather than drive the tenant to use his entitlement elsewhere.

[116] Mr Kermack faintly advanced the argument that, to take account of "naked acres" distorted the market by artificially increasing the supply of land. However, there is nothing artificial about this concept. It is one which happens in practice. In any event, the Act does not make provision for correction of any over supply of land.

[117] In short, without requiring to make any assumptions as to the policy behind SFP or the implications of Mr Kermack's acceptance that it was to be seen as an "income support for tenants", the way it operates in practice has the direct effect that, in the real world, a rational tenant, however willing, would not have any reason to give half the payment stream to his landlord. This would have been the effect of the experts' budgets, if it was to be treated as part of the earnings of the farm. We would only be justified in concluding that he would agree a rent calculated on the basis that SFP was to be treated as derived from the landlord, if something in the statutory assumptions forced us to take an artificial approach which had that result.

[118] We put the matter in that way because it is clear that there is no direct material, statutory or otherwise, which explicitly requires the income from SFP to be taken into consideration when assessing rent. At its highest, the landlord's case relied on comparison with other forms of grant, subsidy, or quota regulation which were said to justify inclusion of subsidy as part of the income derived from the right to use the landlord's land. But, Mr Kermack was unable to identify any provision in the EU Council Regulation 1782/2003 or any other factor which would alter the above practical analysis. He did not identify any principle of construction which would either require or entitle us to reach a different conclusion. The main emphasis was on the fact that existing tenants of other landlords had not raised this question.

[119] Mr Kermack made the point that rent was paid because a landlord gave up his rights to use the land in favour of his tenant. The tenant was entitled to the fruits of that use. He had to pay rent for these fruits. It is, perhaps, salutary, when considering the concept of fruits of the land, to bear in mind what the landlord could obtain if he was free to decline to let and kept the subjects in hand. There would be no question of income from SFP being part of the potential earnings of the farm. To get such income he would have to buy entitlement and would recognise the need to set off the cost of purchase against the income.

[120] Consideration of the policy behind the single payment scheme leads us to the same conclusion. The details of the scheme are well known but it is appropriate simply to record the main elements. The scheme followed a mid-term review of the Common Agricultural Policy. Three main options were available for Member States. The first option – the "historic option" – was to base entitlement on the individual farmer's direct aid as received by that farmer in the reference period. This was the option adopted in Scotland. Other options involved flat rates based on the regional average of aid payments and without regard to individual receipts. When the schemes came into force in 2005 various steps had to be taken to secure entitlement. If a farmer failed to take appropriate steps in time that farmer would lose the entitlement. Entitlement not taken up would be transferred to the National Reserve. This Reserve provided a fund for new entrants and other purposes. However, it was agreed that by 2008 the National Reserve had no relevant bearing.

[121] The substantive provisions of EU law relating to SFP are to be found in Community Regulation (EC) 1782/2003. The following passages from the preamble may be noted:

"(2) The full payment of direct aid should be linked to compliance with Rules relating to agricultural land, agricultural production and activity ...

(21) The support schemes under the common agricultural policy provide for direct income support in particular with a view to ensuring a fair standard of living for the agricultural community. This objective is closely related to the maintenance of rural areas....

(24) Enhancing the competitiveness of Community Agriculture and promoting food quality and environment standards necessarily entail a drop in institutional prices for agricultural products and an increase in the costs of production for agricultural holdings in the Community. To achieve those aims and promote more market-orientated and sustainable agriculture, it is necessary to complete the shift from production support to producer support by introducing a system of decoupled income support for each farm. While decoupling will leave the actual amounts paid to farmers unchanged, it will significantly increase the effectiveness of the income aid. It is, therefore, appropriate to make the single farm payment conditional upon cross-compliance with environmental, food safety, animal health and welfare, as well as the maintenance of the farm in good agricultural and environmental condition.

(29) In order to establish the amount to which a farmer should be entitled under the new scheme, it is appropriate to refer to the amounts granted to him during a reference period. To take account of specific situations a national reserve should be established. That reserve may also be used to facilitate the participation of new farmers in the scheme. The single payment should be established at farm level.

(30) The overall amount to which a farm is entitled should be split into parts (payment entitlements) and linked to a certain number of eligible hectares to be defined, in order to facilitate transfer of the premium rights. To avoid speculative transfers leading to the accumulation of payment entitlements without a corresponding agricultural basis, in granting aid, it is appropriate to provide for a link between entitlements and a certain number of eligible hectares....”.

[122] The Regulation includes the following Articles:

“Article 2 ... the following definitions shall apply:

(a) “farmer” means a natural or legal person, or group of natural or legal persons ... who exercises an agricultural activity,

(b) “holding” means all the production units managed by a farmer situated within the territory of the same MemberState.”

(c) “agricultural activity” means the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in good agricultural and environmental condition ...”

“Article 3

1. A farmer receiving direct payments shall respect the statutory management requirements referred to in Annex III ... and the good agricultural and environmental condition established under Article 5.”

[123] Title III of the Regulation contains, in Chapters 1 to 4, the basic rules applicable to the “entitlement” to income support. Put shortly, it provides that farmers who, during the reference period from 2000 to 2002, benefited from a payment under certain schemes should receive entitlement based on the total amount of payments granted under those schemes. Chapter 3 provides for a farmer to receive “a payment entitlement per hectare which is calculated by dividing the reference amount by the three year average number of all hectares which in the reference period gave right to direct payments...”. It also provides: “The total number of payment entitlements shall be equal to the above mentioned average number of hectares”.

Article 36(1) states:

“Aid under the single payment scheme shall be paid in respect of payment entitlements as defined in Chapter 3, accompanied by an equal number of eligible hectares as defined in Article 44(2).”

Under Article 44:

“1. Any payment entitlement accompanied by an eligible hectare shall give right to the payment of the amount fixed by the payment entitlement.

2. ‘Eligible hectare’ shall mean any agricultural area of the except areas under forests or used for non agricultural activities.

3. The farmer shall declare the parcels corresponding to the eligible hectare accompanying any payment entitlement. Except in case of force majeure or exceptional circumstances, these parcels shall be at the farmer’s disposal on the date fixed by the Member State...”

Article 46 provides:

“1. Payment entitlements may only be transferred to another farmer established within the same Member State except in case of transfer by actual or anticipated inheritance.

2. Payment entitlements may be transferred by sale or any other definitive transfer with or without land. In contrast, lease or similar types of transactions shall be allowed only if the payment entitlements transferred are accompanied by the transfer of an equivalent number of eligible hectares.”

[124] Sir Crispin advanced an argument that it was not possible to include SFP as part of the earnings of the farm because to do so was equivalent to entering an agreement to share the entitlement with a person who was, in the context, to be seen as a non-farmer. He referred to the Opinion of Advocate General Mazak in *Harms v Heidinga*. The essential question in that case was whether Article 46 precluded certain contractual arrangements whereby the payment entitlements would be held by one party for the benefit of another. In the Opinion the Advocate General summarised the effect of the scheme as follows:

“24. First of all, it is only farmers who have received a payment entitlement – by transfer or from the national reserve – who are eligible to have access to the [single payment scheme (SPS)]. Only those persons are considered to be ‘farmers’ who exercise an ‘agricultural activity’ within the meaning of the Regulation. However, the mere fact that a farmer has obtained payment entitlements does not automatically result in him receiving actual support connected with those entitlements. To benefit from single payments, the farmer is required not only to hold the payment entitlements but also to activate them by having at his disposal a corresponding amount of hectares of agricultural land and by complying with other management requirements – such as conditions imposed under environmental and animal protection and safety laws (so-called cross-compliance).”

[125] The Opinion went on to stress that the issue turned on interpretation of Article 46 and continued:

“30. For the purposes of that interpretation it is necessary to give full consideration to the purpose of the regime governing payment entitlements and the rules governing their transfer.

31. First, the purpose of a payment entitlement, when coupled to an eligible hectare, is to create a right to the payment of the amount fixed by the payment entitlement ... the SPS is intended for farmers and, in particular, for those farmers who are active. It may be pointed out here that –

unlike production rights and premium rights, which stem from the common agricultural policy reforms of 1992 and 1999 – the single farm payments are solely ‘an income support for farmers’.

32. Secondly, as regards their transfer, it is clear that the community legislature intended payment entitlements to be transferable and traded in. The single farm payment was broken down into payment entitlements precisely so as to facilitate its transfer. Indeed, contrary to milk quotas for example, payment entitlements may, in principle, be freely transferred and are not linked to specific agricultural land...

...

35. It follows that the basic objective underlying the detailed provisions on transfers of payment entitlements is to avoid transfer that are speculative in nature. As has been seen, the end pursued by the SPS is to provide income support to active farmers, and not to persons who, by trading in payment entitlements, pursue other financial interests outside the sphere of agriculture. Indeed, the Regulation seeks to avoid single payments being given to persons who do not exercise an agricultural activity within the meaning of the Regulation and who should, therefore, not benefit from Community financing in this area.”

[126] The Advocate General concluded that the contractual arrangement created a form of transfer which did not meet the conditions laid by Article 46. “...the result of the transaction is that the corresponding sums (single payments) – permanently – fail to achieve their purpose as subsidies, that is to say, income support for the farmer actually cultivating the land corresponding to the payment entitlements”.

[127] The plain thrust of the opinion was that payment entitlement should belong to the farmer and not to the landowner or lessor.

[128] We accept that a contract to transfer the income to another person may be unlawful. However, it does not follow that an agreement to make a payment is unlawful simply because the source of the funds is the SFP. A farmer might take a loan in circumstances where the banker was aware that the interest payments could only be funded from SFP. That would not, in our view, be equivalent to an agreement to share the entitlement to SFP.

[129] However, we accept that the dicta support the view that the intention was to provide direct support to farmers’ incomes.

[130] Dicta in *Kornelis van Dijk v Gemeente Kampen* also appear to us to support the view that SFP should not be seen as having been provided by the landlord and that the landlord is not entitled to any share. In that case the national court asked the European Court of Justice whether Community Law required a lessee, on the expiry of the lease, to deliver to the lessor the leased land along with the payment entitlements accumulated thereon or relating thereto or to pay him compensation. In the judgement the Court pointed out that the single payment scheme differed from the milk quota scheme under which the principle was that quotas were transferred with the holding. The judgment included the following passages:

“26. However, it is apparent from both the objectives and the scheme of Regulation No 1782/2003 that, in the absence of a clause to the contrary, payment entitlements remain with the lessee on the expiry of the lease.

27. First in accordance with the second indent of Article 1 ..., the single payment scheme constitutes an income support for farmers, the objective of which is ... to ensure a fair standard of living for the agricultural community...

29. In addition, Article 44(1) of the regulation recognises that there is a link between payment entitlements and agricultural areas in that each payment entitlement which corresponds to an eligible hectare gives a right to payment of the amount fixed by the payment entitlement. ...

31. In that regard, as is apparent from recital 30 in the preamble ... such a link exists between payment entitlements and eligible hectares, inter alia in order to avoid speculative transfers leading to the accumulation of payment entitlements without a corresponding agricultural basis.

32. By contrast, it is not apparent from Article 36(1) that the payment entitlements are linked to specific parcels, in particular to those which the farmer held during the reference period.

33. Thus, what ultimately matters is that, for the grant of the aid, the number of a farmer's payment entitlements corresponds to an equivalent number of eligible hectares, and not to specific parcels...".

The Court went on at paragraph 37 and 38 to say:

"Article 46(1) ... also states that, except in the case of transfer by actual or anticipated inheritance, payment entitlements may only go to another farmer ... In that regard it should be noted that ... the single payment scheme is aimed at farmers ... However, a lessor of land is not necessarily a farmer within the meaning of Article 2(a)...".

[131] The Court had no difficulty in concluding that there was no obligation on farmers who leased land to transfer their payment entitlements to the lessor. The Court did not require to address the question of whether the SFP should properly be seen as part of the return derived by the tenant from occupation of the land. We accept Sir Crispin's submission that the reference in paragraph 33 of the decision, contrasting eligible hectares and specific parcels, supports the view that the SFP should not be seen as attached to any specific land. But we think the significance of this decision is limited to the stress placed on the intention to benefit farmers and the recognition that a landlord while owning land is not necessarily a farmer.

[132] Of course, it is clear that in an entirely open market any increase in money supply will tend to increase prices and this includes rents. If all tenant farmers have the support of subsidies or, indeed, any income from other sources, they will be able to pay higher rents. But that is quite a different question from agreeing to share the extra income with the landlord.

[133] For completeness, it is appropriate to deal shortly with the suggestion that an incoming tenant might decide to acquire SFP entitlement by purchase on the open market. We heard that this could have been done for a figure of about 2½ times the current annual value. However, as it was expected that the SFP would end in 2012, we are satisfied that the prudent tenant would require to make a special writing down provision to cover the purchase of the entitlement. The whole cost of purchase would have to be written down over that period. We need not look at the precise detail of figures. It is plain that, on any view of them, the surplus of income flow over the writing down figure would be comparatively modest. We do not consider that the possibility of buying an entitlement has any realistic part to play in our assessment.

[134] There is little doubt that consideration of the effect of SFP is clouded by comparison with the perception of what went before. It is perhaps too soon to expect farmers to have fully adapted to the implications of the current regime.

[135] If there had been no subsidies regime, prices of farm produce in Britain would no doubt have been higher. They might not have been much higher because there is little doubt that supply of food is now a world wide operation. However, there is no doubt that part of the justification for the earlier subsidy regimes was a cheap food policy. The farmer received payment in part from consumers and in part from State support in the form of subsidies. It may seem unfair that the landlord whose land is the basis of all produce, should not be entitled to a share of the return

whether that return comes directly or indirectly. However, if there had been no subsidies prior to SFP, the effect of the introduction of SFP would have been seen as the introduction of new money to tenants, not as a payment for production. This might have made them willing to spend more on rent, at least in times of scarcity of land, but they would equally have seen themselves as free to spend the money on other assets such as machinery or improvements.

- [136] At the heart of Mr Kermack's submission was the proposition that there was a critical distinction to be drawn between the entitlement to receive payments and the actual payments themselves. We consider that there is a distinction but are not persuaded that it is of critical importance. If the entitlement itself is accepted as having a value, it cannot be contrasted with the flow of income in the simplistic way implicit in Mr Kermack's contentions. Its value must arise from the right to that flow. Accordingly, even if some part of the flow of income payments is seen to be attributed to the use of the farm, the value cannot come solely from that farm.
- [137] Although Mr Addison-Scott had contended that entitlement to SFP could not be regarded as "tenant's capital", Mr Henson, another surveyor with experience of negotiating farm rents for landlords, freely described the SFP in such terms. It is plain that it should be treated as an asset brought to the farm by the tenant. It is not attached to the farm. It would be surprising to find that the income from tenant's capital was to be treated as income from the farm.
- [138] We have looked at matters from purely pragmatic basis above in terms of how a prospective landlord and tenant might settle on a rent. However, in applying section 13(3) a more theoretical approach may be appropriate. We are satisfied that the stream of payment derived from the SFP entitlement cannot properly be viewed as part of the earnings of the farm. We note the observations in Scammell and Densham to the same effect: para 25.29. However, the situation is undoubtedly complicated by the fact that the entitlement to income cannot be turned into a stream of payments without reference to some land. There are conditions relating to management of land but it must be noted that they relate to all the recipient's land not simply to that relied upon to match the entitlements. The critical point is that the person holding entitlement cannot obtain the income without land to match his entitlements. That must have value in the rental process. In relation to SFP there is an open market undistorted by scarcity. That is the market for "naked acres". Accordingly, assessment of the appropriate allowance to be made for the use of the farm, purely to allow release of the payment stream, leads to broadly the same conclusion as we reach on a pragmatic view. The tenant would pay a market rate which would reflect the convenience of having the land under his immediate control.
- [139] We have not found any provision in the regulations which could potentially be construed in a way which might have a direct bearing on the issue in the present case. Accordingly, although Sir Crispin did raise the possibility of a reference to the European Court of Justice, we find no justification for this. It can also be said that we have not found any provision in the relevant case law which has any direct bearing on the matter. However, we accept that the general scheme of the Regulation and the approach in the cases cited points to an intention to support producers. The argument that this income should be treated as income derived from the land and that the surplus of such income should be divided between landlord and tenant on the basis contended for by the landlord would mean that, in effect, one half of it would go to landowners instead. Even if the idea of a 50:50 split is rejected, we think that including SFP in any calculation as if it was simply part of the earnings of the farm is not justified and is not a sound basis for assessment of rent.
- [140] Sir Crispin made the point that attempts to support farmers' incomes would lead to a vicious circle if the payments inevitably had the effect of increasing costs by inflating rent. However telling that point may be, it seems to us that it simply reflects the market. In an open market, when incomes go up prices tend to go up. If the right to payment is tied to a right to occupy land, the value of the latter right will increase. There will, at the very least, be a negotiating element. In an open market the value will depend on other options available to the tenant. In some countries

within the European Union, there may be little option. However, where there are “naked acres” the market will reflect that.

[141] We are satisfied that any budget used in rental assessment should include a figure to show a value for use of the land to realise the income from the SFP. That should be assessed by reference to the cost and trouble of leasing naked acres. We understood it to be agreed that rent would be at a rate of £6.50 per acre but no specific figure was spoken to as being appropriate to cover the saving of time and effort in obtaining a lease and the responsibility of maintaining the naked acres in compliance with GAEC and other conditions. It is plain that parties regarded this latter aspect as a modest element but the requirement of compliance does carry a risk and any farmer would prefer to be dealing with land under his immediate supervision, if possible. We consider that an overall allowance of £2.50 per acre should be made for the element of convenience. We regard this as a conservative figure but in absence of evidence do not consider it appropriate to take a higher figure. The effect is that we consider that a figure of £9 per acre should be allowed to the landlord under this head.

The implications of our view of SFP for comparables

[142] As we have seen, Mr Addison-Scott relied on his expert assessment of an appropriate rent for Moonzie by reference to his experience of some 50 tenancies where rents had been freely negotiated with other sitting tenants. He explained the basis upon which he had approached these rental agreements. He had obtained budgets for a sample number of farms. These budgets had all included SFP as part of the earnings of the holding. It was accepted as probable that all 50 sitting tenants held entitlement to SFP in amounts broadly appropriate to the size of their various farms. It is clear that he included this as an assumed income in each of the budgets. In other words, the whole exercise was underpinned by the assumption that SFP was to be included in full as a relevant element in the assessment of potential earning capacity for each tenancy. The point was forcefully made that this assumption was common to both sides. The tenants had accepted his approach without question although there had been some discussion about the nature of the particular holdings.

[143] We heard that Mr Lean had advised his particular clients that this assumption could be challenged. He had expressed to them his view that SFP should not play any part in the rental. But he had also advised that the matter was not entirely clear. It would have to be tested in court. It is plain that, for whatever reason, none of the tenants in question was willing to challenge the inclusion. We do not know the individual reasons. But the matter is not beyond explanation. We have no doubt that the cost of litigation would be seen as likely to be grossly disproportionate to the sum at stake. It may also be assumed that most farmers would have come to see subsidies as simply being “the government’s” contribution to the cost of food. As a consequence of cheap food policy, consumers have paid less for farm products than would provide an adequate income to farmers. The government has, in effect, supplemented the price by subsidy. The payments were originally made by reference to the produce of the farming enterprise. That produce is properly described as the fruits of the land. Farmers may have found it difficult to come to terms with the change in policy represented by the SFP. They were aware that the entitlement derived from the fruits of the land in the reference years. They may have been slow to grasp the concept of leasing naked acres when they, of course, would have no reason to do anything other than use their existing rented land for that purpose. It is, perhaps, surprising that none attempted to argue the matter with Mr Addison-Scott when he opened discussions with them. But we can draw no relevant inference from the absence of dispute at that stage. On his evidence, there is no doubt that the whole flow of income from SFP was an important factor in each of the agreed rents. We consider that this makes it impossible for us to place any reliance on use of information derived from rents of the 50 farms as comparables. The level of income derived from the SFP in each case would be significant and we do not have information which would allow us to make an appropriate adjustment.

- [144] It should be said that, if we were wrong in our conclusion that the full SFP requires to be excluded from assessment, we would have accepted the evidence of the landlord's comparables and, more broadly, the evidence of Mr Addison-Scott as supporting a rental level for a farm the size of Moonzie of the order of £65 per acre for class 3(1) and £60 for class 3(2) land. Although we did not find all his arguments persuasive we accept that his evidence would justify figures of that level. For the reasons discussed above, we do not accept that the figures derived from these comparables fell to be discounted by reference to all the assumptions made by Mr Henderson.
- [145] One of the comparables related to land let on SLDT at Birkhill. This was some 250 acres of bare land let at £90 per acre. No SFP was involved. We heard submissions as to how a short let might compare with a market let for a 1991 Act tenancy. It seems to us to be quite clear that the latter would normally be expected to attract a higher rent. The willing tenant is offering for a secure long term benefit. He can properly allow for a higher rent in early years. He will have the safety of rent review after the contractual period expires. With these differences in mind it might have been possible to derive a comparative open market figure from the detail of this let. However, it is plain that an important element to be considered would be the adjustment for marriage value.
- [146] We go on to discuss the arguments which might have been advanced for inclusion of marriage value in relation to the subjects at Moonzie. However, we accept that it is appropriate to attempt to strip out any element of marriage value before making a comparison. There is an obvious difference between the role of marriage value in relation to comparables and marriage value as part of the open market value of specific subjects of assessment. Marriage value depends on a detailed consideration of the whole circumstances including relative sizes at a very practical level of assessment. We heard evidence that the size of the farm was of importance in relation to the spreading of costs. A small farm, operating on its own, would be quite likely to have a wasteful surplus of capacity in terms of machinery. The larger the farm the larger the productive area over which costs are spread. There is an optimum point, or perhaps more accurately, a potential series of critical points. These will vary from farm to farm but arise when the point is reached when existing equipment is no longer adequate and any extra equipment will provide surplus capacity.
- [147] Other factors have to be considered. For example, a neighbour might be reluctant to take on responsibility for fixed equipment, including, perhaps, a farm house, if he had no need of it. Although assessment of an open market rent for specific subjects requires a broad approach because it proceeds on the basis of a hypothetical willing tenant, it is entirely appropriate to try to identify and strip out the detail of elements which actually add a marriage value to a comparable.
- [148] We heard some inconclusive evidence about the marriage value element at Birkhill but no direct assessment was proffered of the nature of the successful tenant's other operations and we cannot attempt to identify a precise figure. We have no difficulty in accepting that it would be a high figure. Much of the value of bare fields necessarily lies in their fit with another holding. Because of the difficulty of identifying the actual marriage value in the Birkhill rent we cannot confidently place much weight on the rental figure. It may be added that we have not been able to identify any factor which would have led the tenant to offer more than the marriage value. Even if the opportunity for such lets was comparatively rare, the scarcity element would not induce a tenant to pay more for a short duration tenancy than the land was immediately worth to him in commercial terms. It is not easy to identify any element of "distortion", properly so called. It is sufficient to say that we would not be surprised to find that the element of marriage value substantially exceeded the typical allowances made by Mr Henderson in his theoretical adjustments to the landlord's comparables.

Marriage value

- [149] It is clear that neighbouring farmers would be among the range of potential tenants in an open market. The element of marriage value is, accordingly, of considerable importance in assessing an open market figure. The problem is particularly acute, in modern farming practice, because some agricultural holdings are now too small to be viable on their own. An extreme example

would be a field intended to be let for grazing which had come to be treated as a full lease but there are many small farms which are essentially in a similar position. A landlord who was seeking to let a farm on the open market to a new tenant would have the advantage of the marriage value. There is nothing in the statutory provisions explicitly excluding neighbours from the open market.

- [150] However, nothing was made of this point on behalf of the landlord. It may be assumed that the landlord proceeded on the basis that the matter was governed by the dicta in *Aberdeen Endowments Trust v Will*. It is sufficient to note that such dicta may require to be reconsidered in the light of the decision of the English Court of Appeal in *Childers v Anker*.
- [151] As will be seen, we are not satisfied that an allowance for marriage value would have led to any increase in our assessment of rent in this case. But we think it appropriate to say a little more about the issues which arise. The Court, in the *Aberdeen Endowments Trust* case, was a distinguished and highly experienced one. However, the question of the relevance of marriage value to assessment of open market value in the context of a statutory rent review is, in the first instance, a question of law. The decision of the Court of Appeal in *Childers v Ankers* demands respect. That Court was considering the very different provisions of English legislation but, at least in a broad sense, the substantive issues were the same. Where there is security of tenure some mechanism has to be found to fix rents if they cannot be agreed. The English legislation has placed more explicit emphasis on the productive and earning capacity of the holding while the Scottish legislation refers expressly to the “open market”. It is unlikely that the choice of an open market test was intended to give tenants a lower rent than one assessed under the English provisions.
- [152] In the *Childers* case, the tenant was tenant of two plots of land held from the same landlord on separate tenancies and farmed by him along with a substantial farm which he owned. Much of the discussion dealt with the significance of the two separate leases and there was also a dispute as to whether the statutory provisions in question were, or were not, equivalent to an “open market valuation”. At page 471, Lord Justice Morritt came to deal with the issue of marriage value. He dealt with the provisions excluding reference to marriage value in a comparable and said that such provisions could not be used to exclude marriage value from the subject holding. He went on to deal with the matter under reference to the express provisions of the English legislation. The subjects in that case were “...bare land less in area than what might be considered as an economic unit yet potentially attractive on that account to a farmer seeking to expand. Such a farmer is a hypothetical figure included in the range of prudent and willing tenants that the arbitrator is required to consider. In my view it is plain that marriage value is a relevant factor for the consideration of the arbitrator. As with all relevant factors, the weight (if any) to be attached to it is a matter for him.” Lord Justices Evans and Neill concurred.
- [153] These observations require to be given some weight. The Court plainly proceeded on the view that there was no need to treat the subjects as a free standing unit. If that is accepted, the element of marriage value would become a question for assessment. However, as we have observed in relation to scarcity, a main aim of the Act was to protect the security of tenure. It is a powerful consideration that there would be little point in giving the tenant security of tenure if the rent fixed in relation to his holding was to assume benefits of economies of scale which would not be possible for him to achieve. The English dicta must be treated with caution. We note that they simply accepted marriage value as a factor for consideration. It may be that this is an issue which can be dealt with on a holding by holding basis. If the subjects are simply bare fields it is obvious that, for them to have any commercial value, it is necessary to assume that they are farmed in conjunction with some other unit. That might be said of any unit without a farmhouse. On the other hand, assessment by reference to use of contract labour and machinery might also allow a sensible result in relation to such small units.
- [154] In the present case, even if marriage value was to be included, we do not have evidence which would justify an assessment significantly above the level we attribute to the equivalence of the

“naked acres”. Moonzie is of a reasonable size but it might be more profitably farmed with another unit. However, any neighbour seeking the advantage of marriage value would have to be assumed to have an existing farm. This gives rise to two main issues. In the first place, as Sir Crispin pointed out, such neighbour would have to take over responsibility for the fixed equipment, including the substantial farmhouse. It could not be sub-let without consent. A neighbouring farmer would be unlikely to have an entitlement to SFP available to release payments either in respect of Moonzie or “naked acres”. Accordingly, there would be no justification for including both an element of marriage value and an allowance for naked acres. When those matters are set against the level of uplift which might have been made in relation to marriage value in this case, it cannot safely be concluded that any element of marriage value is of significance.

[155] In the whole circumstances it is unnecessary and inappropriate for us to express any further view on the issue of marriage value in relation to the assessment of rent for the purposes of section 13.

The budgets – matters agreed

[156] The witnesses directly involved in the preparation of the budgets assessed at 4 December 2008 were able to reach agreement on a variety of matters. Although the parties appeared to face some difficulty in converting such agreement into a formal joint minute they were able to present heads of agreement in the following terms:

“1 Combinable crops, yields and prices agreed.

2 Seed and Spray Cost for combinable crops agreed.

3 Fertiliser Prices Agreed.

4 Labour Power General Overheads Agreed.

5 Dry Store Haul Sundry Costs Agreed

6 Hay price £67–50/t

7 Hay Variable Costs, excluding fertiliser agreed. Seed, spray sundries agreed at £33 /ha

8 Interest on capital = Base + 3%

9 Tenants Capital £153,789 agreed as reasonable

10 Potato Return (Sub-Contractor let) £659/ha

though we are in disagreement over this being gross or net of management charges.”

These heads of agreement were agreed between Mr Hall and Mr Siddle.

[157] The parties did lodge a joint minute narrating agreement that:

“1 the date at which potential works of improvement were undertaken and the ownership of them is not a material consideration and will not affect the rent of the holding on the assumption, arising from the fact that the parties agronomists have agreed on a system of farming that does not require grain drying or storage facilities on the holding, that there are no such facilities on the holding, but that there are sufficient buildings that have the potential for the installation of such grain drying or storage facilities.

2 the cottage rental income to be applied in the budget for the one bed roomed cottage [Merchant's Cottage] and the two bed roomed cottage, being half the combined rental value after an agreed deduction for voids and management shall be taken as £3,825 per annum.

3 that the three bed roomed cottage has a potential letting value of which one half the rental value after an agreed deduction for voids and management, shall be taken as £2,677.50 per annum. There is no agreement between the parties as to how this sum is to be applied or whether it is to be considered at all in the rental of the farm."

Approach to budgets

[158] It is not disputed that the budgets took the form of "snap-shots" indicating the witnesses' views of the position as it would have been at 4 December 2008. In particular prices and costs were agreed as at that date. As discussed above we are satisfied that weight must be given to the conditions prevailing at the time. But that can properly be done by assuming a tenant considering his position in light of information available at that date as to future prospects. Where there was no agreement we have made our assessments on the basis of likely income and expenditure as best we can on the evidence available. As will be seen we have found it necessary to work on our best assessment of what figures might have been assumed to be for a three year period and then taken an average to fit the agreed format of a one year budget. We have set out, in Appendix I, our calculation of the effect of our conclusions on the disputed issues of detail and principle. We have followed the broad approach of the budgets discussed between Mr Siddle and Mr Hall. We now deal with the various matters in the order in which they appear in that calculation.

Potatoes

[159] The parties were agreed that the tenant would expect to be able to derive an income from use of the land by specialist potato growers and that some 24.3 hectares of potatoes could be grown each year. The "return" was agreed by the expert witnesses to be £659 per hectare if it was assumed that the potatoes would be grown by a specialist on the basis of a sub-let. It was accepted that an incoming tenant would not consider it worthwhile to equip the farm for potato growing as a single unit. The costs of equipment would be excessive relative to the size of the holding. As we have observed, the landlord did not attempt to argue that rent should be fixed on the assumption that on the open market the farm would be attractive to an existing farmer with suitable equipment.

[160] The dispute between the parties related to the implied prohibition on sub-letting. There was no dispute that the landlord would, in fact, agree to sub-letting for potatoes. He would have no reason not to agree and would share the benefits. But, parties were agreed that rent should be fixed on the basis of the conditions implied at common law in absence of a formal lease. It was accepted that sub-letting would be a breach of the lease. For the tenants it was contended that potato growers would expect an ordinary contract of sub-let and that if there was to be some other form of contract or arrangement it would require the tenant to incur legal costs to set it up and additional management costs. It was suggested, by Mr Hall, that the legal costs could be between £500 and £1000 with continuing costs of the order of £2000 per annum.

[161] It was also contended that as the farm had no irrigation or potential for irrigation it would be less attractive to growers. However, we are satisfied that the effect of agreement on price covers that type of issue. Price is the mechanism for balancing supply and demand. We heard no evidence of special circumstances pertaining to potato growing which might mean that lower valued land would simply fail to find a market.

[162] Mr Kermack referred to various cases suggesting that an agreement to give a potato grower use of land for a single season's crop might not amount to a let of the land. However, we do not consider that these have any bearing on the real issue here. We accept that a simple agreement, if

it gave an unrestricted right to occupy the land for the purpose of growing potatoes, would be likely to fall foul of the implied prohibition on sub-letting.

[163] However, we are satisfied that there would be no great difficulty in having a grower accept a different type of agreement. We need not attempt to express a view as to precisely what arrangements might be made but are satisfied that some form of joint venture could readily be adapted to meet the needs of the situation. We heard nothing to persuade us that potato growers were unduly concerned about the formal detail of their arrangements with farmers. It is important to bear in mind that there is no obvious conflict of interest between farmer and grower which might give rise to a desire to involve lawyers or specialist advisors. We heard that arrangements traditionally proceeded on a handshake. As Lord Gill observes, parties were often unaware of the legal implications of the agreements they did enter. But we accept that careful landowners have always wished to avoid any risk of creation of a 1991 tenancy. Lord Gill's warning would not be ignored by a prudent factor: para. 4.15. The use of joint venture arrangements, if not common, is far from unusual. Indeed, Sir Crispin properly drew attention to one in the Encyclopaedia of Legal Styles: Vol.7 para 146.

[164] There was some suggestion that an incomer might find it hard to set up a suitable contract in his first year and that some allowance should also be made for this. However, we consider it unnecessary for the purposes of section 13 to assume that the incoming tenant will be new to farming. The successful tenant might well be expected to have established contacts within the potato trade. As we have said, the present tenants might be a potential tenant on the open market. In any event, as a sitting tenant's occupation is to be disregarded, there is no justification for our assessment to be based on an assumption that the new tenant is inheriting the system currently in place. It is not disputed that we have to assume that an incomer would be farming under a hypothetical system without regard to the system operated by the existing tenant. We are not persuaded that there is any reason to assume that the incoming tenant is operating the hypothetical system from scratch. If the farm is to be taken as running on a part contract labour basis with potatoes grown under some joint venture arrangement, we see no reason why the incomer should not be taken to have the benefit of such a system to move into. The newcomer would reasonably expect to be able to reach some agreement with the hypothetical potato grower already in place. There is no reason to assess rent on the basis of an assumed void year for potatoes.

[165] In short, we are not persuaded that the tenants have established that there would be any difficulty in having a potato crop without significant additional management cost. In particular we are not persuaded that a joint venture would, in practice, involve any significant additional management costs. Accordingly, we have treated the agreed figure of £659 per hectare as part of the earnings without deduction for supervision. We have, however, accepted that there should be a modest deduction to cover the legal cost of a suitable simple contract. We do not accept that this would need to be repeated annually and would not expect the cost to exceed £600. That figure would be incurred in year one but can properly be treated as spread over three years. We accordingly allow a deduction of £200 in the calculation.

Fertiliser

[166] The experts agreed the cost of fertiliser as at 4 December 2008. However, they were not in agreement about appropriate rates of application at that date. Put shortly, the dispute arose from the fact that there had been a sharp increase in fertiliser costs in 2008. With hindsight it was clear that there was a "spike" in late Autumn of 2008. But there was no dispute that matters had to be viewed at the entry date and without the benefit of such hindsight. It may be added that there was a tentative suggestion on behalf of the tenants that the tenant should be assumed to have possession in advance or should in some way be taken to have budgeted for his fertiliser requirements in advance. No doubt a tenant offering for a let as at 4 December would, in the real world, make his calculations in advance of that date. However, we are satisfied that the exercise required by statute is to have regard to the situation on the review date. It is an artificial exercise

but, at least as far as timing is concerned, a comparatively straightforward one. We see no justification for adding an extra layer of hypothetical assumption.

- [167] Three types of fertiliser were agreed to be required: nitrogen, phosphate and potash (N, P & K). Broadly speaking, the landlord accepted that normal rates of nitrogen would have to be applied despite the cost and would have to be budgeted for. However, it was contended that application of phosphate and potash raised a different issue. These were released more slowly. It would be expected that there would be a “bank” or “reservoir” of such plant nutrients in any well maintained soil and it was contended that, accordingly, some variation from the recommended rates of application in any year would have no appreciable effect on crops. There was evidence that many farmers had taken a “P & K holiday” when prices were high relying on them to come down again in due course. We indicated that this was consistent with our own expert knowledge. But the issue was not what other people had done but what a new tenant would do. The landlord contended that such tenant would rely on soil analysis. If levels were reasonable, he would take a “holiday”. He could miss a year without adverse effect. We had no evidence of actual levels at Moonzie but an assumption could be made that the land was in good heart.
- [168] Mr Siddle explained that the high price in December 2008 was mainly attributed to the unusually high grain prices which had been obtained in 2007 and which had encouraged many more farmers to grow grain in 2008. This had led to an increased demand for fertilisers. However, by December 2008 it was apparent that grain prices had not sustained their 2007 level. Indeed, the budget returns in 2008 were low precisely because of the lag between supply and demand. Grain prices had dropped dramatically but input costs had gone up. It was a very reasonable assumption that they would fall in line with grain prices. Although the price of nitrogen followed the price of oil (or gas), P & K were regulated by supply and demand. It was accepted that there was a world market for grain and increasing demand for fertilisers.
- [169] Mr Hall, who gave evidence on this matter for the tenants, did not profess to be an expert in soils and fertilisers but he relied on technical publications to support the view that proper application of these two fertilisers was necessary to produce the most robust crops. All farmers seek to avoid risk. Risk of the effects of adverse weather and disease could be minimised by proper fertiliser application. A prudent incoming tenant would not take the risk of cutting back. His figures were based on Technical Note 308 of 1992 published by the Scottish Agricultural College. These figures were to be preferred to the average figures shown in the SAC Farm Management Handbook because they allowed precise matching of fertiliser to expected crop yields. He said that the parties had agreed the yields and rotation and it was therefore entirely appropriate to use the available technical information to assess fertiliser needs. He said that it was necessary to put back into the soil as much as the crops would take out. He accepted that on a well run farm there would be a “bank” of P & K. As they were relatively slow release elements, there might well be sufficient in the bank to provide for the needs of crops in the short term. But, this would depend upon soil analysis. He could not give technical evidence as to how the fertiliser was taken up or the precise implications of a fertiliser “holiday”. However, he thought that a prudent farmer would rely on published guidance and would wish to apply recommended amounts.
- [170] We are satisfied that an experienced farmer would have expected to cut back on potash and phosphate in 2008. Farming necessarily involves balancing of risks and costs and we do not accept the tenants’ approach as realistic. We accept Mr Siddle’s evidence that, assuming land in good heart, a shortfall over a year would have no significant effect on crops and the level of risk would be accepted by an experienced farmer. However, we consider that such a farmer would expect to make up the shortfall in ensuing years.
- [171] Because of the use of snap-shot budgets we did not have any explicit calculation of the cost over three years if the tenant was to allow for a shortfall in year one being made up in following years. We did not have detailed evidence as to how an incoming tenant might make an assessment of longer term prices. However, we consider that adequate evidence was available for us to exercise an expert assessment on this issue.

[172] The incoming tenant would have to proceed on the pattern of prices in the past. We are satisfied that sufficient material is readily available in the public domain for us to carry out a broad assessment. We have concluded that a skilled and experienced farmer would take the view that prices in December were so high that a partial “holiday” in 2009 would be justified. Increased applications would be applied in 2010 and 2011 to redress the shortfall. Because of the long term slower release characteristics of P & K we think that would have been seen to be unlikely to have any appreciable impact on the crops.

[173] Prices for P & K in December 2008 were about three times the prices applying in 2007 and previous years. We think an incoming tenant and his advisors would recognise that grain and fertiliser prices were dominated by a world market. We accept that fertiliser prices tend to follow behind the price of grain. We are satisfied that an experienced farmer would be reasonably confident that prices would soon return to lower levels. He would recognise that, in the longer term, the world-wide trend would assert itself to keep prices rising but we think that even on a conservative approach the new tenant, looking at years two and three, would conclude that they were very unlikely to exceed twice the 2007 rate once the spike was past.

[174] Although we heard much reference to “P & K holidays” in the course of examination and cross-examination, we note that Mr Siddle did not suggest a full “holiday”. He proposed rates of application for different crops which, in some instances, were not far short of the figures published in the Handbook. We accept Mr Hall’s figures as soundly based on the technical information available to him and conclude that a tenant might well wish to match his levels. However, we have satisfied ourselves that even if the price of fertiliser in the following two years only fell to a level which was double the 2007 level, the sums allowed by Mr Siddle would allow an average application over three years of the same order as the rates proposed by Mr Hall. In all the circumstances we consider it appropriate to use Mr Siddle’s figures in the calculation.

Miscellaneous

[175] The current tenants derive a gross income of £3500 from an environmental scheme relating to footpaths. It was not disputed that this income would in fact continue in 2009 and that such income was consistent with the way in which the hypothetical tenant could be taken to run the farm. For the landlord it was contended that as various environmental schemes were on offer it could be assumed that a similar income would be available indefinitely. However, no specific scheme was positively established as being likely to be available at Moonzie after the footpath scheme ended. We heard that most schemes would lead to loss of productive parts of the farm and that any gain would accordingly have to be matched with some loss of gross margin.

[176] For the tenants, Mr Henderson and Mr Hall both gave evidence to the effect that, in viewing the matter in December 2008, it would not be clear to an incoming tenant what schemes, if any would be available from 2010. Schemes such as the creation and management of grass margins schemes, which might be considered, would require commitment of some seven hectares of otherwise arable land and allowance would have to be made for that. Mr Hall accepted that there might be available a net figure of £1200 to £1500 in years two and three. Mr Henderson was tentatively prepared to accept that, allowing for the net £3325 in 2009, an average of £2000 per annum could be allowed on this head. We accept that as reasonable.

[177] For the landlord it was suggested that there were various sources of income which the incomer might hope to exploit. He might hope to utilise his grassland by wintering stock. He might use surplus time and equipment to derive income off the farm. A suggestion was that he might cut hedges. However, if the grassland was all used for stock, there would be a potential loss of the agreed income of £4,317 for hay. We are not persuaded that an incoming tenant would see the cost and risk of over-wintering cattle as justified. We see no reason any profit derived by a farmer using his own equipment off farm should be included as farm earnings. We recognise that a farm might provide a convenient base for such work and that some allowance might, in an appropriate

case, be made for this. However, we are not persuaded that any allowance can be made in the present case.

Return on tenant's capital

- [178] The parties reached agreement as to the amount of capital which the incoming tenant would require and the cost of borrowing. The total of £153,789 agreed in the experts' heads of agreement, could be seen to be broken down as £101,480 for machinery and £52,309 which represented half of the annual expenditure on variable items such as seed. Agreement on this point was reached when parties were still in dispute over matters which might have been expected to have a bearing on the figures included as capital items. However, we encourage a pragmatic approach to settlement of matters of detail and are satisfied that it is appropriate to use the agreed figure. Mr Hall gave evidence that it was normal practice to treat one half of the total annual expenditure as capital. Expenditure and returns varied throughout the year but a tenant would have to be in a position to fund about half of them at any time. Although the expert witnesses had entered a written agreement which included an explicit item "interest on capital equals base plus 3%", it was expressly agreed in course of submissions that this was intended to reflect the cost of borrowing and that, if the Court was simply considering an appropriate figure for a return on tenant's capital invested in the business, this would not necessarily be at a borrowing rate. For the landlord it was contended that the incoming tenant was to be assumed to come fully equipped with sufficient capital to run the farm. For the tenants it was contended that, in practice, the tenant would borrow at least to fund the variable costs element of his annual expenditure and that an allowance of a commercial borrowing rate in relation to half his overall capital was appropriate.
- [179] In the open market a tenant would normally hope to see return on his capital as well as a prospect of reward for his management. As it was put by the arbiter in the *Southesk* case: "There is no logical reason why a business tenant should offer a rent which would deprive him of a reasonable chance of making a profit, including a reasonable return to his working capital and to the amount of time and effort he is required to commit to the business." A similar approach was discussed and followed in the *Murray Threipland* case.
- [180] We consider that it takes the dicta in *C.E.C. v Gunn* too far to conclude that the Court had in mind a fully funded tenant with no borrowing requirement. We are satisfied that in practice most tenants will borrow to fund their annual outlays, or "rolling capital" – and might also have substantial borrowings related to their fixed capital. To determine a rent based on an assumption of full funding might render nugatory the tenant's primary right to security of tenure by making the holding unviable in practice. We think it reasonable to proceed on the assumption that a tenant will come with sufficient equipment but will fund his annual outlays by borrowing. We consider that the cost of borrowing is a proper deduction when calculating the income from the farm. In other words, it is an item which should go "above the line". However, the expected return on capital is not an item of expense in that sense. It is part of the tenant's expectation and allowance has to be made for it. The difficulties and indeed the dispute between the parties on this issue arose from the assumption that once a figure "below the line" was assessed, the rent could be found by a simple straight division. As will be seen, we do not accept this as a proper approach in the context of section 13. It is sufficient to say that a tenant investing capital would normally be looking for some return. This represents the interest foregone from the option to seek an alternative investment with similar risk and similar opportunities for profit. But, the investment in machinery and equipment and the return the tenant might expect from that part of his commitment to the farm, does not stand alone. It is just one part of an over-all package or return – financial and otherwise – which he seeks.
- [181] However, as the tenant will be looking for an element of return on his capital before deciding what rent to pay, it does not matter at what stage the allowance for capital is made. Some allowance will have to be made before he decides what he can afford to pay as rent. But, we accept that it is misleading to treat this as an outlay or cost in making an assessment of the

potential earning capacity of the farm. It is not a fixed amount. The tenant has no obligation to pay himself interest. The landlord has no obligation to pay him interest. There is, in short, no absolute entitlement to a return.

[182] However, we allow as an outlay, the agreed bank interest on the sum of £52,309. The base rate on 4 December 2008 was 2% and this produces a figure of £2615.

Division of net profit

[183] The expert witnesses had proceeded on the basis of a simple 50:50 division of the resultant profit from farming activities. We heard no evidence as to any basis of principle behind this agreement. As we have seen, they were in dispute over the question of whether the return on tenant's capital was an item to be deducted "above the line", in other words before the stage when they made their division. Sir Crispin agreed that if we took a different view of any aspects of the case, we would be entitled to make our own assessment of the appropriate division of profit.

[184] We recognise, of course, the convenience of an assumption that the surplus should be split in accordance with some fixed percentage. This would make the task of a valuer much simpler. However, our task is to attempt to find the open market rent in accordance with the provisions of section 13. Parliament has not attempted to reduce the exercise to a formula and we have no justification for creating, or indeed, rubber stamping a formula which is not secure in principle.

[185] We are satisfied that determination of the appropriate amount to be paid to the landlord as rent in any case is a matter of judgment rather than application of any assumed rule of equal division. We accept that dicta in relation to crofting rents require some care before being used in relation to renting under section 13 as the statutory bases of assessment are quite different but we note that in *Sutherland Estates v Sutherland* (at 42A-B) the Court said: "In theory, assessment of rent on a profit basis is an attempt to find the minimum return a reasonable tenant would be prepared to accept from taking the tenancy. Once this is deducted from the projected profits, the landlord would expect the rest as rent."

[186] Some assistance on this approach might have been obtained by consideration of authorities in the different, but related, context of assessment of rental value for the purposes of rating: see for example *Cairngorm Chairlift Co Ltd v Assessor for Highland Region*. The so-called "ordinary" approach of a division of 80% to landlord and 20% to the tenant was rejected in that case and it must be noted that in the rating context it is usual to allow a figure for return on capital "above the line". But, in any event, we are satisfied that the issue before the Court is not one which requires a formal division of profits. The budgets were only snap-shots. They were simply adminicles of evidence. They have no formal status. The question is what the willing tenant would be prepared to offer on the open market which would result in the willing landlord accepting his offer.

[187] The open market price is determined by the highest bidder. In the context of any lease, that proposition must be qualified by reference to the continuing interest of the landlord in the subjects. That is particularly so in relation to farms. The landlord can be expected to prefer a sensible offer to one which seems irrational. However, it seems clear to us that in the open market a tenant would assess his rental bid on the basis of what he could afford rather than by reference to any concept of a fair division with a landlord.

[188] We consider that the availability of income from the SFP would inevitably play a part. Although, as we have seen, that income cannot properly be described as part of the potential earning of the farm, it was provided as "income support". There was an implicit recognition that the income a farmer might reasonably expect to derive from the produce of his labours would be insufficient. The SFP can properly be regarded as making up the shortfall available from farm earnings. A reasonable tenant would have this in mind when considering what share of these earnings he would require before paying rent. He would recognise that the payment of SFP was a recognition

that the farm itself would not be expected, in present market circumstances, to provide an adequate return.

- [189] Further, although the underlying basis of all rentals is the annual value to the tenant of each acre of agricultural land as provided by the landlord, we would expect a prospective tenant to have regard to the whole package of benefits provided by the let. He might not be greatly influenced by aspects of pure amenity but would have regard to the over-all benefit he expected to derive from the lease.
- [190] The parties were tacitly agreed that although Moonzie included an attractive farmhouse in an attractive part of the country with convenient access to shops and local facilities, it would be inappropriate to approach the assessment of rent by treating the farmhouse as a separate unit. That is plainly correct. But it is part of the package provided by the landlord. If open market comparables were available it might be possible to determine a value for a farm with an attractive farmhouse as opposed to one without. In every case, the benefit has to be weighed against cost. A house which was too big for a particular holding might be a comparative liability when maintenance costs were considered. However, in modern times an attractive house providing accommodation for the farmer and accommodation for a working spouse and family is normally to be regarded as an asset.
- [191] Having regard to the level of surplus shown in Appendix I, we consider that the benefit of Moonzie in providing an attractive house and home would play a significant part in the tenant's thinking. That might not be so important in a farm with a higher earning capacity or if the date of assessment fell at a more prosperous time. He would also have regard to the income available to him from the cottages.
- [192] The budget assessment simply provides a cap. An offeror on the open market would be unlikely to exceed what he could expect to receive by way of return if the holding was operated efficiently. But he would have no reason to assess that by reference to any concept of equal division of profit with the landlord.
- [193] We are satisfied that in the particular circumstance of this case the hypothetical tenant would be willing to allow the major share of profit from farming activities to go to the landlord in order to secure the tenancy. The precise amount is a matter of assessment and we have to take a view on all the circumstances described in the evidence in this case. Although matters have to be approached on a broad basis it is convenient to express the matter in percentage terms. We consider that competing on an open market undistorted by scarcity a tenant, considering what was on offer from a lease of Moonzie would be prepared to allow the bulk of the surplus to go towards rent, retaining for himself about 20%.

Cottages

- [194] There are three cottages on the farm. The parties eventually reached agreement that the cottage rental income to be applied in the budget for the one bedroom cottage and the two bedroom cottage, being half the combined value after an agreed deduction for voids and management, should be taken as £3825 per annum. They agreed that, on a similar basis, half the value of the three bedroom cottage should be taken as £2677.50. There was no agreement as to how this sum was to be applied or whether it was to be considered at all. This cottage was currently occupied by young Mr Paterson who worked on the farm.
- [195] In terms of a Minute of Agreement between the parties, the tenants undertook to "keep all cottages on the farm, that is to say the cottage known as Merchant's Cottage and the said two new cottages, occupied as dwelling-houses and to use their best endeavours to keep the larger of the two new cottages which has three bedrooms occupied by a farm worker in full time employment of the tenants on the Farm of Moonzie". After then making provision for

resumption, the Minute went on “The tenants may sub-let the above cottages as dwellinghouses only”.

[196] There had been no attempt in the pleadings or productions to include the three bedroom cottage as part of the budget income. However, it was not disputed that when Mr Siddle and Mr Hall came to work out their final agreed figures for costs, they had agreed to do so on the basis of significant use of contract labour and equipment. On that basis there would be no need for accommodation for a farm worker. The cottage would be free to let.

[197] Sir Crispin objected to attempts to include potential rental income from this cottage. He pointed out that no such claim was made in the pleadings or in reports of calculations. He stressed that, in terms of the Minute of Agreement, the tenant was not simply free to let the cottage. He was obliged to use his best endeavours to keep it for an employed worker. Mr Kermack said it was a matter which only arose at a late stage when the experts had agreed a budget on a basis which did not require accommodation for a worker.

[198] We see no prejudice in the circumstances arising purely from late notice. It was clear, during the evidence of Mr Siddle, that this matter was in issue. There was ample time to consider whether any new evidence was needed to deal with it. The experts had agreed a figure. We did have a concern that the argument in relation to the cottage arose out of an agreement which, on the face of it, related to a quite separate issue. It is in the public interest that parties should feel free to compromise matters on any basis they like without fear that a concession on one point will be held against them on another. The problem is the risk of confusion of a pragmatic concession of practical detail with a concession of principle. The experts were simply attempting to identify a basis for cost. Their agreement was reached at a stage when they had no need to consider the implications of the agreement on the question of the cottage. They might have proceeded on a view that it would not be possible to demonstrate much difference between contract labour and the cost of employing and housing a worker. Contract figures were readily available and use of them would preclude the need for detailed assessment of the alternative cost structure. Having agreed to use contract farming rates as the basis of elements of the costing, there is an obvious risk of prejudice if the agreement, intended as one of practical detail, is treated as establishing a principle capable of being used for another purpose.

[199] However, Sir Crispin did not take this point explicitly as a separate ground of objection and we have come to the view that, in the circumstances of this case, no clear distinction could be drawn between the detail of the labour budget and the principle that contract labour could be used. If the budget had been based on the cost of employed labour, some allowance – albeit modest – would have had to be made for the benefit of accommodation. Provision of accommodation has a value which cannot simply be disregarded. The tenant is not prejudiced by our accepting that there was an effective concession that the farm could be operated by use of contract labour and on a basis which left the cottage free for letting.

[200] We recognise that in order to implement his obligation to use his best endeavours to use the cottage for a worker the incoming tenant might choose to adopt a different system of farming. However, he would not expect to do so if it would lead to a lower over-all return. The expression “use his best endeavours” is one which will take its precise meaning from the context. We do not say that the extent of such an obligation is necessarily met by a simple balance of cost. A tenant may have to face an element of cost in using his best endeavours. However, in the context of this case we consider that if a proper appraisal leads to the view that the more efficient way to operate the farm as a whole is to use contract labour, the obligation to use best endeavours to use the cottage for a workman would not stand in the way of that.

[201] In short we accept that rental income from the three bedroom cottage falls to be taken into account. As we have seen parties were able to agree that if we reached that view the appropriate figure to include would be £2677.50. Accordingly, the total to be included under the head of cottages is £6502.

Allowance for “naked acres” equivalence

[202] We have dealt, at paragraph [141], with our reasons for an allowance of £9 per acre for the benefit to the tenant of being able to use the holding to realise his SFP entitlement rather than seek to rent “naked acres”. We have accepted that the incoming tenant would have an entitlement appropriate to Moonzie. We heard little discussion of the precise entitlement to be assumed. The landlords contended that it was to be an entitlement appropriate to what would have been available had the 146 ha. (361 ac) of crops eligible for arable aid, as shown in the budgets, been grown in the reference years. No other figure was suggested and in all the circumstances we accept that figure as the basis of calculation of this allowance. We accordingly add £3249 on this head.

Conclusion

[203] In light of the foregoing we have assessed rent on the basis of the calculation shown in the “Budget and Rent Determination” set out in Appendix I. It is convenient to repeat, in summary, our findings on the disputed matters which were seen to have a direct bearing on the appropriate figure for rent. It will be apparent that some matters of detail are peculiar to this particular case.

- The willing tenant is not to be assumed to be a complete newcomer. He can be assumed to be taking over a farm operating on the same hypothetical basis as he is assumed to adopt and to have a full knowledge and understanding of the farm and its operation.
- Such a tenant would have an SFP entitlement appropriate to the farm.
- SFP is not part of the earnings of the farm.
- A tenant would make an allowance for the convenience of being able to use the farm to realise his entitlement rather than seek a cheaper method, such as by renting naked acres.
- The allowance for the convenience of the farm to release income from SFP would be based not only upon the cost of the alternative but would include the element of convenience.
- The farm would be operated using part contract labour and machinery.
- The tenant would be able to make an arrangement with a potato grower at much the same rate of return as if there was no issue over sub-letting.
- An allowance of £200 per annum should be made in respect of setting up a simple contract to cover such arrangement
- The tenant would have reduced the application of P and K fertiliser in the first year but expect to make this up within a three year period.
- The hypothetical tenant would have sufficient capital of his own to provide necessary equipment but would be expected to borrow to cover his annual variable costs.
- The cost of such borrowing is a proper outlay in calculating farm earnings.
- The tenant would expect to derive an income from agri-environment schemes but would have no certainty as to amount or availability of such income after the first year.
- There would be no expectation of significant “sundry income”.
- The incoming tenant would want a share of profit to compensate for his input but, in the whole circumstance of this case, would be prepared to allow the major share of profit to go

to the landlord having regard to the over-all package of benefits provided by the lease and the income support provided by SFP.

- Farm workers would not be employed and the three bedroom cottage would therefore be free for letting.

[204] As appears from Appendix I we have, in the result, determined the rent at £20,800. The decrease from the previously agreed rent may seem surprising but, as we have seen, it is attributable in substance to the change in the treatment of subsidies under the Common Agricultural Policy. Although we have required to consider a number of disputed issues in this case, it is plain that the change from payment based directly on the produce of the land to a payment decoupled from production, in itself provides an explanation for reduction.

Expenses etc

[205] Parties were agreed that the question of expenses should be deferred. However, it was agreed that Mr Addison-Scott and Mr Siddle for the landlord and Mr Henderson and Mr Hall for the tenants, should be certified as expert witnesses. In light of the parties' agreement we can so certify.

[206] Sir Crispin's motion for certification of the cause as suitable for the employment of senior counsel was opposed. However, we have no doubt whatever that the issues arising in this case justified the employment of senior counsel. Indeed, we were indebted to counsel for his presentation of much of the voluminous material including his comparatively efficient and well structured cross-examination technique.

For Applicant: Mr Lewis Kermack, Solicitor; Messrs Turcan Connell, Solicitors, Edinburgh

For Respondents: Sir Crispin Agnew of Lochnaw Bt QC; Messrs Stronachs, Solicitors, Aberdeen

Appendix I

Budget and Rent Determination

Gross Output

Winter Wheat	£44,701	
Spring Barley	£65,007	
Winter OSR	£22,978	
Potatoes	£15,814	para [165]
Hay	£4,317	
Agri-environment Income	£2,000	para [176]
Sundry Income	nil	para [177]
Total Gross Output	£154,817	

Variable Costs

Fertiliser	£37,320	para [174]
Sprays	£14,794	
Seed	£10,153	

Dry / haul / store	£16,724	
Total Variable Costs	£78,991	
Gross Margin		£75,826
Fixed Costs		
Labour and Power	£48,436	
Other Overheads	£11,010	
Interest on Capital	£2,615	para [182]
Total Fixed Costs		£62,061
Relevant Net Farming Income		£13,765
Allocation to Rent (80%)		£11,012 para [193]
Additional Rent Items		
Cottages	£6,502	para [201]
SFP naked acre rent equivalent	£3,249	para [202]
Total of Additional Rent Items		£9,751
Rent Determination		
Allocation of Relevant Net Farming Income		£11,012
Additional Rent Items		£9,751
Total Rent		£20,763
Accordingly, and under reference to para [204] we determine the rent for Moonzie Farm with effect from 4 December 2008 at £20,800 .		

Appendix II

Landlord's Comparables

1. Skelpie & Waltonhill Farms, Cupar, Fife

Although Skelpie and Waltonhill were separate tenancies they were farmed by the same tenant and the rent was assessed and agreed treating them as a single unit held on a 1991 Act tenancy.

Rent review date: 28 November 2008

Area: 226.34 Ha comprising

- 156.49 ha arable
- 27.77 ha permanent pasture
- 12 ha rough grazing
- 29.98 ha woodland

The woodland area was not included in the renting process.

Landlord's fixed equipment: farmhouse; 2 cottages; traditional steading and one cattle shed.

Land quality: mainly class 3(2) but with some class 5(1) and class 5(2) and a small area of class 6(1).

Stock: 25 suckler cows /160 ewes.

Height above sea level: 70 to 190 metres.

Rent: £27,000 per annum.

The landlord's analysis of this figure was: arable £58 per acre; cows £90 per cow; and sheep £15 per ewe. It was noted that the two cottages were sublet and in poor condition. No rent was apportioned to the cottages. The farm was higher than Moonzie and with a greater level of tenant's improvements.

2. Cults Farm, by Cupar, Fife

This was held on a 1991 Act tenancy. There was a post lease agreement under which the tenant had responsibility for renewal of fixed equipment.

Rent review date: 28 November 2008

Area: 213.35 ha consisting of 211.25 ha arable and 2.09 ha other land.

Landlord's fixed equipment: farmhouse; 3 cottages (1 sublet under a short assured tenancy and 2 tied cottages for workers); traditional steading.

Land quality: 101 ha of class 3(1) and 110 ha of class 3(2).

Height above sea level: 50 to 100 metres.

Rent: £33,000 per annum.

The landlord's analysis of this figure was: arable 3(1) £61.29 per acre; arable 3(2) £57.27 per acre and the sublet cottage £2,100.

3. Wardmill Farm, Forfar, Angus

This was let on a 1991 Act tenancy. There was a post lease agreement under which the tenant had responsibility for renewal of fixed equipment.

Rent review date: 28 November 2008

Area: 103.65 ha comprising 45.96 ha arable 1; 48.85 ha, arable 2; and 8.83 ha permanent pasture.

Landlord's fixed equipment: farmhouse (with 3 bedrooms); terraced bothy/cottage (sub-let, 1 bedroom); detached cottage (vacant, 2 bedroom); traditional steading and 5 bay Dutch barn.

Land quality: class 3(1) and 3(2) with some 4(1).

Height above sea level: 76 to 137 metres.

Rent: £16,500 per annum.

Landlord's rental analysis was prime arable land £67 per acre; secondary arable £58 per acre; and permanent pasture £40 per acre. Allowance for sub-let cottage £1,000.

4. Baggerton Farm, Forfar, Angus

This was let on a limited duration tenancy (LDT) of 15 years to 28 November 2019. The landlord and tenant shared responsibility for repairs and maintenance on a statutory basis.

Rent review date: 28 November 2008

Area: 99.24 hectares including 12.14 ha arable 1; 37.24 ha arable 2; 27.53 ha arable 3; and 20.24 ha permanent pasture.

Landlord's fixed equipment: farmhouse (3 bedroom); traditional steading; GP shed; Dutch barn; and two 2 bedroom cottages (one sub-let and one occupied by a family member).

Cropping / stocking: cereals / potatoes / beef fattening.

Land quality: some class 2 (30 acres) but mainly class 3(1) and 3(2).

Height above sea level: 75 to 157 metres.

Rent agreed: £18,000 per annum

Landlord's rental analysis: prime arable £87 per acre; secondary arable £82 per acre; tertiary arable £67 per acre; and pasture £47 per acre. Allowance for sub-let cottage £1,000.

5. Birkhill Farm, by Cupar, by Fife

This was offered in three blocks as bare farm land for mixed arable cropping with an operative date of 28 November 2008. We heard little of the two blocks let for a single year. We heard some evidence of the Balmerino block of 103.06 hectares (254.66 acres) let on a five year SLDT at £90 per acre. It was grade 3(1) and 3(2) with some 4(1). It was noted that no SFP was on offer and that there was no irrigation.

6. West Kinleith Farm, Currie

This was let on a 1991 Act tenancy.

Rent agreed 28 November 2008

Area: 629 acres consisting of 241 acres arable; 14 acres pasture; and 374 acres rough grazing.

Fixed equipment: farmhouse and cottage (occupied by tenant's mother); traditional steadings.

Land quality: class 3(2)(w) with some rough grazing, class 4(2).

Height above sea level: 200 to 260 metres

Rent agreed: £18,500 per annum

Landlord's analysis of rent: arable 1 £60 per acre; arable 2 £50 per acre; pasture £50 per acre; and rough grazing £10 per acre.

The tenant operated a diversified horse livery business and grew arable crops. The tenant had fitted out the steading with loose boxes etc. The rent was agreed taking account of the tenant's

diversification activities but discounting all the improvements which enabled such diversification to take place.

7. Carrington Mains, Carrington, Midlothian

This was a traditional 1991 Act tenancy.

Rent review date: 28 November 2008.

Area: 468.58 acres consisting of 409 acres arable and 59 acres pasture.

Landlord's fixed equipment: farmhouse; two cottages; and traditional steading.

Land quality: mainly class 3(1)(w); some 3(2) and 4(1)(s); and a small area of class 2.

Height above sea level: about 151 metres.

Rent: £34,000 per annum.

Landlord's analysis of rent: £63 per acre arable and £45 per acre pasture with an allowance of £5,400 for the two sub-let cottages.

The evidence from the landlord was that, in each of the comparables, where appropriate, adjustment had been made in arriving at the agreed rent to take account of the level of tenant's improvements. In other words, the passing rent reflected the landlord's fixed equipment provision.

West Kinleith Farm and Carrington Mains were referred to by the landlord principally by way of comparison and analysis of the three comparables initially relied upon by the tenant where there were elements of diversification.