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The *Nottingham Law Journal* is a refereed journal, normally published in Spring each year. Contributions of articles, case notes and book reviews to the *Journal* are welcomed. Intending contributors are invited to contact the Editor for a copy of the style sheet, which gives details of the format which submissions must follow. Submissions and enquiries should be addressed to:

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EDITORIAL

Welcome to this anniversary edition of the *Nottingham Law Journal* which marks 50 years of Nottingham Law School with a special introduction by Professor Andrea Nollent, Dean of Nottingham Law School.

As promised, our thematic section features four of the first articles to be published in the Insolvency and Business Law electronic journal with a forward by the Journal's editor, Professor Paul Omar.

Our articles on contemporary legal significance include a re-think of the law on nervous shock, acceptance of contractual obligations by conduct and an assessment of the implications of insolvency on company employees. The legal commentary section features an analysis of victim statements in criminal proceedings.

As ever I would like to extend my sincere gratitude to all the contributors, reviewers, subscribers and readers. Nottingham Law Journal has a small editorial team all of whom are research active academics, balancing (sometimes juggling!) the demands of academic life. At times this proves an impossible balance and it is with sadness that we see the departure of our assistant editor, Andrea Nicholson whose support has been vital to the Journal over the last decade. We wish her every success in the completion of her PhD on contemporary forms of slavery. My final thanks is extended to our administrative assistant, Carole Vaughan who single-handedly provides the organisational support needed to keep us on track.

DR HELEN O'NIONS

CELEBRATING 50 YEARS
of excellence in legal education

SPECIAL INTRODUCTION by PROFESSOR ANDREA NOLLENT

I am delighted to be asked to introduce this anniversary edition of the Nottingham Law Journal which commemorates 50 years of legal education at Nottingham Law School.

The 50 years have witnessed tremendous change in legal education and we at Nottingham Law School have lead the way, establishing a reputation for excellence and innovation. In 1968 NLS launched the first law sandwich degree in the UK, the LPC and GDL launched in 1993 became the national standard for these courses joined by the launch of the BVC (now BPTC) in 1997. Our highly successful suite of LLM courses were first introduced in 1994 expanding to include bespoke provision to international legal professionals with the LLM in Advocacy Skills in 2011. Reflecting the importance of research to the School, 2012 saw the launch of specialist research centres in Legal Education, Business and Insolvency Law, Conflict, Rights and Justice, followed by centres for Advocacy and Mediation.

The editorial in the 1977 first edition referred to the importance of legal writing and research in a polytechnic law school known for its teaching of law at graduate, postgraduate and professional level. The aim of the journal was to promote and celebrate a culture of research. In this mission, the NLJ has gone from strength to strength, publishing over 350 peer reviewed articles and playing a central role in the enhancement of a vibrant research culture underpinning all of our teaching and promoting the reputation of our research externally.

The key factor in the great success of Nottingham Law Journal has been the intellectual excellence, academic rigour and dedication of our staff both past and present. This includes the contributors, editors and administrators who have given their time and great effort over the last half century. To them we extend our thanks as we look forward to further successful 50 years and more of the Nottingham Law Journal.

PROFESSOR ANDREA NOLLENT

PROXIMITY, PSYCHIATRIC INJURY AND THE PRIMARY/SECONDARY TORTFEASOR DICHOTOMY: RETHINKING LIABILITY FOR NERVOUS SHOCK IN THE INFORMATION AGE

*EUGENE C. LIM**

INTRODUCTION

Digital technology has revolutionized the way human beings communicate. It is now possible for us to see and to interact with others, to be shocked, saddened, thrilled, tickled, amused, enthralled and even traumatized by scenes or images sent from many miles away. The potential to view and perceive events in other parts of the world through the screen of a mobile communication device or other audio-visual equipment has melted away the distance between individuals, rendering physical barriers less of an obstacle to human communication.

This article seeks to examine the impact of modern communication technologies on the law relating to psychiatric injury[1] in the United Kingdom, and to critically evaluate the compatibility of existing case law with the new modalities of communication in the digital age. It will consider whether the traditional restrictions placed on the scope of negligence liability for nervous shock might prevent deserving claimants from recovering compensation for severe emotional harm arising from the viewing of transmitted video footage. It will also critically evaluate the extent to which the bounds of negligence liability ought to be expanded in this area.

Furnishing proof of clinically recognized psychiatric injury has always been more challenging than adducing evidence of physical injury.[2] While the latter might take the form of an X-Ray image of a broken bone, the former often requires expert medical testimony from a trained psychiatrist based on observation, interaction with the patient and other clinical tests.[3] Mental conditions such as post-traumatic stress disorder and chronic fatigue syndrome are arguably easier to ''feign'' than physical injuries with objectively observable characteristics, such as bruises and lacerations.[4] In light of these concerns, the law of negligence relating to nervous shock has traditionally restricted

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1 In this article, the terms ''psychiatric injury'' and ''nervous shock'' will be used interchangeably, although the expression ''psychiatric injury'' is sometimes viewed more favourably by courts than the more dated ''nervous shock''. See for instance *Attia v. British Gas plc* [1987] 3 All ER 455, 462, where the English Court of Appeal expressed a preference for the term ''psychiatric injury''; John Cooke, *Law of Tort* (Pearson Education 2009) 68 and M H Ogilvy, 'The Fly in the Bottle and Psychiatric Damage in Consumer Law' (2010) 2 Journal of Business Law 85, 85, who notes that 'while the law of tort has always compensated for physical injury to person or property, it has only very slowly over the course of the 20th century compensated for negligent injury to mental health through damages for 'nervous shock', now 'psychiatric damage''. See also W *v* H Rogers, *Winfield & Jolowicz on Tort* (17th edn, Sweet & Maxwell, 2006) 224–25, where it is observed that the term ''nervous shock'' is falling into disuse, while ''psychiatric injury'' or ''mental injury'' is becoming more frequently employed.

2 See M H Ogilvy (n1) 85, who observes that tort law has always been more amenable to awarding damages for physical injuries, owing to a perceived lack of foreseeability in claims for nervous shock. The law relating to psychiatric injury has followed a significantly different trajectory, beginning to offer remedies to victims of nervous shock very slowly over the course of the 20th century.

3 It is well established in the case law that the psychiatric illness complained of must be recognizable and acknowledged, and amount to more than anxiety and vexation. See, generally, *Hinz v Berry* [1970] 2 QB 40; *Jaensch v. Coffey* (1984) 155 CLR. 549; *Calveley v CC Merseyside* [1989] AC 1228.

4 M H Ogilvy (n1) 86. Ogilvy summarizes this evidentiary concern as relating to the difficulty courts might experience in ascertaining whether a claim for psychiatric injury is ''imaginary'' or not. This difficulty, as observed by Ogilvy, is one of two policy reasons offered by Sir Richard Crouch in *Victorian Railway Commissioners v Coultas* (1888) LR 13 AC 222 PC (Australia) for rejecting such claims.

liability and recovery to claimants in specifically enumerated categories.[5] Recovery in psychiatric injury cases is generally confined to primary victims and secondary victims.[6] While primary victims are physically endangered in some manner, with physical injury being reasonably foreseeable, secondary victims suffer shock not from their own personal involvement in the accident but from their perception of an accident, or its immediate aftermath, that had injured or killed other individuals with whom they had a close tie of affection.[7]

In most of these cases, the claimant must either be physically present at the site of an accident or disaster, or physically present at its immediate aftermath, in order to stand a plausible chance at recovery.[8] This criterion of *physical* and *temporal* proximity appears to be a key element that animates much of the jurisprudence on nervous shock; a criterion that is often viewed as a *sine qua non* for a successful tort action for psychiatric damage.[9]

The astounding growth of modern digital technology has, however, redefined the boundaries of the human sensory experience. It is now possible, through the use of communication devices that have become ubiquitous, to view, perceive and experience events (occurring elsewhere) in real time. Some of these technologies are beginning to offer the potential of real-time "immersion" experiences,[10] which allow users to perceive themselves as having been transported to another environment, either real (depicting actual natural or urban landscapes) or simulated (such as a fantasy world designed by software programmers).

This article seeks to challenge the viability of existing restrictions against recovery in nervous shock cases, in light of these technological developments. It will focus on two issues relating to psychiatric injury arising from the digital transmission of audio-visual content in the information age. First, it will consider whether the requirement of "direct, unaided perception" of a tragic event or its immediate aftermath should continue to be a criterion for a successful claim by a secondary victim who has suffered nervous shock. It will critically evaluate the viability of the *Alcock* "media filter rule", which generally excludes claims for nervous shock arising from the witnessing of a tragic event through a media device, such as a television screen, instead of through one's own "unaided senses". It will argue that this "media filter rule", which was articulated in the seminal case of *Alcock v Chief Constable of South Yorkshire Police*,[11]

[5] This general reticence is aptly described by Kenneth MacKenzie J. in 'Oh, What a Tangled Web We Weave' in Stephane Beaulac, Stephen G A Pitel and Jennifer L Shultz (eds), *The Joy of Torts* (Lexis Nexis 2003) 148, who observes that "there is still some judicial nervousness about nervous shock."

[6] See John Cooke (n1) 70, where he notes that post-traumatic stress disorder (PTSD) suffered by primary and secondary victims is generally recoverable, while victims who learn about a serious injury to a close family member are generally not entitled to recovery.

[7] More recently, some commentators have noted that the English case of *Page v Smith* [1995] 2 All ER 736 has been criticized for adding uncertainly to the primary/secondary victim dichotomy. Under the rule in *Page v Smith*, as long as physical injury is foreseeable, an individual is to be treated as a primary victim, even though his injury is psychiatric in nature. This interpretation has been construed as an expansion of the primary victim category. See for instance Stephen Bailey & Donal Nolan "The Page *v* Smith saga: a tale of inauspicious origins and unintended consequences" (2010) 69(3) C.L.J. 495, 511–514 and 518.

[8] In *Page v Smith* (n7), for example, "primary victim" was defined by Lord Lloyd as an individual who falls within the "range of foreseeable physical injury". *Hambrook v Stokes Bros* [1925] 1 KB 141, on the other hand, is authority for the proposition that secondary victims can recover only if they suffer shock as a consequence of witnessing an event through their own unaided senses.

[9] See for instance *Page v Smith* (n7) where the victim was involved in a car accident carelessly caused by the defendant; *McLoughlin v O'Brian* [1983] 1 AC 410 where the victim witnessed the injuries suffered by her family very shortly after the accident.

[10] Examples include "four-dimensional movies", where physical effects such as vibrations, smells and wind are synchronized with key events in a film. Special eyeglasses may also enable moviegoers to perceive themselves interacting directly with the environment portrayed in a film, such as when an approaching animal seemingly "leaps" off the screen toward the viewer.

[11] [1991] 4 All ER 907.

should be relaxed, and that spatial proximity to the scene of an accident need no longer be a strict requirement for recovery as long as the other elements of foreseeability and proximity are present. In particular, close family members who suffer nervous shock upon viewing tragic events in real time through a "media filter" ought to be considered secondary victims eligible to recover under the tort of negligence despite the lack of *physical* proximity to the scene of the accident.

While *Alcock* can be viewed as having firmly reinforced the principle of spatial and temporal proximity to the scene of a tragic event,[12] the extent to which liability ought to be imposed for negligent video *transmissions* is an issue that has not been satisfactorily resolved. There have, of course, been calls, most notably by the Law Commission of the United Kingdom, for a relaxation of the direct perception of and physical proximity to a tragic event as the basis for liability in nervous shock. However, the questions of *when* liability for psychiatric injury can arise in respect of transmitted video content and *who* ought to be liable in such situations deserve closer study and attention. It is noteworthy that the Law Commission recommended in its *Report on Liability for Psychiatric Illnesses* of 1998 that the physical proximity requirement be abolished if there is sufficient closeness of relationship between the plaintiff and the primary victim.[13] The "liberal" proposals of the Law Commission have largely been ignored in the subsequent jurisprudence.[14] Further, it should be borne in mind that *Alcock* has not been expressly overruled in the United Kingdom.[15] Interestingly, some of the Commission's recommendations have found favour in other parts of the Commonwealth, such as Australia, which appears to have done away with the physical proximity and direct perception requirements for a claim relating to psychiatric injury.[16] As long as *Alcock* remains good law in England, there is a danger that the principles for recovery articulated therein may constrain future courts from deciding cases in the realm of transmission-related psychiatric injury with the nuance and flexibility necessary to cope with the changing modalities of communication in the technological age.

Apart from critiquing the "media filter" rule, this article also seeks to discuss the role of a "secondary tortfeasor" in cases where disturbing content is negligently or recklessly disseminated by an intermediary. It proposes a separate category of liability in nervous shock for passers-by and onlookers who disseminate video footage of a tragic event in real time or shortly after an accident, resulting ultimately in psychiatric damage to the close family members of the primary victim. The article discusses a number of policy factors to support the recognition of this category, including the importance of encouraging responsible communication and transmission of digital video content in the information age, the growing ubiquity of devices with video

[12] Law Commission, *Liability for Psychiatric Illnesses* (Law Com Report No 249, 1998) 20, where it is noted, in para 2.29, that several plaintiffs in *Alcock* failed in their attempt to extend the concept of proximity beyond the "immediate aftermath", not having been present at the scene when the tragedy occurred. A key factor which militated against recovery was that there had been a delay of between eight and nine hours before the first of these plaintiffs arrived at the scene.

[13] *Ibid* 88–89.

[14] See for instance *White v Chief Constable of South Yorkshire Police* [1999] 1 All ER 1, in which the House of Lords denied the claims of police officers who had been present at the Hillsborough football disaster in the capacity of employees and as rescuers. See also John Cooke, *Law of Tort* (10th edn, Pearson Education 2011) 74 and at 87, where it is observed that the majority of the House of Lords in *White* were demonstrably unsympathetic to the expansionist views of the Law Commission.

[15] The law on secondary victims in England was established and continues to be governed by the rule in *Alcock*. A secondary victim must therefore establish the necessary "control factors" – the requisite elements of proximity, consanguinity and closeness in time to the accident – in order to recover. See John Cooke (n14) 76–78 and 87–88.

[16] See *Tame v New South Wales* (2002) 76 AJLR 1348, [18], [51], [188] and [365]. The majority of the High Court of Australia held, *inter alia*, that liability for psychiatric injury is not limited to cases where a plaintiff has directly perceived a distressing phenomenon or its immediate aftermath.

transmission capabilities and the attendant foreseeability of near-instantaneous digital transmission of recorded events, particularly in crowded urban areas. Further, the article will explore the issue of whether a "secondary tortfeasor" – the transmitter or disseminator of content – ought to be jointly liable for psychiatric injuries suffered by the viewer of such content. By critically evaluating the existing case law on nervous shock, this article seeks to challenge the traditional view that psychiatric injuries suffered by secondary victims are generally traceable only to one primary tortfeasor – the party responsible for causing physical injury to the "primary" victim.

In Part I of this article, I trace the contours of the law relating to liability for nervous shock, and discuss the categories in which courts are generally willing to recognize a duty of care. Part II focuses on one of these categories – witnessing a tragic event involving a close family member – articulated in the *Alcock* case. The *Alcock* rule against recovery for claimants who witness an event through a "media filter" will be critically examined and evaluated. Part III will consider the viability of a separate category of liability for "secondary tortfeasors" who assist in disseminating footage of a tragic event, resulting in psychiatric injury to secondary victims who view the disseminated content, and will conclude with several recommendations for reform.

A BRIEF OVERVIEW OF THE LAW RELATING TO LIABILITY IN NEGLIGENCE FOR PSYCHIATRIC INJURY

In light of the concerns relating to the "floodgates argument",[17] courts have traditionally been reluctant to recognize a general duty of care in the area of psychiatric damage.[18] Early cases tended to deny recovery for claimants who had suffered mental injury unaccompanied by physical injury.[19] However, over the past century, courts in the United Kingdom have etched out a number of categories in which liability in negligence for psychiatric injury is more likely to be recognized.[20] One of the earliest cases in this area is *Dulieu v White & Sons*,[21] which established the principle that plaintiffs who are physically endangered by a defendant's carelessness and suffer nervous shock as a result are eligible to recover compensation for their psychiatric injuries. Later decisions have loosened the bounds of negligence liability even further, recognizing a duty of care in cases where the plaintiff either witnesses a tragic event involving a loved one, or attends the immediate aftermath of an accident. In *McLoughlin v O'Brian*,[22] which is often considered a high point or an apogee in the expansion of liability for nervous shock,[23] a mother who witnessed the immediate

[17] The floodgates argument is often used to describe an "unacceptable" increase in claims resulting from the removal of control mechanisms that restrict liability in tort. See, for example, the dictum of Lord Hoffmann in *White v Chief Constable of South Yorkshire Police* (n14).

[18] See John Cooke (n1) 68–69, where it is also observed that English law does not award damages for the "shock" itself, which is the principal response to trauma, but rather to the secondary, longer-lasting effects arising from the trauma.

[19] See for instance *Victorian Railway Commissioners v Coultas* (1888) 13 AC 222.

[20] Courts began to recognize liability for psychiatric injury towards the end of the nineteenth century, although it took somewhat longer for courts to award damages for shock resulting from the endangerment of another. See W *v* H Rogers (n1) 226.

[21] [1901] 2 KB 669.

[22] n9.

[23] See, for instance, the judgment of Lord Jauncey of Tullichettle in *Alcock v Chief Constable of South Yorkshire Police* (n11) 936, who notes that prior to *McLoughlin* in the early 1980s, there had been no case which recognized liability "out of sight and out of earshot". *McLoughlin* was effectively the first case in the UK in which a plaintiff who did not witness the accident succeeded in an action for nervous shock. See also John Cooke (n1) 71, who notes that the decision in *McLoughlin* appeared to signify a relaxing of the requirements for a successful claim, observing that the law appeared to be moving in a direction of reasonable foreseeability. This was followed by a "tightening of controls" on nervous shock

aftermath of a tragic accident which had severely injured members of her immediate family was allowed to recover for her psychiatric injuries.

Nevertheless, in *Alcock*, the House of Lords narrowed down the scope of liability by placing restrictions on the *type* of secondary victim who could recover successfully for psychiatric injuries sustained from witnessing a tragic event or accident. In articulating what will be referred to in this article as "the *Alcock* media filter rule", the House of Lords clarified that only secondary victims who had directly witnessed the accident through their own unaided senses were generally eligible to recover for their psychiatric injuries, thereby dismissing the claims of family members and others who had learned of the accident through televised video footage of the disaster. This case underscores the strong requirements of proximity in a successful claim for nervous shock – emotional ties to a loved one, coupled with spatial and temporal closeness to the scene of the accident.

Although *Alcock* was a decision that ultimately resulted in the rejection of claims for psychiatric injury, and is generally considered more "restrictive" in its approach to liability, both *Alcock* and *McLoughlin* are significant in that they have, at least in principle, expanded the scope of recovery to secondary victims who were not directly endangered by the defendant's act but who were sufficiently connected in space, time and perception to an accident which had severely injured a close relative.

An interesting issue facing tort law in the information age is whether the requirement of "spatial proximity" is as relevant a connecting factor today as it was twenty years ago. The next section will discuss the pertinence and defensibility of the *Alcock* media filter rule in an age where modern communication technologies have, in many respects, rendered physical distance between individuals less of an issue where the transfer of information in real time – including sound and video footage – is concerned. In particular, should the boundaries of liability be stretched even further to allow recovery for individuals who suffer psychiatric injury after witnessing an event in real time through a media filter?[24]

ALCOCK AND THE MEDIA FILTER RULE

Alcock v Chief Constable of South Yorkshire Police is one of the most frequently cited cases in the field of negligence for psychiatric injury. It is significant for having elucidated the distinction between "secondary victim" and "primary victim",[25] and the control factors that have to be satisfied in order for a secondary victim to recover compensation for psychiatric injury.

The facts surrounding this case are among the most tragic in the sporting history of England. As a result of poor crowd management by the police at a major football match between Liverpool and Nottingham Forest football clubs, hundreds of spectators were injured and 95 crushed to death.[26] The South Yorkshire Police had allowed too many intending spectators into an enclosed area reserved for Liverpool supporters at the Hillsborough Football Stadium in Sheffield, England, resulting in hundreds of

in the 1990s, with cases such as *Alcock* placing stronger emphasis on the distinction between primary victims and secondary victims.

24 In *Alcock v Chief Constable of South Yorkshire Police* (n11) 931, Lord Oliver of Aylmerton cited an example discussed by Nolan LJ in *Jones and others v. Wright* [1991] 3 All ER 88, 122, who suggested that televised scenes could, in exceptional cases, give rise to a claim for psychiatric damage. Nolan LJ's dictum will be discussed further in the next section.

25 Interestingly, the term "primary victim" was introduced by Lord Oliver in the *Alcock* case. See *Alcock v Chief Constable of South Yorkshire Police* (n11) 923.

26 See *Alcock v The Chief Constable of South Yorkshire Police* (n11) 910 (per Lord Keith of Kinkel).

spectators being crammed into two pens below the West End of the stadium.[27] The Chief Constable admitted liability in respect of the deaths and physical injuries.[28] Some of the relatives and friends of these victims, who had witnessed scenes from the disaster over live television or at the site of the accident, brought suit against the Chief Constable of Police, claiming damages for psychiatric injury arising from nervous shock caused by seeing or hearing news of the event.[29] There were altogether 16 such claims brought against the Chief Constable by individuals who were not physically injured themselves, but who were in some way connected to close relatives or loved ones who had been in the area when the tragic event occurred.[30] Most of these claims were brought by plaintiffs whose close relatives or loved ones had been killed or injured in the human crush at the stadium.[31] The trial judge (Hidden J) allowed ten of these claims and denied six of them.[32] On appeal to the Court of the Appeal, the claims of all six unsuccessful plaintiffs were rejected.[33] The House of Lords affirmed the finding of the Court of Appeal, holding that the plaintiffs lacked the proximity required to succeed in their claims.[34] Reasonable foreseeability was not the sole criterion for recovery. Merely witnessing edited scenes on television or hearing about them on the radio did not sufficiently connect the plaintiffs' psychiatric injuries to the negligence of the police.[35]

The principal barrier against recovery in *Alcock* was therefore the lack of spatial and temporal proximity to the scene of the accident. The majority of claimants in this case had heard about or seen footage from the accident through the media, but were not physically present at the stadium when the actual injuries occurred. Further, in some of the cases, the claimants did not arrive at the scene of the accident until the very next morning, hours after the tragedy. Another important factor might have been the *extent* to which the claimants perceived the entire accident through the images that had been broadcast on television. In accordance with the broadcasting code of ethics, the televised scenes of the tragedy did not depict the suffering of identifiable individuals.[36] As a result, the effect of the initial "perception" of edited footage, through the media filter of the television screen, might have been more muted and less acute than if the event had been perceived in close proximity through unaided senses.

The House of Lords considered the dictum of Nolan LJ in the Court of Appeal, who acknowledged the possibility that televised footage could in exceptional cases result in recoverable psychiatric injury.[37] In such cases, the sight and sound of an accident might be "transmitted and reproduced with a vividness that can equal, or even exceed, that experienced by those on the spot."[38] As an example, Nolan LJ described a hot balloon carrying children bursting into flames – televised live to the parents of the children concerned.[39] Such an occurrence might be significant enough to trigger the proximity

27 *Ibid*.

28 *Ibid*.

29 *Ibid*.

30 *Ibid*.

31 *Ibid*.

32 *Ibid* 911.

33 *Ibid*.

34 *Ibid* 914.

35 *Ibid* 915.

36 *Ibid* 936 (per Lord Jauncey), where it was observed that under then prevailing television broadcasting guidelines, shocking pictures of persons suffering and dying would not be transmitted.

37 See *Jones and others v. Wright* (n24) 122.

38 *Ibid*.

39 *Ibid*. It has also been suggested, by way of *obiter dicta* in the *Alcock* case, that in other extreme situations even bystanders witnessing a horrific accident may be able to claim sufficient proximity to the primary victim. Lords Ackner, Keith and

requirements necessary to establish nervous shock, but the precise mechanics through which such proximity would be satisfied were not fleshed out in Nolan LJ's judgment. The House of Lords, in citing such dicta with approval,[40] recognized that there could be valid exceptions to the media filter rule, where the impact of televised images could be as great, if not greater than, that of directly witnessing a tragic event. Such an exception did not, however, apply to the facts before the House.

Given the significant role that digital technology now plays in the quotidian realities of communication in the present age, it is perhaps timely to consider the viability of a judicial exception to the *Alcock* media filter rule, and to elucidate how such an exception can be accommodated under the legal framework for negligence liability. In the ensuing paragraphs, I engage in an analysis of the media filter rule, and argue that spatial proximity to the scene of the accident should no longer be an essential requirement for recovery against the tortfeasor responsible for causing the accident if other connecting factors are satisfied. As long as the claimant has a close relationship with the victim, and the perception of the accident that results in shock occurs within a reasonably short period of time after the accident, there are no strong policy reasons which militate against recovery.

Alcock is often cited to support the proposition that claimants may recover for nervous shock if they directly witness, through their unaided senses, a tragic event involving a close family member.[41] This ground for recovery expands the scope of recovery for nervous shock victims traditionally limited to physical endangerment and witnessing the immediate aftermath of a tragic event involving a close family member. However, it should also be borne in mind that *Alcock*, despite its recognition of a new ground for recovery, can be considered to be a relatively conservative judgment for having denied recovery, on the facts, to the claimants in question, since they had not actually witnessed the tragedy through their unaided senses.[42] It might be viewed as a retreat from the "expansionist trend" exemplified by *McLoughlin v O'Brian*, which recognized a duty of care to a plaintiff who witnessed not the actual accident, but its immediate aftermath. The key question that needs to be considered, therefore, is whether witnessing such an event in real time through a media filter or a mobile device would satisfy the foreseeability and proximity requirements under the law of negligence relating to psychiatric injury.

Unlike the situation two to three decades ago, it is becoming increasingly commonplace for individuals to own their own portable mobile communication devices, which often possess in-built photographic and video recording functions, as well as wireless internet capabilities. Technology has advanced to the point where powerful computing and image recording functions can be contained within a device that can fit comfortably within a small bag or pocket. Given the portability and convenience that these devices offer, they have almost become ubiquitous accessories; indispensable aids for communication and information retrieval in the modern age.

Oliver of Aylmerton were hesitant to categorically rule out claims by bystanders who witness a particularly horrific event that would affect even a relatively strong nerved person. An example given by Lord Ackner in *Alcock v The Chief Constable of South Yorkshire Police* (n11) 918 was of a petrol tanker careering out of control into a school in session and bursting into flames, causing severe injuries to children. This example was however viewed narrowly by the Court of Appeal later in *McFarlane v EE Caledonia* [1994] 1 All ER 1, where it was emphasized that a close tie of love and affection was necessary to establish proximity between the primary victim and the secondary victim. See also John Cooke (n1) 75.

40 See the dictum by Lord Ackner, in *Alcock v Chief Constable of South Yorkshire Police* (n11) 921.

41 See for example W *v* H Rogers (n1) 233, para 5–60.

42 It has been suggested that a plaintiff must witness the aftermath through "unaided senses", and that a person viewing "live" scenes through a simultaneous television broadcast would normally have no claim. A live broadcast depicting the suffering of identifiable individuals would likely constitute a *novus actus interveniens*, breaking the chain of causation from the original negligent act. See John Cooke (n14) 79.

Bulky photographic equipment is no longer necessary to "capture" images of reality; it is now a matter of simple convenience to take photographs and/or video footage of scenes or events that are of interest to a mobile device owner. Mobile technology, coupled with the increasingly widespread reach of wireless networks, afford ordinary members of the public the opportunity to record video footage and take photographs of relatively high quality, and to then share that material, almost in real time, to a large audience through the internet.[43]

Taking into account the increasing use of mobile "smart phones" and other devices such as iPads and tablets with video-recording and internet access capabilities, it is now reasonably foreseeable for accidents to be recorded and shared through information networks, due to the large number of individuals in possession of devices with such technological capacities. At this point, it may be helpful to distinguish between accidents that occur during planned televised broadcasts, (such as the exploding hot air balloon in Nolan LJ's example) and accidents that occur in more "routine" situations with no "planned presence" of a "media crew" on location. In the former case, the transmission would be done by the television or media company in question, while in the latter case, the recording would be unplanned, and done on the spur of the moment by bystanders who happen to have devices with video recording and transmission capabilities. From the traditional standpoint of negligence liability, it might be argued that transmission to third parties is reasonably foreseeable in the first instance, while less so in the second, since the tortfeasor who causes the accident may not be aware of the presence of such bystanders.

While such an argument might have seemed persuasive twenty years ago, the ability to broadcast video instantaneously through information networks is now no longer the sole province of media stations. As such, it is now not just possible, but highly probable, particularly in crowded urban areas, for the scenes of an accident to be transmitted in real time to individuals not physically present at the site. The psychological and emotional impact of such unplanned broadcasts would, consequently, be felt beyond the immediate physical boundaries of the accident. While the lack of reasonable foreseeability of such footage being transmitted might have been suitable grounds to deny a duty of care in the past, the ubiquity of recording devices in modern society renders such an argument less plausible in the present day and age.[44] Indeed, "lack of reasonable foreseeability" would no longer be a very convincing ground on which to deny recovery for psychiatric injuries suffered by a secondary victim as a result of witnessing footage of a carelessly caused accident on an information network through the filter of a mobile communication device.

Another argument in favour of allowing recovery in such cases is to promote responsible and careful communication in the present "digital society". Compared to ten or twenty years ago, it is now more likely for the repercussions of careless actions to be felt beyond their immediate physical location, due to the transmission and broadcasting capabilities of modern mobile devices. In light of the growing prevalence

[43] The increasingly widespread use of mobile devices to share video and other data through information networks is reflected in a recent report on data traffic by Cisco. For example, the average mobile connection speed is predicted to surpass 1 Mbps in 2014. Increasing use of smartphones will result in handsets exceeding 50 per cent of mobile data traffic in 2013. In addition, the report predicts that two-thirds of the world's mobile data traffic will consist of video content by 2017. Mobile video is anticipated to increase *sixteen*-fold between 2012 and 2017, accounting for over 66 percent of total mobile data traffic by the end of the forecast period. See Cisco Visual Networking Index: Global Mobile Data Traffic Forecast Update, 2012–2017, online, at: <http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white_paper_c11–520862.html>.

[44] According to the study released by Cisco, *Ibid*, the number of mobile-connected devices will exceed the number of people on earth by the end of 2013. By the year 2017, it is predicted that there will be over 10 billion mobile connected devices, including machine-to-machine (M2 M) mobiles, which translates into nearly 1.4 mobile devices per capita.

of wireless technology in daily communication, the "reasonable person" of the 21st century would now be aware that accidents arising from one's carelessness may be recorded and shared with third parties not physically present at the scene. Removing the "media filter barrier" against recovery in nervous shock cases would serve as a deterrent against careless behaviour that endangers others, and place the onus of proof on potential tortfeasors to demonstrate that they had acted reasonably in the circumstances. This step can also be justified on utilitarian grounds, to re-balance the twin objectives of tort law of compensation and deterrence, by ensuring that recovery is available to deserving victims who have suffered clinically proven psychiatric injury that can be traced back to the defendant's negligence through an unbroken chain of causation.

An immediate concern that springs to mind relates to the danger of "limitless liability" if the *Alcock* media filter barrier to recovery were to be relaxed. This concern springs from the extensive reach of digital communication technologies, particularly its potential to disseminate content almost instantaneously to a global audience. Yet, it should be borne in mind that the class of eligible claimants in this case would be limited to those family members who are linked to the primary victim through strong ties of consanguinity. Courts have traditionally defined these categories as relating primarily to spouses, children, and parents,[45] although in *Alcock*, Lord Ackner suggested that "close family member" needs to be determined on a "case by case" basis.[46] A further restriction on liability relates to the requirement of medical proof of clinically recognized psychiatric injury, which would further narrow the class of potential claimants under an expanded media filter rule.

Given the factors that would limit the scope of liability in cases of psychiatric injury occurring through a "media filter", the "floodgates" concern against recovery is not an insurmountable one. In lifting the media filter bar against recovery, the key test for liability would remain strongly connected to the basic requirements for a cause of action in negligence – reasonable foreseeability, proximity and policy. Whether the dissemination of footage from the accident is reasonably foreseeable is a question of fact, and is dependent on circumstances such as the number of spectators present, the area in which the accident occurred, the availability and presence of mobile communication equipment and telecommunication signals, as well as the quality of video footage actually captured. Due to the challenge of getting clear footage of an accident in certain circumstances, and the difficulty of establishing immediate or near-immediate contact with the victim's next of kin after the accident, it is not in all cases of media transmission that the relevant connecting factors will be satisfied. Further, even if an arguable case for the duty of care is made out, the secondary victim in question will need to demonstrate breach of the standard of care by the defendant[47] and causation of harm[48] before any claims for recovery are likely to succeed.

[45] See, for example, the dictum of Lord Wilberforce in *McLoughlin v O'Brian* (n9) 304, who notes that parents, children and spouses are traditional examples of the "closest of family ties".

[46] See *Alcock v The Chief Constable of South Yorkshire Police* (n11) 919–920 (per Lord Ackner).

[47] The test for whether there has been a breach of duty is based on the "reasonable person" standard, as articulated by Alderson B. in the frequently cited case of *Blyth v Birmingham Waterworks Co.* (1856) 11 Ex. 781, 784. Negligence, in effect, consists of doing something that a reasonable person would not do, or of not doing something that a reasonable person would do, taking into account the considerations that govern the ordinary conduct of human affairs.

[48] "Causation of harm" is made up of two elements: causation in fact (where the tortfeasor's act or omission contributes to the claimant's injury) and causation in law (which takes into account whether the claimant's injury is a reasonably foreseeable consequence of the tortfeasor's carelessness; whether the loss is remote, and whether it would be unfair to hold the tortfeasor liable). See, for instance, the dictum of Lord Hoffmann in *Kuwait Airways Corp v Iraqi Airways Co (Nos 4 and 5)* [2002] 2 AC 883 [127] (on "causation in fact") and *The Wagon Mound* [1961] A.C. 388 (on "causation in law"), in which the Judicial Committee of the Privy Council held, in the context of a case involving the spillage of oil from a vessel on to water which later caught fire, that the damage caused must not just be a direct consequence, but also a

Relaxing the *Alcock* media filter rule against recovery would therefore not result in a radical expansion in the scope of negligence liability. While perceiving an accident through a media filter, rather than though one's unaided senses, would not bar recovery altogether, it is important to note that the claimant must still demonstrate the required elements of consanguinity (close relationship to the primary victim depicted in the transmitted footage) and temporal proximity (closeness in time between the accident and the actual viewing of the transmitted footage) in order to succeed in their action. Hence, video footage that is transmitted to a large audience would not necessarily result in a large class of potential claimant, even if numerous members of that audience were to suffer psychiatric injury. Only those with a sufficient connection to the primary victim – temporally and by consanguinity – would be eligible to recover for their mental injuries.

If one were to apply this modified media filter rule to the original facts in *Alcock*, would the case have been decided differently? Several of the claimants in that case were family members of victims who had been crushed to death in the stampede at the stadium, and had viewed scenes of the tragedy on television. In the absence of a rule requiring direct perception of an accident through one's "unaided senses", would these family members be eligible to recover if they had suffered clinically provable psychiatric illness upon viewing the television footage? Two factors militate against recovery in *Alcock*, even in the absence of a media filter rule. First, the transmitted footage had been edited to remove any depictions of suffering by identifiable individuals. Second, there was a time lag between the accident and the perception of the transmitted footage depicting the accident. Hence, the claims in the original *Alcock* litigation would still fail due to the particular facts of the case. However, if unedited scenes depicting suffering of recognizable individuals were to be transmitted by a third party through a mobile device, and viewed instantaneously or shortly afterward by close relatives of the primary victims, then the result would likely be different, and the argument in favour of recovery for nervous shock would be considerably stronger.

Several important issues that need to be teased out therefore relate to the circumstances surrounding the accident and the subsequent video transmission, the relationship between the primary victim and the viewer, the impact that the video had on the viewer, and the nature of the psychiatric injury that flowed from the viewing of the accident. The significance of relaxing the media filter rule for nervous shock claims, however, extends beyond the mere facts of *Alcock*, and addresses some of the more novel mechanics of causation of psychiatric harm in the information age. In this vein, it ought to be borne in mind that wireless mobile technology is only one way in which modern digital communication is changing the way we perceive portions of reality. While digital media allows us to perceive scenes and events taking place in other parts of the world, technology is beginning to allow us to transcend the perceptional limits of physical reality through visual equipment that enables users to perceive themselves in another, often virtual, environment. As technology evolves, the law of negligence will have to adapt itself to accommodate new forms of harm, particularly psychiatric harm, as well as new conceptions of "primary victim" that may arise from activities in simulated or virtual environments.

reasonably foreseeable consequence of the defendant's carelessness. This holding in *The Wagon Mound* effectively disapproved of the earlier case of *Re Polemis & Furness, Withy & Co Ltd* [1921] 3 KB 560, in which the Court of Appeal held that a defendant is responsible for all the direct consequences of its negligence.

TOWARD A SEPARATE CLASSIFICATION OF "SECONDARY TORTFEASOR" IN TRANSMISSION CASES?

Negligent Disseminator of Video Footage as "Secondary Tortfeasor" in Nervous Shock Cases: An Alternative Target?

The previous section of this article discussed the liability of a tortfeasor for carelessly causing an accident which results in physical injuries to a primary victim, as well as psychiatric injuries to a secondary victim who views the accident. I argued in favour of relaxing the *Alcock* media rule to allow the secondary victim to recover compensation from this tortfeasor, subject to the requisite criteria of foreseeability and proximity, even if the accident is witnessed through a media filter with the aid of mobile communication technology. However, the recording and transmission of scenes from the accident in such cases are usually *not* done by the *primary* tortfeasors themselves (the parties who cause an accident), but by *another* individual, such as a witness, an onlooker or a passer-by.[49] In this section, I consider whether these third party intermediaries who record and disseminate video footage of the accident can be held liable in tort to the secondary victim, and the legal basis for such liability. In addition, I shall evaluate the viability of recognizing a new class of "secondary tortfeasor" in such cases, along with the possibility that it may present the nervous shock victim with an alternative target for the recovery of damages, if compensation from the primary tortfeasor is not available.

Traditionally, the tort of negligence has distinguished between primary victims and secondary victims in determining the scope of liability of psychiatric injury.[50] Primary victims are generally physically endangered in some way by the defendant's negligence, while secondary victims are not generally in physical danger themselves, but suffer psychiatric harm upon witnessing the endangerment or injury of their loved ones. The classification of "secondary victim", however, takes on a new dimension when the psychiatric injury suffered by the victim occurs through a "media filter". In such cases, the victim is neither at the scene of the accident nor at its immediate aftermath, and hence does not fall within any of the major established categories for recovery. In the previous section of this article, I argued that witnessing scenes through a "media filter" should not be an absolute bar against recovery from the primary tortfeasor, as long as the necessary elements of temporal proximity and consanguinity are satisfied. Deserving claimants who satisfy these requirements would therefore be eligible to recover compensation despite the lack of physical proximity to the scene of the accident. Nevertheless, the involvement of a third party – the disseminator or transmitter of disturbing video footage – mandates a more careful examination of the potential defendants against whom an action in negligence may be brought. Apart from the defendant (i.e. the primary tortfeasor) whose carelessness was the chief cause of the

[49] There may of course be exceptions to this. For example, a driver whose car has just collided with a pedestrian might videotape the series of events unfolding, including the pedestrian's reaction to the collision and the magnitude of the pedestrian's injuries. However, in many cases, the driver would likely be preoccupied with assisting the injured pedestrian rather than videotaping the aftermath of the accident. It is perhaps more likely that a driver in such cases may choose to take still photographs of the scene as evidence rather than videotape the aftermath of the accident, but it needs to be borne in mind that in serious accidents, some drivers may be too stunned to even take photographs. Curious onlookers and passersby, on the other hand, would be better positioned to take photographs and video-footage of the scene, particularly if they have the appropriate equipment and are situated close to the accident.

[50] See W *v* H Rogers (n1) 227–34, para 5–56 to 5–60. In many respects, tort law continues to make this distinction, although the dividing line between physical and psychiatric harm has been blurred somewhat by the House of Lords in *Page v. Smith* (n7), where it was held that a primary victim's psychiatric injuries do not have to be foreseeable, as long as physical injury is reasonably foreseeable. In treating the psychiatric harm as part of the primary victim's injuries, *Page v Smith* represents a more permissive approach in facilitating recovery by primary victims.

tragic event, should the disseminator of content be liable to the secondary victim as well, and if so, on what basis?

The jurisprudence on nervous shock in the United Kingdom has provided relatively little guidance on the rules of recovery against negligent disseminators of disturbing video content. The paucity of guidance provided in the case law on this issue is perhaps not surprising, given that liability for negligence in nervous shock cases has focused largely on the tortfeasor who causes the primary victim to suffer physical injury or to experience physical endangerment. In a situation involving the direct perception of injury, the secondary victim is usually also present at the scene of the tragedy, and the target of its lawsuit would be the *same* party who endangered or injured the primary victim.[51]

Interestingly, there have been a small number of decided cases either involving only "secondary victims" and no "primary victim", or "primary victims" who directly receive inaccurate information from the primary tortfeasor. Such cases relate to the careless dissemination of incorrect information by a single tortfeasor, which creates the impression of there being a "primary victim", when in fact there is none. In the case of *Froggatt v Chesterfield & North Derbyshire Royal Hospital NHS Trust*,[52] for instance, a ten-year old boy was awarded damages after overhearing a telephone conversation that misdiagnosed his mother as having contracted cancer. On the other hand, in F*arrell v Avon Health Authority*,[53] a father was allowed to recover after being given a dead baby to hold that was not his. Although the basis for this claim was the inaccurate information that he had been given, his close proximity to the dead baby placed him in the position of "primary victim". These cases, while interesting, do not shed much light on whether the careless dissemination of video footage through a wireless network can lead to liability for nervous shock on the part of the negligent disseminator. Rather, they have focused principally on the liability of a single tortfeasor for having carelessly exposed the victim to emotional harm or injury through the negligent communication of inaccurate or misleading information.

However, cases involving carelessly disseminated video footage can potentially implicate more than one tortfeasor, and the time is ripe for the tort of negligence to develop clearer rules on when the seemingly "intervening" acts of a second tortfeasor can result in the imposition of liability for the negligent dissemination of content.

It is the contention of this article that the involvement of a third party disseminator need not necessarily break the chain of causation flowing from the original act of carelessness that injured the primary victim. Taking into account the likelihood of scenes from an accident being videotaped and transmitted, there are no strong reasons to deny recovery by nervous shock claimants against either the original tortfeasor or the negligent disseminators of video content, as long as the requisite criteria of foreseeability, proximity and causation are satisfied. First, it must be reasonably foreseeable that the disseminated content would be viewed and that the viewer would suffer psychiatric injury. Second, in regard to the element of proximity, there must be a link of consanguinity between the viewer and the primary victim whose injury or suffering is depicted in the transmitted video footage. In addition, there needs to be closeness in time (temporal proximity) between the accident involving the primary victim and the viewing of the recorded footage by the secondary victim. Psychiatric injuries that are thus sustained by close family members upon viewing this footage

[51] In the case of *Alcock* (n11), both primary and secondary victims sought to recover against the same party in negligence, that is, the Chief Constable of South Yorkshire Police.

[52] [2002] All ER (D) 218 (Dec).

[53] [2001] Lloyd's Rep Med 458.

would no longer be a remote consequence, but rather an event whose cause can be traced back to at least two separate acts of negligence.

It might perhaps be argued that holding disseminators liable for nervous shock would open the floodgates of litigation, create the danger of unlimited liability for a single act of transmission and stifle freedom of expression. Such an argument would, of course, be based on the assumption that the wide net of distribution afforded by the Internet would cover a very large audience, and that the large number of viewers concerned would suffer trauma upon viewing the transmitted content. However, as with the case of the primary tortfeasor, this danger is likely to be overstated. The scope of liability would be restricted by time, consanguinity requirements, as well as evidentiary requirements of clinical proof. Only close relatives of the primary victim who happen to view the disseminated content in real time or shortly thereafter, and who suffer clinically proven psychiatric damage, would be eligible to recover compensation as secondary victims. It is therefore not the case that the disseminator would be liable in tort to numerous claimants, even if all of them were close relatives of the primary victim. To succeed in a tort action, they would have to demonstrate clear evidence of a debilitating, clinically recognized mental condition that was triggered by the transmitted footage, *and* that the footage was viewed within a very short time after the original accident.

There are, in addition, strong policy factors in favour of recognizing a duty of care by disseminators of video content to secondary victims. In the present "information age", it has never been easier to quickly and easily record and share digital content, including scenes of an accident or disaster, with the help of the Internet and ubiquitous communication devices.[54] An increasing proportion of the world's population now has access to technology which enables the viewing and sharing of such content.[55] It is now not unforeseeable for a live recording of a tragic event, particularly a major event receiving international attention, to reach a very large audience, and generate a huge outcry or backlash from the viewing community within minutes of the dissemination.[56] Recognizing a duty of care on the part of disseminators to exercise caution in sharing recorded video footage would therefore be an important step toward in fostering and promoting responsible communication in the new technological age. Incorporating this ideal of responsible communication into the tort of negligence would accordingly entail balancing the competing ideals of promoting freedom of expression and taking responsibility for the consequences of one's actions.[57]

It is nevertheless important to have a clear set of guidelines to demarcate the boundaries of liability in transmission-based nervous shock cases. The next section of this article will outline a five-stage test for determining whether a duty of care is owed by a disseminator to the secondary victims of a tragic event – an event that has been

[54] See Andrew Clark, "Road Sage: Why I'm having a Twit-fit over roadside rubberneckers", *Globe and Mail*, Wednesday, May. 08 2013, online, at: <http://www.theglobeandmail.com/globe-drive/car-life/why-im-having-a-twit-fit-over-roadside-rubberneckers/article11745336/>, who observes a growing trend among motorists and passers-by to slow down or stop and take pictures of an accident. Such habits are facilitated by technology that was not widely available ten years ago.

[55] A recent study by Cisco (n43) reveals that handsets will exceed 50 percent of mobile data traffic in 2013, as a result of increased smartphone usage. In addition, the study indicates that mobile network connection speeds will increase 7-fold by 2017.

[56] Noted examples include the tragedy at the Boston marathon in April 2013 and the explosion at the Texas power plant that same month, both of which generated a flurry of activity on the Internet.

[57] It has been observed, in the context of the posting of private information in an "altered picture" lawsuit, that "many people do not realize the consequences" of their actions on the Internet. One of the key concerns with internet communication is that once published, information is impossible to retract. See Curtis Rush, "Man with Down syndrome sues for $18 million after picture altered online", *The Star*, Wed May 01 2013, online, at <http://www.thestar.com/news/world/2013/05/01/down_syndrome_man_sues_for_18_million_after_picture_altered_online.html>, featuring an interview with Attorney Larry Crain.

recorded digitally and shared through an information network. It will be argued that the following five principal criteria be used to ascertain the presence of a duty of care in "transmission cases" which result in psychiatric injury:

1. The disseminator's purpose in recording and disseminating the content
2. The location and avenues of dissemination
3. The quality and content of the disseminated footage
4. The time lag between the original accident and the dissemination of the footage
5. The relationship between the primary victim and the secondary victim

A Five-Stage Test for Determining Duty of Care in Transmission Cases Resulting in Nervous Shock

The five criteria discussed in this section relate to the disseminator's state of mind, the time frame and nature of the dissemination, the quality of the disseminated footage, and the relationship between the primary and the secondary victim. These factors govern the foreseeability and the proximity elements, which are necessary to establish a duty of care in negligence. Given the relatively novel mechanics of harm in "transmission cases", special rules would be helpful in guiding the exercise of judicial discretion in this area.

The disseminator's purpose in recording and disseminating the content

The disseminator's goal or objective in sharing a video recording of a tragic event is a significant factor in determining the foreseeability of any psychiatric harm that might result from the viewing of the footage. The dissemination might be motivated by a number of reasons, including a desire to report a current event, social commentary – including criticism of an organization's management of a public event, an attempt to promote social awareness of a problem, or even to deliberately cause alarm or annoyance to the intended audience. Evidence of recklessness or malice on the part of the disseminator would likely contribute to a finding that a duty of care is owed, and secondly, that this duty has been breached.[58]

It might be argued that intermediaries who disseminate footage of an accident for purposes such as news reporting or social commentary are sharing information for the general benefit of the public, so that others can be made aware of the incident and to possibly assist in rescue efforts or contain the amount of harm that might arise. Even if a duty of care is found to be present, courts have traditionally found that activities which benefit the public may reduce the standard of care expected of the person performing those activities.[59] Hence, an individual who shares video footage for the purpose of news reporting may not have breached the standard of care expected of a reasonable person in the circumstances even if the footage depicts the suffering of identifiable individuals. In such cases, the depiction of suffering may be an incidental consequence of the legitimate exercise of the freedom of expression, as long as the footage was edited with reasonable care. Nevertheless, it is a question of context

[58] The presence of a deliberate intention to cause harm or annoyance can sometimes transform an otherwise innocuous act into an unreasonable one. In the tort of nuisance, there is case law to suggest that proof of malice may contribute to the imposition of tortious liability. See *Christie v Davey* [1893] 1 Ch 316, where an injunction was awarded against a defendant who banged on the wall and shouted in retaliation to piano lessons held in the adjoining property which he found annoying.

[59] See for instance *Marshall v Osmond* [1983] Q.B. 1034, where it was held that whether a defendant behaves "reasonably" in the circumstances is based on a test of flexibility which takes into account conditions of emergency under which the defendant acts. See also *Capital & Counties plc v Hampshire County Council* [1997] 2 All ER 865, which imposed a limited duty of care on the fire brigade.

whether a dissemination of footage depicting suffering is considered "reasonable". The test for whether a disseminator has acted with "reasonable care" may very well hinge on the purpose or intention behind the transmission of footage. Evidence of recklessness or malice on the part of the disseminator would weaken an argument that the disseminator had acted reasonably in the circumstances.[60]

The key feature of reckless dissemination is that the disseminator records, through photographic or audio-visual means, scenes from a tragic accident and disseminates that material to a large audience, on file sharing networks or social networking sites such as Facebook and YouTube, without necessarily having specific knowledge of the individuals who will view the material. Nevertheless, it would be reasonably foreseeable for the material in question to reach family members of the primary victim, particularly if it contains scenes of major disasters or accidents that have already received prior extensive coverage on news stations and television networks. This is especially the case if the "reckless" disseminator transmits footage that is unedited or poorly edited, and depicts, in graphic detail, injuries suffered by individuals at a major disaster who are readily identifiable. In such cases of "reckless dissemination", the prior publicity generated by the event would heighten the foreseeability that the footage posted on file sharing sites will be viewed by close family members of the primary victim.

On the other hand, recorded video footage of a tragic accident can also be circulated for a malicious purpose, through "targeted transmissions" that are aimed at specific individuals who are closely related to the primary victim featured in the footage. In these "targeted transmissions", the close relationship between the primary victim and the secondary victim is known to the disseminator, and the underlying purpose behind the transmission is to cause anguish to the intended recipient of the transmitted content. In such circumstances, the foreseeability element would be more readily established, since the very purpose of the act of transmission would be to cause harm.[61]

Although, as discussed earlier, a traditional argument that might be raised against recognizing a duty of care in such cases is the danger of a flood of litigation, such a risk may be overstated given the relatively small class of potential claimants. The class of eligible claimants for nervous shock in transmission cases – whether reckless or malicious – would generally be limited only to individuals with a close tie of affection to the primary victim who view the accident in real time or shortly thereafter. If the viewer either does not perceive the accident or its immediate aftermath through a media filter or through unaided senses, or is not related to the primary victim by a close tie of affection, then the claim for nervous shock would likely fail.[62]

In addition, there are a number of policy arguments in favour of recognizing a duty of care in cases involving reckless or malicious transmissions. Relaxing the *Alcock* media filter bar against recovery would play an important role in deterring "ghoulishly

[60] The point at which a transmission becomes "reckless" could very well depend on when the disseminator realises the potentially shocking nature of the material being transmitted. What might start out as a seemingly innocuous broadcast, for instance, of a public event might trigger tortious liability if, after an unexpected accident or catastrophe, the disseminator continues to transmit graphic footage of the injuries sustained in the aftermath of the tragedy instead of ceasing transmission.

[61] See *Wilkinson v Downton* [1897] 2 QB 57, which is often cited as authority for the proposition that a wilful and calculated act designed to cause injury gives rise to a cause of action. More recent cases such as *Wainwright v Home Office* [2003] 4 All ER 969 have nevertheless established that the infliction of humiliation by conduct designed to humiliate, does not give rise to a cause of action under the common law. The common law does not provide a remedy for emotional distress that falls short of recognizable psychiatric injury.

[62] As mentioned earlier, there is some discussion in the case law considering whether a bystander who witnesses a particularly horrific accident is eligible to recover. While some judges have expressed, in *obiter dicta*, reluctance to categorically rule out such a possibility, others have adopted a somewhat more restrictive approach to liability. See n39.

curious"[63] spectators from sharing gory images or footage of an accident for perverse pleasure, or simply to derive entertainment from its "shock" value. This would help promote the objective of encouraging the responsible sharing and use of media in the information age, and heighten the awareness, among file sharers, that such media content can have a profound impact on members of its audience. In drawing a distinction between information sharing for the public interest, and the indiscriminate dissemination of disturbing content, the law of negligence would go some way in striking a more equitable balance between promoting freedom of expression in civil society, and responsible dissemination. Disseminators of graphic visual content would therefore be under a duty to edit the material responsibly before sharing it with a large audience, or run the risk of being held liable for psychiatric injuries suffered by close family members of the primary victim. Under a relaxed *Alcock* media filter rule, dissemination of recorded video footage would result in liability if the material reaches and is viewed by a close family member of the primary victim shortly after the accident and causes psychiatric injury.

The extent to which the material is accessible to the general public

Apart from the purpose of the disseminator, how widely disseminated a recorded video clip is can have a significant impact on the likelihood that it will be viewed by a close family member of the primary victim whose suffering is depicted in the clip. As such, the forum that the disseminator chooses to showcase or disseminate the recorded content, as well as its general availability to the public, will influence, at least in part, the foreseeability of the psychiatric injury that is caused to the viewer.

A video clip of an accident that is posted on a major file sharing website such as YouTube is likely to be more accessible to the general public than one that is uploaded onto a personal web site, or onto a server that only grants access by subscription. A video recording of a major sporting event or disaster that has garnered a huge amount of public attention is particularly likely to become "viral" in a very short span of time,[64] taking into account the speed at which information can be reproduced and exchanged on the Internet.

In this vein, the approximate size of the disseminator's intended audience, which can be deduced from the forum and channels that the disseminator uses to transmit the digital content, is an important factor that contributes to the foreseeability of nervous shock, and, ultimately, liability in negligence for the psychiatric harm in question. However, this factor, on its own, is not determinative, and other considerations, such as the quality of the disseminated footage, may also be relevant.

Quality and content of the disseminated footage

Another important consideration in determining foreseeability in transmission cases relates to the quality and content of the disseminated footage. In particular, factors such as the clarity of the video clip, its length and duration, the extent to which it focusses on the suffering of the primary victim, the extent to which the identity of the primary victim is verifiable, and whether the video clip is edited to protect its audience,

[63] See *White v Chief Constable of South Yorkshire Police* (n14) 38, per Lord Steyn, who used the phrase "ghoulishly curious spectators" to refer to individuals who were not "true rescuers" at the scene of an accident, but who assisted in the aftermath in some minor, peripheral way. Such peripheral involvement did not, in Lord Steyn's view, give rise to an entitlement to claim for psychiatric injuries sustained by these spectators in the aftermath.

[64] In his work *Contagious: Why Things Catch On* (Simon & Schuster 2013), Jonah Berger outlines a list of principles which enable a news event to become "viral" on the Internet. These include social currency, triggers, emotion and public recognition. Video depictions of a very recent tragic event, particularly one that causes loss of life and/or severe injury, are likely to satisfy the currency and emotional triggers described by Berger in his book.

are all likely to materially affect the foreseeability of any psychiatric injury that the viewer may sustain as a result of viewing the material.

In essence, an unedited, full-length video clip that captures, in high resolution, the entire sequence of events surrounding a tragic event, and that clearly depicts the primary victim's facial features and sheer magnitude of the physical injury, is more likely to contribute to a finding of foreseeability than a highly edited, unprofessionally taken and shaky video clip that does not clearly depict an identifiable primary victim.

Whether there is a significant time lag

The amount of time that has elapsed between the moment of the accident and the moment of transmission to the secondary victim is another important criterion in determining foreseeability. The primary reason for this is that the impact of viewing a shocking event is likely to be most acutely felt when it is perceived immediately or shortly after its occurrence, rather than days or weeks after, particularly if the victim has already heard about the event from another source. In this respect, it is the contention of this article that a secondary victim who perceives a tragic event through a media filter should not be treated differently from secondary victims who perceive the same event through their unaided senses, at least where the issue of time lag is concerned. It ought to be noted, at this point, that instantaneous and continuous video transmission of a live event through a hand-held mobile device is more likely to be unedited than a recorded broadcast, hence potentially strengthening the secondary victim's claim that the event was witnessed in its "entirety". For the purpose of determining foreseeability, a secondary victim who witnesses a tragic event, or its immediate aftermath, by viewing clear, unedited video footage depicting the primary victim's injury in graphic detail, within a short span of time after the accident, ought to be treated on an equal footing as another witness who perceives the same details through their unaided senses within the same time frame. Hence, a secondary victim who would otherwise satisfy the requirements of foreseeability and proximity in *Alcock* and *McLoughlin*, ought not to be denied recovery simply because their perception of the tragic event was facilitated by a media device or other equipment.

It must be emphasized, however, that the perception of the accident needs to satisfy the "immediate aftermath" threshold requirement in order to be eligible for recovery as a claim in nervous shock, regardless of whether the perception occurs through unaided senses or through a media filter. A prescribed time frame is necessary to keep the bounds of liability within reasonable limits. Hence, although the *Alcock* media filter rule, as currently formulated, is too narrow and restrictive for secondary victims, it is not the contention of this article that secondary victims seeking redress for psychiatric injury be given a prolonged amount of time within which to view a recorded version of the original accident. Relaxing the spatial proximity requirement, while maintaining the temporal proximity requirement in nervous shock cases, would help to strike a fairer balance between facilitating recovery by deserving claimants and avoiding a flood of litigation in the tort of negligence.

Proximity of relationship between the primary and the secondary victim

A further factor that would be a relevant consideration in determining whether a duty of care is owed relates to the relationship of consanguinity linking the secondary victim to the primary victim. In order to ensure that the boundaries of liability for nervous shock are kept within reasonable limits, only those secondary victims who have a close relationship, usually by blood or marriage, to the primary victim would be eligible to recover compensation for their psychiatric injuries.

In *Alcock*, close family members such as children and spouses were considered, as a rebuttable presumption, to have satisfied the consanguinity requirements for a claim by a secondary victim in nervous shock. Nevertheless, Lord Ackner emphasized that a close family relationship is to be determined, not by closed categories, but by reference to the love and affection normally associated with persons in such relationships that the defendant would reasonably contemplate as being closely affected by negligent acts of omissions.[65] A successful claimant for nervous shock would have to satisfy this requirement of proximity by blood or marriage, although mere proof of a family tie is not always determinative. The closeness of even blood relations can vary tremendously,[66] just as not all spouses regard each other with the same degree of affection. The present requirement of consanguinity can be appropriately applied to "transmission cases" to limit the class of eligible claimants to close relatives. The rationale for this rule is clear – the impact of severe injury is generally far more acutely felt by a close blood relation than by a distant relative or a casual acquaintance. Nevertheless, there are exceptions to this general proposition, and while a consanguinity requirement ought to be preserved in transmission-based nervous shock cases, there appear to be no strong policy reasons to deny claims by other family members not included in the "traditional" formulation, such as extended family members of the primary victim, as long as the requisite elements of closeness and affection are satisfied. The difficulty, and perhaps futility, of defining blanket rules for what constitutes a "close family member" is encapsulated in Stocker LJ's dictum, who astutely observes that no general definition is possible, since relatives or even friends may have love for the primary victim like that of a normal parent or spouse.[67]

CONCLUSION

It has sometimes been observed that "a broken heart is much harder to endure than a broken leg".[68] In a similar vein, it might be argued that "an injured mind is far more difficult to nurse back to health than an injured body" and can be more "debilitating" and "disrupting".[69] For many years, however, psychiatric injuries have been relegated to a position of secondary importance by the tort of negligence, which has traditionally given greater priority to claims for physical injuries and property damage. "Nervous shock" has been treated as a somewhat "suspect" category of harm, attracting greater scrutiny and more stringent tests for liability. While some of this scrutiny is justified by the unique nature of psychiatric damage, the restrictive approach laid down by judicial precedents in this field prevents many deserving claimants from recovering compensation for their injuries.[70]

This article has sought to demonstrate that some of the barriers against recovery are difficult to justify in light of the new modalities of communication in the information age. The traditional reticence that has characterized judicial decisions in this field, often driven by concerns regarding the expanding boundaries of negligence liability, is now

[65] See *Alcock v The Chief Constable of South Yorkshire Police* (n11) 919–920 (per Lord Ackner).

[66] *Ibid* 921. Lord Ackner sums it up well when he writes, "The quality of brotherly love is well known to differ widely – from Cain and Abel to David and Jonathan."

[67] *Jones and others v Wright* (n24).

[68] See Allen M. Linden & Bruce Feldthusen, *Canadian Tort Law* (9th edn, LexisNexis 2011) 445.

[69] See Nicholas J. Mullany and Peter R. Handford, *Tort Liability for Psychiatric Damage: The Law of "Nervous Shock"* (Law Book Company 1993), 323.

[70] Southin J., for instance, suggests that the time is now right for scars on the mind to be treated as seriously as scars on the flesh. See *Rhodes v C.N.R. Co.* [1990] BCJ No. 2388, 5 CCLT (2d) 118 (CA) 182.

no longer a thoroughly convincing basis on which to deny recovery, particularly to secondary victims who satisfy the "temporal proximity" and "consanguinity" requirements. The foreseeability of transmission, coupled with the limiting factor imposed by the requirement of consanguinity, mandate a critical re-evaluation of the traditional tests for liability that have focused primarily on the physical proximity of the secondary victim to the scene of the accident. It has been argued, in line with developments in other parts of the Commonwealth, that physical proximity should no longer be the determining criterion for liability in the case of secondary victims, and that the *Alcock* media filter rule should be relaxed to allow recovery in deserving cases where the transmission of recorded media and the subsequent nervous shock are both foreseeable.

In addition, this article has raised a number of policy grounds in support of a separate category of tortfeasor in secondary victim cases – the "secondary tortfeasor" who negligently disseminates footage of a tragic event caused by the primary tortfeasor. Recognizing a duty of care on the part of content disseminators would play an important role in fostering responsible communication in the digital age, and to hold negligent disseminators legally responsible for their careless or reckless behaviour. The requirement of consanguinity between the primary victim and secondary victim would, in addition, place restrictions on the classes of eligible claimant, thereby alleviating the concern that such a category might open the floodgates of litigation. Nevertheless, guidelines on the factors to be used in determining the presence of a duty of care in transmission cases, such as the five part test outlined in this article, would be helpful in redefining the boundaries of negligence liability in such cases. The chain of causation linking carelessness to psychiatric injury needs to be examined more closely and critically in an age where technology has radically altered the modes of communication, so as to strike a fairer balance between deterrence and compensation in the "information age", and to redistribute, in a more equitable fashion, the burdens and benefits of socially responsible communication in modern society.

LOUDER THAN WORDS: ACCEPTANCE BY CONDUCT OF UNILATERAL OFFERS

*DANIEL DAVISON-VECCHIONE**

INTRODUCTION

The role of conduct in contractual formation has been adopted by UNIDROIT in their proposals for an international law of contract. Article 2.1.1. of the UNIDROIT Principles of International Commercial Contracts 2010 provides that a contract may be concluded "by conduct of the parties that is sufficient to show agreement". This reflects Holmes' 19th century observation that "the making of a contract does not depend on the state of the parties' minds [but] on their overt acts".[1] Ever since Mrs Carlill was immortalised in legal history by purchasing her carbolic smoke ball and using it as directed,[2] it has been accepted in English law that, if the terms make it possible, a unilateral offer can be accepted by conduct, even if the offeror is at that moment unaware of the acceptance. Acceptance by conduct therefore forms an exception to the general principle that there must be *consensus ad idem* (a "meeting of the minds") to form a contractual agreement.

In spite of how long-established a point of law it is, the basis in principle for acceptance by conduct remains remarkably unclear, particularly where the offeree has only partly completed the requested performance, but this is still found to be effective acceptance. The following arguments will be advanced over the course of this article: (i) the point at which part performance amounts to an effective acceptance by conduct is dependent upon factual circumstances; (ii) the existence of an implied term is not a satisfactory explanation for the prevention of an offeror from revoking his or her offer after part performance; (iii) the existence of a collateral contract is likewise an unsatisfactory explanation; (iv) the prevention of revocation can be best rationalised on the grounds of equity. There exist views contrary to those expressed, but these will be addressed in turn.

THE QUESTION OF PART PERFORMANCE

In *Great Northern Railway v Witham*,[3] the defendant sent a tender to supply the plaintiffs "in such quantities as the company's store-keeper might order from time to time". The Court of Common Pleas held that a contract had arisen as by placing their order, the plaintiffs had "done something which amounted to a consideration for the defendant's promise".[4] In his judgment, Brett J made a now famous example of a unilateral contract to walk to York for £100: by the offeree's going to York at the offeror's request, the offeror becomes contractually bound by his or her promise.[5] Whilst this example makes it clear that to undertake the performance requested in the

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[1] Oliver Wendell Holmes, *The Common Law* (Barnes & Noble 2004) 188.

[2] *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256 (CA).

[3] (1873–74) LR 9 CP 16.

[4] *Ibid.*, 19.

[5] *Ibid.*,

offer is sufficient to create a binding agreement, it does not completely establish the point at which the acceptance becomes effective. It remains uncertain if the offeror is contractually bound once the offeree has *begun* the requested performance or if the offeree needs to have *completed* the performance. Put another way, is the offeror bound once the offeree has taken the first step towards York, or is the offeror only bound once the offeree has actually reached York? Brett J believed the offer to be revocable at any point before the offeree's arrival in York.[6] Nonetheless, there is authority to support the view that the mere commencement of performance is sufficient to render the offer irrevocable, providing that the performance is not abandoned.

A prominent case supporting this standpoint is *Errington v Errington and Woods*.[7] Here a father told his daughter-in-law that the house he had purchased would become hers if she continued to occupy it and pay off the remaining mortgage instalments. Possession proceedings were brought against the daughter-in-law by the father's widow following his death. It was held by Denning LJ that the father's promise amounted to a unilateral offer which could "not be revoked by him once the couple entered on performance of the act, but it would cease to bind him if they left it incomplete and unperformed".[8] As this "was the position during the father's lifetime",[9] it would continue to be the position after his death, allowing the daughter-in-law to remain in the property since she had continued to pay off the mortgage.

The *Errington* principle was approved by the Court of Appeal in *Soulsbury v Soulsbury*,[10] where the deceased had agreed to leave a lump sum to his former wife in return for her not enforcing periodical maintenance payments to which she was entitled. Whilst it was acknowledged by Longmore LJ that there was a stronger case for a unilateral contract than in *Errington*, since "Mrs Soulsbury had completed all possible performance of the act required for enforcement of Mr Soulsbury's promise",[11] his Lordship recognised it to be the governing principle that once the promisee has begun to act on the promise, "the promisor cannot revoke or withdraw his offer" unless the promisee subsequently ceases to perform.[12]

In *Schweppe v Harper*[13] there was an agreement by the claimant to annul the defendant's bankruptcy and secure finance to pay off his creditors in exchange for a fee. Whilst the majority in the Court of Appeal held that on the facts there was no contract because the terms of the agreement were insufficiently certain, it was stated by Waller LJ that where an offer has been made "to pay for the performance of a certain task, part performance can produce a contract under which that offer cannot be withdrawn".[14] It was further suggested by his Lordship that there should be a greater reluctance to allow an offeror to revoke his or her offer after part performance by the offeree where "there is a real benefit being accepted by the offeror from that part performance".[15] This was rationalised by the need for the courts not to support sharp practice unless this is unavoidable; as such, "if A offers to pay £1000 if B walks from

6 *Ibid.*,
7 [1952] 1 KB 290 (CA).
8 *Ibid.*, 295.
9 *Ibid.*,
10 [2007] EWCA Civ 969, [2008] Fam 1.
11 *Ibid.*, 20.
12 *Ibid.*, 19–20.
13 [2008] EWCA Civ 442.
14 *Ibid.*, 46.
15 *Ibid.*,

London to York, A should not be entitled to withdraw that offer once it is realised B is within very few miles of York''.[16]

It thus appears that part performance by the offeree will be sufficient to prevent an offeror from revoking his or her offer, but that this is dependent upon circumstantial factors such as the extent to which the offeree had completed performance at the time of the attempted revocation, whether the offeree was at this point continuing to perform the requested action, and whether the offeror had received a benefit from the commenced performance. Nonetheless, the question remains unanswered as to what the basis for this prevention of revocation is. The following possible theories will therefore be discussed: the existence of an implied term, the existence of a collateral contract, and the raising of an equity in favour of the offeree by reason of his or her reliance on the promise.

THE IMPLIED TERM THEORY

In *Mackay v Dick*[17] there was an agreement to purchase an excavator required for the construction of a railway line on the condition that it could excavate a given quantity of clay in a fixed time on a ''properly opened-up face''. The excavator was delivered by the pursuers and after it had experienced some difficulties, the defender refused to give it any further trial to ascertain whether it could fulfil the agreed condition. The pursuers were held by the House of Lords to be entitled to payment of the excavator's price. As stated by Lord Blackburn, ''the Defender, having had the machine delivered to him, was by his contract to keep it, unless on a fair test according to the contract it failed to do the stipulated quantity of work''.[18] Additionally, Lord Watson cited with approval a passage from *Bell's Principles* that where a debtor ''bound under a certain condition [has] impeded or prevented the event'' necessary for the creditor to complete contractual performance, it is held to be accomplished if the creditor has done all he or she can to fulfil the incumbent condition.[19]

It can be argued that these aspects of the *ratio* in *Mackay* hold little relevance to the position in English law on acceptance by conduct as they concerned a condition precedent in a bilateral contract rather than the acceptance of a unilateral offer. Additionally, one could argue that the principle outlined by Lord Watson is solely reflective of the position in Scots law. Nevertheless, since *Mackay* the notion of an implied obligation that the offeror will not frustrate the offeree's attempt to fulfil the necessary condition has seen support in English case law. In *Daulia Ltd v Four Millbank Nominees Ltd*[20] the plaintiffs sought damages for the breach of an oral agreement that the defendants would exchange contracts for the sale of certain properties if the plaintiffs attended their offices with a draft contract that accorded with the terms already agreed, as well as a banker's draft for the amount of the deposit.

It was held by the Court of Appeal that whilst there was a valid unilateral contract, as it concerned the disposition of an interest in land, the now-repealed s 40 of the Law of Property Act 1925 applied and, in the absence of writing, this could be enforced only ''if there was sufficient part performance to take the case out of the section''.[21] The

[16] *Ibid.*, 45.
[17] (1881) 6 App Cas 251 (HL).
[18] *Ibid.*, 264.
[19] *Ibid.*, 270; George Joseph Bell, *Principles of the Law of Scotland* (10th edn T & T Clark 1899) § 50.
[20] [1978] Ch 231 (CA).
[21] *Ibid.*, 245.

agreement was found to be unenforceable as the plaintiffs' actions appeared to have been done in contemplation of entering a contract rather than in performance of a contract.[22] Whilst the *ratio* in *Daulia* turned on the statutory regime which then governed contracts for the sale and disposition of interests in land, in his judgment Goff LJ made some observations on unilateral contracts in general. One such observation was that where a condition has been imposed by the offeror, "there must be an implied obligation on the part of the offeror not to prevent the condition becoming satisfied", which arises "as soon as the offeree starts to perform".[23]

Complications for the implied term theory arise from *Luxor v Cooper*.[24] Here an action was brought by Cooper against two companies for a commission, which he alleged to have been agreed to be paid for his introduction of the purchasers of the companies' property. Cooper further alleged that there was an implied term in the contract between him and the companies that nothing would be done to prevent him from earning the commission in accordance with the contract, and that this term had been breached by the companies' failure to complete the contract of sale with his client. The House of Lords found for the companies, with Viscount Simon LC distinguishing *Mackay* on the basis that the work Cooper was invited to do (producing an offer for the property) did "not require [the defendants'] co-operation at all".[25] Furthermore, Lord Wright held that in cases such as *Mackay* where a defendant is alleged to have "prevented the plaintiff from fulfilling a condition on which his right to payment depends", it must be shown that the act which prevented this fulfilment "was wrongful, and the wrong would be generally a breach of the contract".[26]

Whilst it is true that *Luxor* dealt with issues of agency which did not arise in either *Mackay* or *Daulia*, their Lordships' decision raises serious questions as to when an obligation to not prevent the promisor's condition from being satisfied can be implied: is it as universal as suggested in *Daulia*, arising immediately upon the commencement of performance, or is it narrowed to circumstances where co-operation is required by the offeror, or where the offeror's intervening act is wrongful? What is most damaging to the implied term theory, however, is its artificiality. As explained by Bowen LJ in *The Moorcock*,[27] contractual terms implied at common law are based upon what the courts consider necessary to give effect to the presumed intentions of the parties.[28] For a period in the late 19th and early 20th centuries, such terms enjoyed popularity as a means of rationalising the imposition of or release from obligations under a contract. This can be seen from the introduction of the doctrine of frustration in *Taylor v Caldwell*,[29] where Lord Blackburn held the parties' contractual duties to have ended after a hired hall burned down "without fault of either party",[30] which he based on an implied term giving effect to what the parties presumably intended to occur if performance of the contract became impossible.[31]

Nevertheless, as stated by Lord Denning in *The Eugenia*,[32] by the mid-20th century this theoretical basis for the doctrine had been "discarded by everyone, or nearly

[22] *Ibid.*, 243.
[23] *Ibid.*, 239.
[24] [1941] AC 108 (HL).
[25] *Ibid.*, 118.
[26] *Ibid.*, 148.
[27] (1889) 14 PD 64 (CA).
[28] *Ibid.*, 68.
[29] (1863) 122 ER 309.
[30] *Ibid.*, 315.
[31] *Ibid.*, 312.
[32] [1964] 2 QB 226 (CA).

everyone, for the simple reason that it does not represent the truth".[33] It is submitted that rationalising the prevention of revocation where there has been part performance on the basis of an implied obligation should likewise be abandoned. Not only does it suffer from the inherent problem with terms implied at common law of being based on a legal fiction as to the parties' intentions, but the willingness of the courts to deem acceptance by conduct as effective in some instances where part performance has been embarked on, but not in others, discounts any possibility of a general obligation to not prevent the condition from being satisfied. Furthermore, attempting to explain the judicial inconsistency by claiming that a term is implied in only certain cases does little more than create uncertainty as to when such an implication can be made; uncertainty which a doctrine based on unreal intentions is simply too blunt an instrument to remove with any precision.

THE COLLATERAL CONTRACT THEORY

Related to the theory of an implied term to not prevent the stipulated condition from being satisfied is that of the existence of a contract which is collateral or ancillary to the primary contract between the parties. The basis of collateral contracts is well illustrated by *Shanklin Pier v Detel Products*.[34] Here the plaintiff pier owners had instructed the painters with whom they had contracted to use a particular paint manufactured by the defendant company, two coats of which was understood to be able to last for seven to ten years minimum because of a warranty provided by the defendants. The paint turned out to be unsuitable, causing the plaintiffs to be put to extra expense. Whilst the defendants were a third party to the contract between the plaintiffs and the painters, the action for breach of warranty was successful. In the King's Bench Division, McNair J held there to be valuable consideration provided for the warranty by the plaintiffs in the form of causing a third party (the painters) to purchase the defendants' warranted product.[35] It therefore appears that the existence of a collateral contract is based on the promisor receiving an indirect, valuable benefit from the action taken in reliance by the promisee.

The theory that an offeror is prevented from revoking the offer after the offeree has begun to perform because of a collateral contract between the parties has some support from the case law on auctions. In *Warlow v Harrison*[36] it was outlined *obiter* by the Court of Exchequer Chamber that where an auction is advertised to be without reserve, a unilateral offer is made that there will be no reserve, with the highest *bona fide* bid constituting acceptance of this offer.[37] These *dicta* were applied in *Barry v Davies (t/a Heathcote Ball & Co)*,[38] where the plaintiff made a bid of £200 at an auction without reserve for two engine analysers, approximately worth £14,000 each. The auctioneer, considering the bid too low, withdrew the analysers from sale. The action against the auctioneer succeeded on basis of a breach of collateral contract, the consideration for this contract existing "in the form of detriment to the bidder, since his bid can be

[33] *Ibid.*, 238.
[34] [1951] 2 KB 854 (KB).
[35] *Ibid.*, 856.
[36] (1858) 1 Ellis and Ellis 295.
[37] *Ibid.*, 307–08.
[38] [2000] 1 WLR 1962 (CA).

accepted unless and until it is withdrawn, and benefit to the auctioneer as the bidding is driven up''.[39]

The collateral contract theory can additionally be supported by the case law discussed above in respect of the implied term theory. After all, one could take the view that the discussion in *Daulia* and *Luxor* of a possible contractual obligation to not prevent the condition outlined in the offer from being satisfied necessarily depends on the existence of an ancillary contract between the parties into which such a term can be implied. In other words, there can be said to be a collateral contract which arises from the offeree's part performance and that it is the breach of an implied term under this contract, not the main contract formed by acceptance of the offer, which gives rise to the offeree's right to damages for the offeror's act of revocation. Such an interpretation would, however, not avoid the problematic issues outlined above regarding implied terms.

Despite its support in case law, the collateral contract theory shares a common, crucial weakness with the implied term theory: artificiality. This manifests itself in two notable respects. First, much like an implied term, a collateral contract is little more than a legal fiction designed to justify the courts' imposition of contractual rights and duties upon the parties, irrespective of their actual intentions. Second, like any contract, the existence of a collateral contract depends upon the finding of valuable consideration. As defined by Pollock and accepted by Lord Dunedin in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*, consideration is the act or forbearance by one party ''for which the promise of the other is bought''.[40] The consequent problem is that to make the finding of an exchange of value between the parties necessary to establish a collateral contract, the courts will often interpret consideration in a significantly broad and unconventional manner.

This can be seen from *Wells (Merstham) v Buckland Sand and Silica Co*,[41] where sand was supplied through a third party to the plaintiff chrysanthemum growers, which was warranted to conform to a certain analysis. The sand did not conform to the analysis and proved unsuitable for the propagation of chrysanthemum plants, causing the plaintiffs to suffer loss. In the Queen's Bench Division, Edmund Davies J held there to have been a breach of collateral contract, stating that there are only two ingredients required for such a contract. The first of these ingredients was stated to be ''a promise or assertion [. . .] as to the nature, quality or quantity of the goods which [the promisee] may reasonably regard as being made *animo contrahendi*''[42] (in other words, with the intent to be bound). The second ingredient was stated to be the ''acquisition by [the promisee] of the goods in reliance on that promise or assertion''.[43] It was further held that ''the act of entering into the main contract'' provided all the necessary consideration for the collateral contract.[44]

As such, the question arises of whether the act of part performance itself amounts to good consideration for a collateral contract. Such a standpoint is supported by the suggestion of Waller LJ in *Schweppe* above that ''part performance can produce a contract under which [the offer] cannot be withdrawn''.[45] Whilst it has the advantage of not requiring the strained finding of an economic benefit which indirectly flows to

[39] *Ibid.*, 1967.

[40] [1915] AC 847 (HL) 855; Frederick Pollock, *The Principles of Contract At Law and In Equity* (8th ed Stevens and Sons Ltd) 175.

[41] [1965] 2 QB 170 (QB).

[42] *Ibid.*, 180.

[43] *Ibid.*,

[44] *Ibid.*,

[45] n 13., 46.

the offeror in accordance with *Shanklin Pier* above, this interpretation is not without its shortcomings. Like the implied term theory, questions are raised as to why in such cases as *Errington* the offeree's commencement of part performance has been found sufficient to prevent the offeror from revoking, whilst in other cases such as *Luxor* it has not. After all, if the act of part performance itself constitutes the execution of consideration for a collateral contract between the parties, it should logically follow that such would be true in any case in which performance is embarked upon by the offeree. It is thus submitted that whether viewed through the lens of an indirect, economic benefit as good consideration or that of part performance itself as good consideration, the collateral contract theory cannot provide a coherent explanation for the prevention of revocation upon part performance. This is because the theory produces too much judicial lip service to the traditional elements of contractual formation and, like the implied term theory, fails to explain the courts' inconsistent decisions on whether part performance amounts to effective acceptance.

On a final note, as seen from the above authorities on auctions and warranties, much of the case law on collateral contracts governs situations where a claimant in an existing contractual relationship brings an action against a third party. In other words, collateral contracts are, by and large, simply used as a means of circumventing privity of contract. As such, many of the justifications put forward by judges in cases on collateral contracts, such as the notion that entry into the main contract is sufficient consideration for a collateral contract, cannot be applied to situations where the claimant is in no contractual relationship to begin with. In light of this limitation to its usefulness, as well as the aforementioned issues of artificiality in respect of the parties' intentions and the finding of consideration, the collateral contract theory provides little assistance in rationalising acceptance by conduct.

EXPLANATIONS IN EQUITY: THE BASIS

With the implied term and collateral contract theories discarded, the search for a principled basis of acceptance by conduct will be taken beyond the boundaries of the common law and into the realms of equity. Particular emphasis will be drawn to the case law relating to equitable estoppel. Equitable estoppel is an umbrella term for a set of doctrines which operate in equity to prevent a representor from unconscionably reneging on an understanding which has been relied on by the representee, even if the representor would be permitted to do so at law.[46] As explained by Lord Denning in *Crabb v Arun DC*,[47] the equitable estoppels are examples of equity "[coming] in, true to form, to mitigate the rigours of strict law".[48]

Before discussing the relevance of the authorities on equitable estoppel, it should be established why it is necessary to consider these authorities in respect of acceptance by conduct rather than those on common law estoppel. The manner in which common law estoppel is understood to operate is well-illustrated by *Cadbury Schweppes plc v Halifax Share Dealing Ltd*,[49] where an indemnity was claimed by Cadbury Schweppes from the defendant stockbrokers to recover losses they had suffered as a result of fraudsters

[46] To clarify, the author is using the term 'equitable estoppel' as understood in English law: *Lester v Woodgate* [2010] EWCA Civ 199 [25] (per Patten LJ). Contrastingly, American courts tend to use it more specifically to describe the form of estoppel that prevents a party from taking unfair advantage of a representation of material fact upon which the representee has relied to a change of position: *Wurl v Polson School District No 23* 127 P3d 436, 443 (Mont 2006).

[47] [1976] Ch 179 (CA).

[48] *Ibid.*, 187.

[49] [2006] EWHC 1184 (Ch), [2006] BCC 707.

usurping the identities of shareholders. Here the Chancery Division held where there is a representation of existing fact, as well as "reliance upon it and detriment suffered by way of reliance", an estoppel arises to prevent the representor from denying the truth of the representation.[50] On the facts, Cadbury Schweppes were found to be estopped from denying the truth of their apparently regular share certificates, which identified the fraudsters as shareholders. This was because the certificates had been relied on by the stockbrokers to their detriment. As a result of the estoppel finding, Cadbury Schweppes were prevented from claiming the sought indemnity.[51]

The operation of estoppel at common law is, however, subject to a significant limitation. In *Jorden v Money*,[52] there had been a bond given to secure the repayment of a monetary sum. The bond was inherited by the plaintiff, who promised to not enforce the outstanding debt, but an action was eventually brought for it regardless. The Privy Council held that the plaintiff's promise could not be enforced on the basis of common law estoppel as the doctrine "does not apply to a case where the representation is not a representation of a fact, but a statement of something which the party intends or does not intend to do".[53] It is true that in *Jorden* Lord St Leonards in a powerful dissenting judgment found it "utterly immaterial" whether a representation that induces reliance is one of existing fact or future intention.[54] It is also true that the High Court of Australia has come to abandon this distinction between common law estoppel and equitable estoppel, finding it "anomalous and potentially unjust to allow the two doctrines to inhabit the same territory yet produce different results".[55] Nevertheless, in light of how this step is yet to be taken by the English courts, common law estoppel is ill-equipped to deal with claims of effective acceptance by conduct, as these arise from the offeree acting upon a representation of future action, not existing fact. It is therefore necessary to instead consider the case law on equitable estoppel.

The most prominent authority to suggest an equitable rationalisation of acceptance by conduct is *Errington*.[56] As outlined above, it was decided by Denning LJ that the daughter-in-law could occupy the house so long as she continued to pay off the mortgage, as this amounted to her acceptance of the father's offer to transfer the house to her. Whilst this at first appears to be a straightforward application of common law principles of contractual formation, not only was attention drawn in his Lordship's judgment to the increased fusion of law and equity in licence cases, particularly in respect of prevented revocation,[57] but to how the son and daughter-in-law, whilst not purchasers, had "acted on the promise, and neither the father nor his widow, his successor in title, [could] eject them in disregard of it".[58] This seems to suggest an approach based less on a strict, common law interpretation of contractual formation and more on the holistic consideration of good conscience which underpins equitable doctrines.

One of the equitable estoppels recognised in English law is proprietary estoppel. Proprietary estoppel can arise where a party has been led to believe that he or she would receive an interest in land and this belief was relied on to detriment. As the

[50] *Ibid.*, 718.
[51] *Ibid.*, 723.
[52] (1854) 5 HL Cas 185 (PC), 10 ER 868.
[53] *Ibid.*, 882.
[54] *Ibid.*, 895.
[55] *Commonwealth v Verwayen* (1990) 64 ALJR 540, 546.
[56] n 7.
[57] *Ibid.*, 298–299.
[58] *Ibid.*, 300.

promise in *Errington* had been one of an interest in land, which was recognised by the Court of Appeal to have been relied on, there is weight to the view that *Errington* could have been decided on the grounds of proprietary estoppel. The question therefore arises of why the doctrine, whilst seemingly hinted at in the aforementioned statements by Denning LJ regarding the prevention of revocation through equitable intervention and the promisee's act of reliance on the understanding that she would receive the house, was not expressly applied by any of their Lordships in *Errington*.

It is submitted that the reasons for this are twofold and both relate to the context of equitable estoppel's development. First, proprietary estoppel was initially based on requirements known as the "five probanda", as outlined by Fry J in *Willmott v Barber*.[59] It was necessary to show that (i) the plaintiff had made a mistake as to his or her legal right over the land, (ii) the plaintiff had expended money or otherwise acted on the faith of the mistake, (iii) the possessor had known of his or her own right inconsistent with that claimed by the plaintiff, (iv) the possessor had known of the plaintiff's mistaken belief, and (v) the possessor had encouraged the plaintiff's expenditure, either directly or by abstaining from asserting his or her right.[60] As such, at the time that *Errington* was decided, proprietary estoppel was understood to be more concerned with the conscience of the landowner than the representation's effect on the relying party. It would thus have proven difficult to directly apply the doctrine to the facts of *Errington* since the occupier's father-in-law had not knowingly encouraged her to act on the faith of a mistake as to her legal right.

Second, the Court of Appeal came to decide *Errington* later in the same year as its landmark ruling in *Combe v Combe*.[61] Here an action was brought by the plaintiff against her former husband for promised payments of maintenance. In the absence of consideration, it was held that promissory estoppel could not be used to enforce the agreement since the doctrine "may be part of a cause of action, but not a cause of action in itself".[62] Whilst *Combe* was a case on promissory estoppel which, unlike proprietary estoppel, more broadly concerns promises to not enforce strict legal rights, it appears likely that the Court of Appeal in *Errington* would have been wary of extending the limits of equitable estoppel so soon after their effort to prevent the influx of equity from significantly eroding the traditional requirements of contractual formation. As such, it is advanced that *Errington* was in reality decided on the grounds of equitable estoppel, but the court could not do so explicitly because of the restrictions upon estoppel perceived to exist at the time.

It is nevertheless worth noting that since *Errington* there has been a noticeable shift in the focus of proprietary estoppel away from the mental state of the representor and towards the detrimental reliance by the representee. In *Inwards v Baker*,[63] for instance, where a son had built a bungalow upon his father's land in the belief that he would be permitted to occupy it for life, an equity was held to be raised in the son's favour, preventing the trustees under the father's will from recovering the land despite there not being an express agreement between the father and son. The expenditure of money by the son in reliance on the induced belief was all that was necessary for him to "be allowed to remain there".[64] This shift towards the effect of the expressly or impliedly-made representation on the relying party was completed with *Taylor Fashions*

[59] (1880) LR 15 Ch D 96 (Ch).
[60] *Ibid*., 105–06.
[61] [1951] 2 KB 215 (CA).
[62] *Ibid*., 220.
[63] [1965] 2 QB 29 (CA).
[64] *Ibid*., 37.

Ltd v Liverpool Victoria Trustees Co Ltd.[65] The case concerned actions brought by the tenants of a pair of adjoining shops for the specific performance of options to renew contained in their leases, with estoppel claims arising from the improvements made by the tenants in reliance on said options. Here Oliver J outlined the modern understanding of proprietary estoppel, which is that it must in all of the circumstances be "unconscionable for a party to be permitted to deny that which, knowingly, or unknowingly, he has allowed or encouraged another to assume to his detriment".[66]

With this considerably broader and more holistic interpretation of the doctrine in mind, it appears probable that had *Errington* been brought before the Court of Appeal after *Taylor Fashions*, the daughter-in-law could have made a strong argument based on proprietary estoppel, which may have given the courts more favourable grounds on which to decide the case than the unusually wide conception of a unilateral contract adopted by Denning LJ. As such, it is submitted that the case law on equitable estoppel, particularly in light of the liberalisation of proprietary estoppel, provides a means by which the courts can more convincingly rationalise decisions relating to acceptance by conduct, since equity allows focus to be more readily drawn to the key questions of legitimate expectation and reasonable reliance which arise in such cases.

RELATIONSHIP WITH CONSIDERATION

Objections can nevertheless be raised against the suggestion that in cases on acceptance by conduct, judges should draw more heavily from equitable concepts. First, there is the issue of consideration. In a case on acceptance by conduct, the finding of an act of acceptance will not in and of itself give rise to a contractual obligation: all the necessary elements of a contract must be satisfied, including consideration. In the words of Denning LJ in *Combe*, consideration is "too firmly fixed to be overthrown by a side-wind".[67] It is for this reason that, unlike proprietary estoppel, promissory estoppel in English law cannot be an independent cause of action; in the famous words of Mr Kee, the counsel for the defendant in *Combe*, it can be used as "a shield and not as a sword".[68] It could therefore be argued that to find that a claimant has effectively accepted an offer by conduct on the basis of an equity being raised in his or her favour could undermine the necessity of consideration in contractual formation. This could be particularly problematic where the assurance in question was not in respect of an interest in land, as this would fall outside the scope of proprietary estoppel.

It is nevertheless submitted that this potential objection to greater acceptance of the role of equity in determining the prevention of revocation is unconvincing. First, it must be clarified that whilst the author has elsewhere discussed the merits of recognising equitable estoppel in general as a cause of action,[69] this article is not advancing that all contractual claims which depend on a finding of effective acceptance by conduct should be treated purely as estoppel claims. It is instead advanced that where such a contractual claim is brought, the question of whether the offeree's act of part performance prevents the offeror from revoking the offer should be determined by

[65] [1982] QB 133 (Ch).

[66] *Ibid*., 151–52.

[67] n 61, 220.

[68] *Ibid*.,218.

[69] Daniel Davison-Vecchione, 'An Estoppel by Any Other Name' (2012) Issue Two, Surrey Law Working Papers Short Notes <http://www.surrey.ac.uk/law/pdf/sslwp/An%20Estoppel%20by%20Any%20Other%20Name_Davison%20 Vecchione .pdf> (accessed 23 June 2013).

the sorts of considerations made when determining an equitable estoppel finding, such as whether the offer would give rise to a reasonable expectation that the promise would be honoured, such that the offeree's reliance was justified in the circumstances and that denying the expectation in light of this reliance would be unjust.

This means that whilst the components of offer and acceptance would be determined on equitable grounds, for the contractual claim to be successful there would still need to be findings of consideration and the intent to be legally bound. Such an application of equitable principles is in keeping with the generally ancillary jurisdiction of equity in the field of contract. It is also in keeping with the *ratio* in *Combe*: whilst the Court of Appeal did hold that promissory estoppel could not be itself a cause of action, it was accepted that the doctrine could be "part of a cause of action".[70] It is therefore perfectly possible under English law for a contractual claim to succeed where it would have failed but for a promissory estoppel finding. As humorously summarised by Blair and Hird, promissory estoppel is a shield and not a sword, but there should be circumstances in which it is "permissible to hit the other party with the shield".[71]

RELATIONSHIP WITH CONTRACTUAL FORMATION IN GENERAL

It is further submitted that an equitable rationalisation of forming the necessary agreement for a contract can help to avoid the artificiality often produced by the more traditional approach to ascertaining contractual formation. As acknowledged by Lord Wilberforce in *The Eurymedon*,[72] such is the "rather technical and schematic doctrine of contract" in English law that in application it "takes a practical approach, often at the cost of forcing the facts to fit uneasily into the marked slots of offer, acceptance and consideration".[73] This is apparent not only from the case law on collateral contracts discussed above, but from the leading authorities on the acceptance of unilateral offers in general. In the famous case of *Carlill v Carbolic Smoke Ball Co*,[74] for instance, a finding of consideration was based on the mere inconvenience of using the smoke ball as directed in reliance on the advertisement.[75] In this respect, the interpretation of consideration adopted by the courts in acceptance by conduct cases more closely resembles the "detriment" and "change of position" tests applied in cases on equitable estoppel than the orthodox understanding of consideration as an exchange of value.

The resemblance between the reasoning which underlies equitable estoppel and that which underlies contracts arising from conduct can be noticed most easily from cases where a contractual agreement has been found by the court despite the absence of offer and acceptance. In *Brogden v Metropolitan Railway Co*[76] an agreement was drawn up between the parties for the supply of coal, which was eventually placed in a drawer with no further action taken to formally execute it. The parties nevertheless proceeded to act in accordance with the arrangements contained within the document. It was held by the House of Lords that a contract had arisen between the parties, the intention to be legally bound being clear from how the company had "commenced a course of

70 n 61, 218.

71 Ann Blair and Norma J Hird, 'Minding Your Own Business - Williams *v* Roffey Re-Visited: Consideration Re-Considered' [1996] JBL 254, 262.

72 [1975] AC 154 (PC).

73 *Ibid.*, 167.

74 n 2.

75 *Ibid.*, 264–65.

76 (1877) 2 App Cas 666 (HL).

dealing" referable to the contract and how said course of dealing had been accepted and acted upon.[77] Similarly, in *G Percy Trentham Ltd v Archital Luxfer Ltd*[78] it was held that agreements in respect of the design and construction of industrial units were enforceable, with the contracts having partly come into existence "during performance even if it cannot be precisely analysed in terms of offer and acceptance", which reflected the "realism about the practical application of contract formation".[79]

The concept illustrated by *Brogden* and *Trentham* that an enforceable agreement can arise from the display of intention resulting from regular conduct bears a particularly close resemblance to the doctrine of estoppel by convention. Under this form of estoppel, a party can be prevented from acting in contravention of an assumption established by previous, consistent behaviour. In *Amalgamated Investment & Property Co Ltd (In Liquidation) v Texas Commerce International Bank Ltd*,[80] a guarantee was made by a company to secure all money owed by its subsidiary to a bank. The company's subsidiary defaulted, but the guarantee was claimed to not cover the money owed to the bank's subsidiary, through which the contended loan had in fact been made. As it was evident from their overall course of dealing that the parties had commonly assumed the company to be liable for the loan despite the express terms of the guarantee, the Court of Appeal held them to be "bound by the 'conventional basis'" on which they had conducted their affairs.[81]

Whilst it is true that, generally speaking, estoppel by convention is understood to be a means of "[rendering] an agreement effective for achieving its purpose"[82] by preventing an inequitable departure from the interpretation of the agreement commonly held by the parties, rather than a means of initially establishing a contractual relationship, the connection between reliance on an understanding arising from consistent conduct and the formation of an enforceable agreement has been recognised by UNIDROIT under its aforementioned 2010 Principles. Article 2.1.6 of the Principles provides that where there are "practices which the parties have established between themselves [. . .] the offeree may indicate assent by performing an act without notice to the offeror", constituting effective acceptance of the offer. It is thus submitted that to rationalise the prevention of revocation on the basis of an equitable intervention where an understanding arises from conduct rather than express agreement is justified.

CERTAINTY AND PRACTICALITY

In addition to the question of how such reliance on equitable concepts can be reconciled with the doctrine of consideration and other traditional elements necessary to form a contract, there is the issue of certainty. Equitable doctrines are of a discretionary nature and their application turns on questions of conscience. It could thus be argued that allowing equitable principles to govern findings of effective acceptance by conduct would cause contractual dealings to become impractically dependent on ethical considerations and factual context. This could prove particularly problematic in the field of commerce, where certainty is crucial in day-to-day

[77] *Ibid.*, 680.

[78] [1993] 1 Lloyd's Rep 25 (CA).

[79] *Ibid.*, 29–30.

[80] [1982] QB 84 (CA).

[81] *Ibid.*, 121.

[82] Catherine Mitchell, 'Contracts and Contract Law: Challenging the Distinction Between the "Real" and "Paper" Deal' (2009) 29 OJLS 675, 701.

transactions. It is true that the forms of equitable estoppel discussed above are "rationalised on the unconscionability ground"[83] and that the concept of unconscionability is arguably too subjective to be a reliable basis for contractual formation or too high a threshold to be met by a claimant in respect of an action arising from the ordinary course of commercial dealing.

It is submitted that such fears are not as strongly founded as initially apparent. First, it should be considered how unconscionability seems to have developed different thresholds in different contexts, overlapping considerably in certain respects with similar concepts known to the common law, such as reasonableness. In the words of Somers J, it is "likely that over the years words such as unconscionable and inequitable have drawn closer to more objective concepts such as fair, reasonable and just".[84] This can be seen from the resemblance between equitable estoppel in its offensive capacity and the common law doctrine of negligent misstatement in tort: as observed by Mitchell, both doctrines operate to remedy the loss suffered by a relying party where an encouraged expectation is not met and "the justification for protecting the expectation is particularly strong".[85] As such, the intervention of equity does not always depend on conduct so outrageously defiant of moral principles as to be unconscionable in the most readily understood sense; it can instead be based on the simple question of whether it would produce the outcome that is fair, just and reasonable in the circumstances.

Furthermore, the concept of a moral dimension in contract law is hardly novel. Fried, who identifies promise as "the moral basis of contract law",[86] academically observes that it is through promising that "we put in another man's hands a new power to accomplish his will".[87] It is morality, according to Fried, which underlies even the "modest, humdrum ends" served by the law of contract.[88] Judicial support for the role of morality in contractual formation can be seen from the case law discussed above in respect of acceptance by conduct, such as the rulings in *Errington*[89] and *Soulsbury*[90] that revocation should not be effective where the offeree at that point is continuing to perform, the suggestion in *Schweppe* that courts should be especially reluctant to allow revocation by the offeror where performance is known to be approaching completion,[91] and the statements in *Luxor* that an obligation to not prevent the satisfaction of a condition should only be implied where the offeror's intervening act would be wrongful.[92] All of these examples indicate an understanding that the revocation of an offer should be prevented where it would be considered contrary to reasonable expectations or otherwise unjust in light of the offeree's induced reliance.

Additionally, it has been observed by Handley that the role of unconscionability in estoppel cases is ultimately determined by "an objective assessment based on the reliance, detriment, and reasonable expectations of the claimant".[93] Not only does this accord with Holmes' view of the law of contract as based on the meaning attached to

[83] Mark Lunney, 'Towards a Unified Estoppel - The Long and Winding Road' [1992] Conv 239, 250.

[84] *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180, 193.

[85] Catherine Mitchell, 'Leading a Life of Its Own? The Roles of Reasonable Expectation in Contract Law' (2003) 23(4) OJLS 639, 662.

[86] Charles Fried, *Contract as Promise* (Harvard University Press 1982) 1.

[87] *Ibid.*, 8.

[88] *Ibid.*,

[89] n 7.

[90] n 10.

[91] n 13, 45–46.

[92] n 24, 148.

[93] KR Handley, 'Unconscionability in Estoppel by Conduct: Triable Issue or Underlying Principle?' (2008) 5 Conv 382, 400.

the overt acts of the parties rather than their privately held intentions,[94] but connections have been drawn by Atiyah between the line of cases on equitable estoppel to which *Errington* and *Inwards* belong on the one hand and reliance-based contractual liability on the other, recognising such developments as based on the prevention of a person from standing by and allowing another to "act to his prejudice".[95] In light of these academic observations, it is submitted that a reliance-based approach which assumes the perspective of a reasonable and moral person would not be excessively uncertain and ill-suited to commercial transactions. After all, in the world of commerce, the practices of businesspersons often assume a regular and consistent nature. In this respect, there may actually be a stronger case for an approach based on reasonable reliance in a commercial setting as the perceived predictability of business practice makes it "more natural and justifiable" for parties to rely upon raised expectations.[96]

CONCLUSION

In conclusion, the effectiveness of acceptance by conduct is dependent on context and more convincingly rationalised by principles of equity than the existence of an implied term or collateral contract. This is because an approach rooted in equity bypasses the need to resort to artificial devices for the imposition of obligations and allows focus to be drawn to what is truly at the heart of acceptance by conduct: whether (i) a legitimate expectation was raised by the offeror and (ii) this was reasonably relied on by the offeree, such that it would be unjust or unreasonable to allow the offer to be withdrawn. As such, if judges were to draw from the case law on equitable estoppel when rationalising decisions on contractual acceptance by conduct, it could finally bring some needed principle and transparency to this crucial aspect of the law of contract.

[94] n 1, 188.
[95] PS Atiyah, *The Rise and Fall of Freedom of Contract* (OUP 1979) 778.
[96] *Ibid.*, 188.

THE LOST VOICE IN INSOLVENCY: THEORIES OF INSOLVENCY LAW AND THEIR IMPLICATIONS FOR THE EMPLOYEES

*SAMUEL E. ETUKAKPAN**

INTRODUCTION

The relationship between employees and the company they work for is symbiotic[1] in nature: employees need the company for the attainment of their economic needs and well-being,[2] just as the company needs the employees for its day to day functioning. The company is a vehicle for organising both property[3] interests and the economic lives of its employees in the economy.[4] Employees are important for the success and daily functioning of businesses. They provide the labour and skills companies require for converting financial capital into goods and services needed in the economy.[5] Employees make human capital investment in the companies they work for.[6] These investments add value to businesses and enhance corporate productivity.[7]

Given the benefits accruing to both parties from the mutual relationship, the expectation is that neither the company nor the employees would exert unnecessary pressure on each other if the long term survival of the relationship is to be guaranteed. However, there are events in the life of the company capable of threatening this relationship with the prime example being insolvency. Insolvency is inherent in every market economy.[8] It is a non-selective and non-respecter-of-size business misfortune

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[1] 'Symbiosis' is a biological science terminology. A 'symbiotic relationship' is a term commonly employed to explain the relationship between two entities that depend on each other to survive and prosper. It is therefore a mutually beneficial relationship for the parties involved. The point here is that there is a positive-sum gain from co-operation between the employees and the company they work for.

[2] 'Well-being' is used here to refer to remunerative employment, fair wages, reasonable working conditions, job security and other employment associated incentives for the employees.

[3] By property is meant productive property. That is, 'property devoted to production, manufacture, service or commerce, and designed to offer, for a price, goods or services to the public from which a holder expects to derive a return'. See Adolf Berle and G Means, *The Modern Corporation and Private Property,* (Transaction Publishers, New Brunswick 1991) 3; A Berle, 'Modern Functions of the Corporate System' (1962) 62 Columbia Law Review, 433, 437.

[4] Adolf Berle, 'Modern Functions of the Corporate System' (1962) 62 Columbia Law Review, 433, 437.;E Merrick Dodd, 'For Whom Are Corporate Managers Trustees?' (1932) 45 Harv. L. Rev. 1145; Allen Kaufman, Ernie Englander & Craig Wood, 'A Team Production Model of Corporate Governance Revisited' (2003) Working Paper 03–03, Department of Strategic Management and Public Policy, George Wash. Uni. School of Business & Public Management.

[5] See e.g. John D Rockefeller, Jr, 'John D Rockefeller, Jr, On Labour and Capital' published in the New York Times (January 9, 1916) <http://query.nytimes.com/mem/archive-free/pdf> accessed 29 October 2012. See also A A Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization, (1972), 62 Am Econ. Rev. 777; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction', (1998–1999) 24 Journal of Corp. Law 743, 745; Blair and Stout 'A Team Production Theory of Corporate Law' (1999) 85 Virginia L Rev. 247.

[6] M Frank, 'The Rights of Employees in the Event of the Employer's Insolvency: A comparative Approach to the Rights of Employees during Restructuring in the United States and Europe' (2005) 1 New Zealand Postgraduate Law E-Journal 7; Donald R Korobkin, 'Employee Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L Rev 5; M Gronow, 'Insolvent corporate groups and their employees: The case for further reform' (2004) Legal Studies Research Paper No.130, Melbourne Law School <http://ssrn.com/abstract=81424> accessed 27 January 2013; Janis Sarra 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, Hampshire 2008) L M LoPucki, 'The Unsecured Creditors' Bargain' (1994) 80 Virginia Law Review, 1887, 1896 -1902; Lynn M LoPucki & W C Whitford, 'Corporate Governance in the Bankruptcy Reorganizations of Large Publicly-held Companies,' (1993) 141 University of Pennsylvania Law Review, 669–800; Mathew L Seror, 'Analyzing The Inadequacies of Employee Protections in Bankruptcy' (2003) 13 (1) Southern California Interdisciplinary Law Journal 141–165.

[7] G S Becker, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (National Bureau of Economic Research, New York 1964) 21; Luigi Zingales, 'In search of New Foundations' (2000) 55 Journal of Finance 1623, 1632. See also Margaret Blair and Lynn Stout, 'Specific Investment: Explaining Anomalies in Corporate Law' (2006) 31 Journal of Corporation Law, 719, 738.

[8] Bruce G Carruthers & Terrence C Halliday, *Rescuing Businesses: The Making of Bankruptcy Law in England and the United States* (OUP, Oxford 1998) 1.

that traverses all sectors of a country's economy. No one sector may be said to be more prone to insolvency than another. It is also a misconception to think that the insolvency of a company has consequences only for the creditors. Insolvency affects a broad range of interests[9] and these interests simultaneously co-exist.[10] One constituency usually impacted by the insolvency of the company is the employees.

Insolvency is a scene of conflicts and the employees can be particularly vulnerable when insolvency strikes their employer.[11] Like all other constituencies connected with the debtor, employees have various kinds of interests in insolvency.[12] There is no denying the fact that in the unfortunate event of an employer's insolvency, there will be employees to whom money is owed by way of unpaid salary that have not been paid by the employer. Others would have various contractual relationships with the employer including those of health care, pension benefits, etc. Going by this comparatively simple level analysis, employees constitute a category of creditors in the debtor's insolvency proceeding.[13]

However, it is both a misconception and misleading to restrict the role of employees to that of creditors in the debtor's insolvency proceeding. This is because the employees' role is considered to be within the debtor's business by which they are employed in contrast to the distanced or arm-length relationship that exists with most of its other creditors.[14] The view is that employees are more closely integrated within the debtor's business than other constituencies such as the creditors whose claims against it[15] in the context of insolvency arise either by way of goods supplied or services rendered to the debtor but not yet paid for, or by way of loans they have advanced to it that are still outstanding.[16]

Because of how closely integrated within their employers' businesses employees are, some jurisdictions have deemed it fit to grant them the right to participate in significant decisions in the life of such businesses.[17] Their participations in the debtor's businesses have, for example, earned employees the right to be consulted on business-related decisions made by their employers. In some jurisdictions, employees are known to have exercise constraints on business decisions proposed by the employer which they do not approve both in the solvent state of the corporate employer and latter into the period of its insolvency proceeding.[18]

Also, due to the important roles employees play in the lives of businesses, the insolvency systems of most jurisdictions have undergone reforms to enable insolvency laws in those jurisdictions to provide indirect sources of protection for employees when

9 Christopher W Frost, 'Bankruptcy Redistributive Policies and the Limits of the Judicial Process' (1995) 74 N.C. L. Rev. 75.

10 Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (YUP, New Haven 1997*)* 19; Andrew Keay, 'Insolvency Law: A Matter of Public Interest?' (2000) 51 NILQ, 509.

11 Marlene Frank, 'The Rights of Employees in the Event of the Employer's Insolvency: A Comparative Approach to the Rights of Employees During Restructuring in the United States and Europe' (2005)1 (1) NZPGLeJ.

12 Donald R Korobkin, 'Employees Interests in Bankruptcy' (1996) 4 Am. Bankr.Inst. L. Rev. 5.

13 Jay Lawrence Westbrook *et al, A Global View of Business Insolvency Systems* (The World Bank, Martin Nijhoff Publishers, Leiden 2010) 183.

14 Jay Lawrence Westbrook *et al, A Global View of Business Insolvency Systems* (The World Bank, Martin Nijhoff Publishers, Leiden 2010) 183.

15 It should be pointed out that although natural persons can also be employers, the focus here is primarily on legal persons (companies).

16 Janis Sarra, *Employee and Pension Claims During Company Insolvency: A Comparative Study of 62 Jurisdiction* (Carswell, 2008); Karen Cross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press, New Haven 1997) 81.

17 Examples of this right abound in several jurisdictions, the most obvious one being Germany under the principle of *Mitbestinnung* (co-determination).

18 Donald R Korobkin, 'Employees Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L. Rev. 15; Jay Lawrence Westbrook *et al, A Global View of Business Insolvency Systems* (The World Bank, Martin Nijhoff Publishers, Leiden 2010) 183.

their employer becomes insolvent. Indirect protection, it should be pointed out, does not advance the interests of the employees by giving them any special rights to be protected. Rather, what indirect protection does for the employees is advance their interests by increasing the likelihood that their insolvent employer will survive as a going concern.[19] There is force in the argument that when insolvency law improves the chances that an insolvent but viable business will survive financial distress as a going concern, this indirectly benefits employees of such businesses.[20] Conversely, it could be argued that the employees as a group potentially suffer adversely if lawmakers make decisions that are likely to make rescuing insolvent businesses as going concerns difficult.[21] It is for these reasons that a number of countries have effected legislative changes in recent years with the aim of promoting and prioritising rescues of insolvent businesses over their liquidations.[22] The United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law has, in addition to highlighting the importance of special treatments for employees in insolvency, noted the rise in the enactments of business rescue oriented laws capable of preserving jobs for employees globally when it observed that:

> In some insolvency laws, the importance of maintaining continuity of employment in priority to other objectives of insolvency proceedings, such as maximization of value of the estate for the benefit of all creditors, is evidenced by a focus on sale of the business as a going concern (with the transfer of existing employment obligations), as opposed to liquidation or reorganization where these obligations may be altered or terminated.[23]

The importance and relevance of employees in the businesses employing them are also underscored by the recognition that they are not just creditors for their wages in insolvency. This recognition has resulted in the enactments of legislation (outside of insolvency), in some jurisdictions aimed at protecting jobs for the employees when insolvency strikes their employer resulting in the whole of the latter's business, undertaking, or part of its business being transferred to a third party purchaser as a going concern. This is the case with all European Union (EU) countries in relation to the Acquired Rights Directive (ARD).[24] This EU-wide labour regime seeks to give a measure of social protection to all those employed in businesses located in the Member States in several ways.[25] However, the purpose of the ARD may be summarised as being to protect European employees in circumstances where the business employing them is transferred (solvent or insolvent) to another employer and the transfer of the business causes some or all of them to be dismissed by the transferor.[26]

[19] Donald R Korobkin, 'Employees Interests in Bankruptcy' (1996) 4 Am. Bankr.Inst. L. Rev. 13.

[20] *Ibid.*

[21] Elizabeth Warren, 'Bankruptcy Policymaking In An Imperfect World' (1993) 92 Mich. L Rev. 336, 354–56; E Warren, 'The Untenable Case for Repeal of Chapter 11' (1992) 102 Yale L Rev.437; Lynn M LoPucki. 'A Team Production Theory of Corporate Reorganization' (2003) UCLA Law School Research Paper No. 3–12 <http://ssrn.com/abstract=397801> accessed 12 December 2009.

[22] See e.g. the French insolvency **law** (*redressement judiciare*) which has something of a worker led ethos to the 'rescue culture' and the UK's Insolvency Act of 1986 reformed by the Enterprise Act 2002 to reflect the government's corporate rescue initiative. See further Samuel Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 (4) Company Lawyer 99 – 113. See also the changes that have been made to the insolvency laws of Brazil and Sweden.

[23] UNCITRAL Legislative Guide on Insolvency Law (2005). Available online at *http://www.uncitral.org* Accessed January 28, 2014. See particularly pages.287–288.

[24] Council Directive 2001/23/EC of March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

[25] See ARD 2001, Articles 1 - 7.

[26] ARD 2001, Article 4 (1).

The ARD has been implemented in the UK through the Transfer of Undertakings (Protection of Employment) Regulations 2006.[27] Like the parent regime (the ARD), TUPE is essentially social legislation[28] for offering greater protection to employees[29] impacted by business transfers resulting in a change of employer.[30] The essence of the policy underlying TUPE is contained in Regulation 4 which provides for the automatic and compulsory transfer of the employees' contracts of employment from the transferor to the transferee except where an employee objects to the transfer.[31] The aim is to prevent employees affected by the business transfer from being placed in a less favourable position solely as a result of the transfer.[32]

There are many theories of insolvency law each with implications for the stakeholders. If it is accepted that in the context of insolvency the stakeholders are those whose investments are at risk in the insolvent entity,[33] then the employees are irrefutably stakeholders by virtue of the human capital investments they make in companies. This means that every theory has implications for the employees. The question therefore is what does insolvency theories say about the employees? What implications do theories have for the constituency referred to in the literature variously as the 'silent voice', 'lost souls' or the 'lost voice' in insolvency?[34]

This paper will explore the implications of insolvency theories for the employees. Part 2 of this paper explores the term 'theory'. Part 3 considers the relevance of theory in insolvency law analysis. Part 4 presents analyses on select insolvency theories. Part 5 explores the types of insolvency systems each of the theories analysed would generate and what their implications for the employees would be. Part 6 concludes the paper.

THEORY AND INSOLVENCY LAW

One of the most important yet difficult to define words in the lexicon of social scientists is 'theory'. The reason is because referents to the term are so numerous and diverse that they obscure rather than illuminate understanding on what the term 'theory' really means.[35] The origin of the word 'theory' is traceable to the Greek words: *'theorein'* (meaning to contemplate, to speculate, to look at, to observe, to consider), and its noun form *'theoria* (observation, consideration, looking at, looking more closely, insight or scientific contemplation).[36] Despite the myriad meanings associated with the term, the

27 Hereafter 'TUPE' for convenience.

28 Sandra Frisby, 'TUPE or not TUPE: Employee Protection, Corporate Rescue and one Unholy Mess' (2000) 4 CFILR 249–271.

29 For a definition of employee in the context of TUPE, see Regulation 4(3) of TUPE 2006.

30 Smit has articulated that in relation to the parent law (ARD) 'this essentially social objective was added by the court, rather than by the Commission, and [that] the objective at the start certainly was to prevent unfair advantages existing between member states'. See Nicola Smit, 'Automatic Transfer of Employment Contracts and the Power to Object' (2003) Journal of South African Law 465, 467.

31 *Rotsart de Hertaling v J Benoidt SA* [1997] IRLA; *Celtic v Astley* [2005] IRLA 649; *Newns v British Airways Plc* [1992] IRLR 525 CA.

32 The ECJ has emphasised this point in relation to the parent law (ARD) in several caes. See e.g. Case C-362/89 *D'Urso v Ercole Marelli Elettromeccanica Generale SpA* [1992] ECR I-4105 (para 9).

33 Janis P Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, (University of Toronto Press, Toronto 2003) 58.

34 See Julie A Veach, 'On Considering the Public Interest in Bankruptcy: Looking to the Railroads for Answers' (1997) 72 (4) Indiana L. J. 1211; Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (CUP, 2002,) 570. See also OECD, *Asian Insolvency Systems: Closing the Implementation Gap,* (OECD Publishing, 2007); G W Johnson, 'Insolvency and Social Protection: Employee Entitlements in the Event of Employer Insolvency' (2003) Global Forum on Insolvency Risk Management. Available online at www.siteresources.worldbank.org last accessed on 20 October 2013.

35 Robert K Merton, *On Theoretical Sociology* (Free Press, New York 1967) 39.

36 Borje Holmberg, Michael Graham Moore & Otto Peters, 'The Theories and the Theorists: Why Theory is Important for Research' (2007) available online at www.eden-online.org/.../research/...D_S-Hoolmberg-Moore-Peters-Oct06.

basic meanings of the Greek '*theorein*' and '*theoria*' respectively remain valid and underpin definitions of theory today.[37]

In general terms, a theory is a fact-based framework for describing and explaining a phenomenon. It is a logical explanation for why something is the way it is, or why something does what it does.[38] This definition is ontological and at variance with the definition of a normative[39] theory because while the former deals with the world as it is according to the law of causation, the latter deals with that as it ought to be according to the norm. 'Normative cognition is methodologically separated from the area of causal cognition.'[40]

There are certain characteristics peculiar to theories. No theory is indisputable. Theories are discipline specific. In other words, no one theory is capable of transcending all disciplines. A theory is not capable of generalisation outside of the field it considers a phenomenon. A theory may yield better but not complete solutions to all issues.[41] It is common to have different theories explaining the same phenomenon. The problem with this however, is that their ideological contents could sometimes cut against their practical utility.

For a theory to offer any meaningful insight into the phenomenon it is seeking to explain, be persuasive and win converts, it must contain evidence of what it claims to be the case. That is, every theory must be grounded in, and consistent with, facts.[42] A theory must also contain some basis for reconciling or balancing multiple values.[43] These attributes are important because they ensure that whatever policies that are predicated on those factual assumptions are not misguided.[44] This is because 'inaccurate factual assumptions can result in policies that are at best ineffective in accomplishing their normative goals and at worst exacerbate the problems they attempt to correct.'[45] Notwithstanding the inherent limitations in a theory, it is pertinent to note that neither complexity nor precision determines the usability of a theory. Rather, the quality, pull, and usability of any theory depend on what the theory is supposed to explain and how successfully it explains and replicates complex phenomena or practice.[46]

There are numerous theories available for explaining phenomena in different areas of law. However, most theories of insolvency law are normative in nature.[47] 'Normative' is a term of art. Although the term has specialised contextual meanings in different fields of study, it is however used specifically in law to describe the way something

[37] *Ibid.*

[38] Karl Popper, *Conjectures and Refutations: The Growth of Scientific Knowledge* (Routledge, London 1963); Charles *v* Reynolds, *Theory and Explanation in International Politics,* (Martin Robertson, London 1973).

[39] Normative theory is further explained below.

[40] George E Glos, 'The Normative Theory of Law' (1969) 11 William & Mary Law Review 151, 159.

[41] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 U. Chi. L. Rev. 775, 797.

[42] Brian H Bix, *Jurispruence: Theory and Context,* (6th edn., Sweet & Maxwell, London 2012) 19.

[43] Jody S Kraus, 'Philosophy of Contract Law' in *The Oxford Handbook of Jurisprudence and Philosophy of Law,* Jules Coleman &Scott Shapiro eds. (Kenneth Einar Himma Associate, OUP 2002) 687 -88; Brian H Bix, *Jurispruence: Theory and Context,* (6th edn., Sweet & Maxwell, London 2012) 4.

[44] Chrystin Ondersma, 'Employment Patterns in Relation to Bankruptcy' (2009) 83 Am. Bankr. L. J. 237, 239.

[45] T Sullivan, E Warren & J L Westbrook, 'The Use of Empirical Data in Formulating Bankruptcy Policy' (1987) 50 (2) Law and Contemporary Problems 195, 200.

[46] Allan Gibbard and Hal R Varian, 'Economic Models' (1978) Colum. J. Phil. 664, 665. See also L J R Herson, *The Politics of Ideas: Political Theory and American Public Policy,* (Waveland Press, 1984).

[47] See e.g. Donald Korobkin noting that bankruptcy scholars use normative theories to justify particular substantive views on bankruptcy. Donald Korobkin, 'The Role Normative Theory in Bankruptcy Debates' (1996) 82 Iowa L Rev. 75. See also Lipson arguing that bankruptcy theory debates the normative goals of bankruptcy policy. Jonathan C Lipson, 'Debt and Democracy: Towards a Constitutional Theory of Bankruptcy' (2008) 83 (2) Notre Dame Law Review 605, 617.

ought to be done according to a value position.[48] Normative statements are value statements. They describe the actions and outcomes each theorist values.[49] Thus, in the context of insolvency, normative theories express opinions to be valued or postulate what insolvency law ought to be.[50] Given that the values preferred by one theorist in insolvency may not be consistent with that of another theorist, it means that there is bound to be conflicting viewpoints on insolvency by different insolvency theories. It is important to note that the normative theory of law has not 'supplanted any existing doctrine or method of legal cognition,' rather what it does is 'fill a gap found in the existing science of law.'* [51]

RELEVANCE OF THEORY IN INSOLVENCY LAW ANALYSIS

Theory is vital in all legal analysis. By describing and informing, theories contribute to the vitality and development of all legal disciplines. Theory enables the strengths, weaknesses and limitations of a legal scholarship or a subject considered to be evaluated. It is a useful tool for evaluating legal arguments and identifying what the implications of laws are for those to whom they apply.[52]

Insolvency scholars employ normative theories to evaluate insolvency-related issues and to persuade legal officials and others interested in the discipline to subscribe to their respective viewpoints. The core object of a normative theory of insolvency law is to establish a critical perspective on the values that underlie extant insolvency laws.[53] Insolvency law theories provide a basis for evaluating and critiquing the policies, legislation and practices on insolvency that may not occur with purely doctrinal content. In addition to illuminate our understanding on the behaviours of stakeholders and how their behaviours are shaped by insolvency laws in different jurisdictions, theories provide the means for assessing the impacts of insolvency policies or laws on them.

Theories can, and have, elicited policy debates and discussions on insolvency matters. Debates about the social policies that underlie insolvency processes in various jurisdictions have been made possible by theories.[54] Theories have also influenced and contributed to changes in bankruptcy[55] policies[56] such as those that were made in the

[48] It is claimed that the original proponents of normative theory of law are Hans Kelsen and Frantisek Weyr. See George E Glos, 'The Normative Theory of Law' (1969) 11 William & Mary Law Review 151, 152.

[49] Nigel Simmonds, *Central Issues in Jurisprudence* (3rd ed., Sweet & Maxwell, London 2010) 149; Adrian Vermeule, 'Connecting Positive and Normative Legal Theory' (2007) 10 Uni. Penn. Journal of Constitutional Law 387; Panu Minkkinen, 'Why is Law a Normative Discipline? On Kelsen's Normology' (2005) 11 (3) Res Publica, 235 – 249. See also Huntington Cairns, 'Law as a Social Science' (1935) 2(4) Philosophy of Science, 484–498.

[50] Charles W Mooney, 'A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure' (2004) 61 Wash. & Lee L. Rev. Available online at http://scholarlycommons.law.wlu.edu/wlulr/vol61/iss3/2 accessed 20 December 2013.

[51] See George E Glos, 'The Normative Theory of Law' (1969) 11 William & Mary Law Review 151.

[52] Brian H Bix, *Jurisprudence: Theory and Context* (6th ed., Sweet & Maxwell, London 2012) 9.

[53] D R Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Texas Law Rev. 98.

[54] Christopher W Frost, 'Bankruptcy and Social Welfare Theory' (2001) Paper presented at the Association of American Law Schools' Workshop on Bankruptcy<http://www.aals.org/profdev/bankruptcy/frost.html> accessed 16 December 2008. On the notion that the views of these two camps influence bankruptcy decision making by courts and policymakers in the US, see Mark Bradshaw, 'Comment: The Role of Politics and Economics in Early American Bankruptcy Law' (1997) 18 Whittier L Rev 739. See also paper by Luben, Stephen J Lubben, 'Delaware's Irrelevance' (2008) 16 Am. Bankr. Inst. L. Rev. 267, 268.

[55] The terms 'bankruptcy' and 'insolvency' are used interchangeably in this article depending on the jurisdiction considered.

[56] For example, articles on bankruptcy theories by renowned bankruptcy scholars in the US have been cited frequently in briefs and opinions in the US Congress and other policy bodies regarding bankruptcy venues. See e.g. Lynn M LoPucki & Joseph W Doherty, 'Why are Delaware and New York Bankruptcy Reorganizations Failing?' (2002) 55 Vand. L Rev. 1933, 1939; Lynn LoPucki & Sara D Kalin, 'The Failure of Public Companies Bankruptcies in Delaware and New York: Empirical Evidence of a ''Race to the Bottom''' (2001) 54 Vand. L Rev. 231, 235, 249–50; Lynn M LoPucki, 'Can the Market Evaluate Legal Regimes? A Response to Professors Rasmussen , Thomas, and Skeel ' (2001) 54 Vand. L. Rev.

US regarding bankruptcy venues.[57] Insolvency theories have also influenced decisions made by both policymakers and courts in different countries.[58]

Theories can also provide the basis for substantive insolvency systems. The designs of most frameworks or substantive legal regimes on insolvency in many jurisdictions are based on competing bankruptcy theories. It has been asserted that the bankruptcy code that was promulgated in Germany in 1994 (Insolvenzordnung),[59] was influenced mainly by Thomas Jackson's Creditors' Bargain Theory.[60] In Britain, there is the view that the Insolvency Service was influenced particularly by the wealth maximisation part of the Contractarian theory in its 2007 consultations on how payments of pre-pack administrators' fees should be made.[61]

If it is true, as articulated,[62] that insolvency laws reflect the national consciousness of countries because they mirror the underlying values and express the policies and priorities of their enacting countries, it could be argued that theories can assist in ascertaining what a jurisdiction's perception of insolvency is, who it might blame when a company becomes insolvent, and its policies in relation to corporate insolvency generally.[63] Theories provide the platform not just for diagnosing insolvency events in different jurisdictions and explaining their causes, but also for prescribing possible responses to them. Theory can also be a useful tool for explaining what the means and ends of insolvency law should be without necessarily dictating what the most efficient proposal for achieving them should be.[64]

Insolvency theories also provide guidance and give meanings to real life experiences in insolvency. A theory can provide the lens for examining and justifying why a particular interest is, for example, accorded priority over others in the design and practice of insolvency laws in different jurisdictions.[65]

331, 333–38. During the debates on major bankruptcy legislation of 2005 in the US, Texas Senator John Cornyn described venue shopping as '...a problem that has been well documented by scholars in the field, most recently in a comprehensive book [just recently] published by ULCA law professor Lynn M LoPucki . . . The professor has documented instances of forum shopping by corporate debtors that have harmed consumers and debtors in virtually all of [s]tates'. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S 256, 109th Cong, 1st Sess (Mar 2, 2005), in 151 Cong Rec S 1892, 1902 (Supp Mar 2, 2005). The book the Senator was referring to is: Lynn M LoPucki, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (University of Michigan Press, 2005).

57 See Stephen J Luben, 'Do Emperical Bankkruptcy Studies Matter?' (2012) 20 ABI L. Rev. 715 – 723.

58 See Mark Bradshaw, 'Comment: The Role of Politics and Economics in Early American Bankruptcy Law' (1997) 18 Whittier L Rev 739.

59 This code was passed in 1994 but took effect in 1999. See Sergi A Davydenko & Julian R Franks, 'Do Bankruptcy Codes Mattewr? A Study of Defaults in France, Germany, and the U.K.' (2008) 63 (2) The Journal of Finance 565–608.

60 See Klaus Kamlah, 'The New German Insolvency Act: Insolvenzordnung' (1996) 70 American Bankruptcy Law Rev., 417, 421. See also Vanessa Finch, *Corporate Insolvency law: Perspectives and Principles* (2nd edn, CUP, Cambridge 2002) 29.

61 See Peter Walton, 'When is Pre-packaged Administration Appropriate? – A Theoretical Consideration' (2011) 20 Nott. L J. 12.

62 International Monetary Fund (Legal dept.), *Orderly and Effective Insolvency Procedures: key Issues*, (IMF Publication Services, Washington 1999) 1–2. See also Sefa Franken, 'Creditor-and Debtor-Oriented Corporate Bankruptcy Regimes Revisited' (2004), Tilburg University, TILEC Discussion Paper (DP 2004–016)1–40; G McCormack, 'Control and Corporate Rescue – An Anglo-American Evaluation' (2007) 56 ICLQ 1.

63 Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee claims' (2008) in P J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, 2008) 49.

64 Charles W Mooney, 'A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure' (2004) 61 Wash. & Lee L. Rev. Available online at http://scholarlycommons.law.wlu.edu/wlulr/vol61/iss3/2 accessed 20 December 2013.

65 A T Guzman, 'International Bankruptcy: In Defense of Universalism' (2000) 98 Michigan Law Review, 2177, 2197–98; Vanessa Finch & Sarah Worthington, 'The *Pari Passu* Principle and Ranking Restitutionary Rights' in F Rose (ed) *Restitution and Insolvency* (Mansfield Press, London 2000) 1; Christopher W Frost, 'Bankruptcy and Social Welfare Theory' (2001). Available online at http://www.aals.org/profdev/bankruptcy/frost.html accessed 16 September 2013.

ANALYSIS OF SELECT THEORIES OF INSOLVENCY LAW

Efforts by scholars to articulate what insolvency law should be, and not necessarily what is politically possible, have resulted in the myriad of theoretical possibilities currently available for analysing insolvency.[66] That there are many theories, each with differing perspective on insolvency, does not *ipso facto* empty theories of significance or interest. Rather, the proliferation of theories and the non-convergence of opinions should be taken as an indication that there is something interesting about insolvency that is worth theorising.

In fact few, if anyone, would contest the assertion that a law which deals with what happens when there is a breakdown in normal creditor-debtor relationship, when private enforcement of contracts is no longer effective and legal enforcement becomes crucial, does not lack something interesting to talk or write about. Therefore, rather than discarding the discrete normative arguments advanced by proponents of the various theories, these should instead be carefully analysed and embraced because they may be capable of shedding light on what the means and ends of insolvency law should be.

Given that it is practically impossible to analyse all extant theories of insolvency law in a paper of this nature, only three theories that are representative of the views of the Proceduralists and Traditionalists[67] between whom normative debates on insolvency philosophy and policy are mostly contested[68] will be considered.

THE CREDITORS' BARGAIN THEORY

Basic corporate law theory, in the solvent state of the company, is premised on the shareholder primacy norm which makes the company's Board of Directors accountable only to the shareholders as the primary risk bearers.[69] However, the view is that when the company is insolvent, the shareholders' primacy norm should be supplanted by the creditors' primacy norm.[70] One of the first theories to propagate the creditors' primacy thesis in insolvency law is the Creditors' Bargain Theory (CBT).

The CBT is the brainchild of Thomas Jackson. Jackson first proposed this heuristic in an article he published in 1982.[71] The model, as further developed by Jackson,[72] and

[66] John Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy' John M. Olin Center For Law & Economics, University of Michigan (2006) .943. Available online at http://www.law.umich/centersandprograms/olin/papers .htm accessed December 12, 2013. See also P. Walton, 'When is Pre-packaged Administration Appropriate?–A Theoretical Consideration' (2011) 20 Nott. L J. 3.

[67] This taxonomy is traceable to the writings of Professor Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L.J 573, 576–79; Donald G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Leg. Stud. 127,133. See also Edward J Janger, 'Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design' (2001) 43 Ariz. L Rev. 559, 566; Ziad Raymond Azar, 'Bankruptcy Policy, Legal Heritage, and Financial Development: An Agenda for Further Research' (2008) 24 (2) Emory Bankr Devs Journal 382 – 466. Charles W Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure' (2004) 61 Wash & Lee L Rev. 931. See also Roy Goode, *Principles of Corporate Insolvency Law,* (3rd ed., Sweet &Maxwell, London 2005) 41–42.

[68] D G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Leg. Stud. 127,133; Roy Goode, *Principles of Corporate Insolvency Law* (3rd edn, Sweet & Maxwell, London 2005) 41–42.

[69] See Adolph A Berle and G Means, *The Modern Corporation and Private Property,* (Transaction Publishers, New Brunswick 1991) 3; A Berle, 'Modern Functions of the Corporate System' (1962) 62 Columbia Law Review 433; Adolph A. Berle, 'Corporate Powers as Powers in Trust' (1931) 44 Harv. L. Rev. 1049, 1049. But see counter opinion by E Merrick Dodd, 'For Whom Are Corporate Managers Trustees?' (1932), 45 Harv. L. Rev. 1145. See also D Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 J. Corp. L. 277.

[70] The courts have given credence to this position in several cases. See e.g. *Kinsela v Russell Kinsela Pty Ltd* [1986] 4 NSWLR 722; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 CA (Civ Div) at 252–253; *Brady v Brady* [1989] AC 755 HL.

[71] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860.

sometimes in collaboration with Douglas Baird[73] or Robert Scott,[74] the CBT employs a neo-Rawlsian[75] contractarian notion to develop a conceptual paradigm on insolvency. This framework, which is based on a hypothetical bargain the creditors would make with the debtor prior to advancing credit and well in advance of insolvency,[76] provides a normative criterion for explaining and justifying the structure and purpose of insolvency law. Through the CBT, Jackson and his collaborators have expressed their normative views on what they believe to be the legitimate province of bankruptcy law. They have made several claims one of which is that the essential features of the insolvency system were not chosen voluntarily by the creditors themselves but were instead imposed on them by the government.

The CBT starts by articulating that when a single debtor having multiple creditors becomes insolvent its creditors would inevitably face a 'collective action' problem.[77] This problem ensues because the debtor's insolvency very often renders it unable to meet its financial obligations to its creditors and any perception that the debtor may not be able to pay its debts in full to all of them would trigger a 'race to collect' on the debtor's assets amongst the creditors. The CBT observes that when the debtor is insolvent the individual incentives of each creditor are to act in a way that will be self-beneficial, but detrimental to the best and overall interests of all other creditors as a group. In other words, when insolvency strikes the creditors act strategically for self interest. [78]

The implication of this strategic-creditor-behaviour is that only 'strong' creditors (in the sense of the contractually and statutorily protected entitlements each creditor already has in place) who are able to press their claims early would be paid in full while those slow off the blocks (e.g. unsecured creditors) are potentially left with nothing. According to the CBT, the creditors would realise that the self-help or individual debt enforcement is unhelpful. They would see that this approach is working against their course in terms of being able to recoup what they are owed by the company. The creditors would reason that they are faced with a problem that not only requires a solution but one that is simultaneously effective and acceptable to all of them. The solution, *a la* Jackson, is to impose a mandatory collective regime. This regime mirrors the terms of an idealised multi-creditor contract to co-operate. The justification for a mandatory regime, as articulated elsewhere,[79] is that 'unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interests'.

[72] Thomas H Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L. Rev. 725; T H Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986).

[73] See D Baird & T H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chicago L. Rev. 97.

[74] T H Jackson & R Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Virginia L. Rev. 155.

[75] There have been several manifestations of the desire to counter especially Jackson's claims that his Creditors' Bargain Theory is an application of Rawls's methodology. In 1993, Donald Korobkin constructed a self-consciously Rawlsian alternative to the CBT. See particularly Donald Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993), 71 Tex. L Rev. 541.

[76] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986).

[77] Douglas G Baird, 'A World without Bankruptcy' (1987) 50 Law & Contemp. Probs. 173; Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986). A 'collective action' is a problematic situation in which the uncoordinated actions of parties may not yield the best outcome for them individually. It is a problem that arises whenever a group is faced with a problem that cannot be solved organically without an individual undertaking to bear the brunt of the burden while only retaining a portion of the benefit. There is however a substantial literature questioning whether a serious collective action problem exists in insolvency. See e.g. Barry E Adler, 'A World without Debt' (1994) 72 Wash. U. L. Q 811–827; B Adler, 'Financial and Political Theories of American Bankruptcy' (1999) 45 (2) Stanford L Rev 31–346.

[78] Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 YALE L.J. 1807, 1821–22

[79] See Mancur Olsen, *The Logic of Collective Action: Public Goods and the Theory of Groups* (HUP, 1971) 2.

Jackson posits the advantages of a collective debt enforcement forum. A collective regime stems the race to the court by creditors and eliminates wasteful and inefficient liquidation of insolvent but viable companies by creditors motivated by self interest to collect what they are owed. In contrast to the individual collection approach, a collective forum facilitates the marshalling of the debtor's assets so that these can be distributed among those holding claims against the debtor or its property in an orderly fashion.[80] Polling the debtor's assets maximises its overall economic value because whenever it is possible to keep the debtor's assets together and a single and all-encompassing decision on disposal is made on behalf of all the creditors, the assets would be worth more in a going-concern sale than they would be in a piece-meal liquidation.[81]

A collective forum also reduces strategic costs. This is because the 'policing' of a common debtor on an individualistic basis is administratively inefficient and could lead to a nil return to the particular creditor if other creditors get to the debtor's assets first. The individualistic debt collection system puts a premium on 'racing' for the debtor's assets while co-operation via the collective forum ensures that no costly and duplicative monitoring of the creditors' common debtor is borne individually.[82]

Another advantage a collective forum has over individual enforcement measure is that it replaces chaos with decorum by ensuring that claims of the creditors are entertained in a rational and orderly manner. Given that debts are met in accordance with terms agreed prior to insolvency, this approach has advantage over the chaotic individualistic collection regime in which claims are met, not in the order in which they arose, but in the order which they are brought. A collective regime is also advantageous for 'risk-averse'[83] creditors. This is because they are guaranteed a better return on their investments than would otherwise be possible in the individualistic system. Risk-averse creditors would, according to the CBT, prefer a lower but more certain return on their investments to a higher yet riskier and uncertain return.

Regarding what the legitimate province of insolvency law is, or ought to be, the CBT is adamant that insolvency law should limit itself to addressing only those issues arising in insolvency. Insolvency law's core mission, according to the CBT, is to allocate the debtor's property or the value of the debtor's property to parties who hold claims and interests in it.[84] In other words, insolvency law exists to maximise recoveries for parties with non-insolvency legal entitlements *vis-a-vis* the debtor's assets.[85] This is the cornerstone of the creditors' bargain normative claim.[86] What this implies is simply that non-insolvency entitlements should not be interfered with, modified or overridden by insolvency law unless such interference is necessary to maximise value for the creditors.

[80] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91(5) The Yale Law Journal 857.

[81] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986); 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 866–68; 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L Rev. 725.

[82] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 866; Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986).

[83] On the notion of risk aversion, see Robert Pindyck and Daniel Rubinfeld, *Microeconomics* (4th edn, Prentice Hall, N J 1997) Ch. 5.

[84] James W Bowers, 'Security Interests, Creditors' Priorities and Bankruptcy' (1999) Louisiana State University Law Centre,<http://www.scribd.com/.../security-interest-creditors-priorities-and-bankruptcy->accessed 30 February 2010.

[85] James W Bowers, 'Security Interests, Creditors' Priorities and Bankruptcy' (1999) Louisiana State University Law Centre,<http://www.scribd.com/.../security-interest-creditors-priorities-and-bankruptcy->accessed 30 February 2014; Charles W Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure' (2004) 61 Wash & Lee L Rev. 931.

[86] T H Jackson & R Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 (2) Virginia L. Rev. 155.

The CBT acknowledges the existence of other interests in insolvency. However, because the model promotes the idea that insolvency exists primarily for the benefit of the creditors,[87] therefore the interests of these other constituencies should be considered only to the extent that the particular members of these constituencies are creditors with enforceable legal rights against assets of the debtor under non-insolvency law.[88]

It follows from the above that the CBT is strongly averse to redistribution in insolvency. For Jackson and his collaborators, redistribution defined variously as the alteration of pre-insolvency entitlements held by parties, the formation of new insolvency entitlements or destruction of pre-insolvency entitlements,[89] or the transfer of wealth from one party to another in insolvency,[90] is not necessitated by the need to promote a predefined insolvency policy. It is inefficient and should not be encouraged because it constitutes what in corporate insolvency may characterise as 'Robin-Hoodism'[91] - a good and practical example of 'robbing Peter to pay Paul'.

The CBT regards insolvency as a foreseeable risk that should be borne individually by each party in any business venture. Proponents and exponents of the theory argue that subjecting voluntary transactions to redistributive liabilities will give parties to those transactions a powerful incentive to structure their deals differently. They contend that altering the rule within insolvency would create a set of entitlements at variance with those existing outside it and provide a strong incentive for forum shopping.[92] For these persons therefore, redistribution is counterproductive and normatively undesirable. Therefore irrespective of how the practice may be couched in noble rhetoric, it is '*prima facie* theft.'[93]

In practice, the position taken by the CBT *vis-a-vis* redistribution is difficult to defend because it requires insolvency law to take all of the creditors' pre-insolvency agreed rights as it finds them, honouring both powers and limitations under non-insolvency law without modifying them.[94] This argument is also faulty for a number of reasons.

[87] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986); 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860; D G Baird, 'A World without Bankruptcy' (1987) 50 Law & Contemp. Probs. 173.
See Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 769.

[88] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986).

[89] Yaad Rotem, 'Pursuing Preservation of Pre-Bankruptcy Entitlements: Corporate Bankruptcy and Law's Self Executing Mechanisms' (2008) 5 (1) Berkeley Business Law Journal 79, 90.

[90] See John Armour, 'Should We Redistribute in Insolvency?' (2006) Centre for Business Research, University Of Cambridge Working Paper No. 319 available online at http://www.cbr.cam.ac.uk/pdf/WP319.pdf

[91] Robin Hood was a heroic outlaw in English folklore. Legend has it that he used to steal from the rich and give to the poor. The origin of the legend is claimed by some to have stemmed from actual outlaws, or from ballads or tales of outlaws. See e.g. Howard Pyle's 1883 novel: The Merry Adventures of Robin Hood.

[92] See G Marcus Cole and Todd J Zywicki, 'The New Forum Shopping Problem in Bankruptcy' (2009) Amsterdam Center for Law & Economics Working Paper No. 2009–11 <http://www.accf.nl/uploads/postkantoor/aclewp2009–11(1).pdf> accessed 12 March 2012; Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L. Rev. 815, 822.

[93] See David Gray Carlson, 'Rationality, Accident and Priority under Article 9 of the Uniform Commercial Code' (1986) 71 Minn. L Rev. 207, 209, 245–46. See also James J White, 'Failure and Forgiveness: A Review' (1999) 73 Am. Bankr. L J. 435, 447.

[94] Creditors' bargain theorists' query: if bankruptcy has an important policy role in balancing the various interests, and if wider interests (workers, community) are to be taken into account in bankruptcy reorganisation, why restrict this to bankruptcy? Many firms close without going through bankruptcy. What is special about bankruptcy? Special rules create incentives for strategic behaviour e.g. repudiation of collective agreement/contract. The CBT's argument is that if a firm cannot repudiate collective agreement when experiencing financial problems, then why should bankruptcy change such a rule? The balancing of interests should be dealt with openly through general legislation, not under the cover of bankruptcy policy. See e.g. ; Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L. Rev. 815; Douglas G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 (1) The Journal of Legal Studies 127–147; T H Jackson, Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860; Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986); D G Baird & T H Jackson, 'Corporate Reorganizations and

First, apart from the fact that insolvency is a mechanism which compels creditors to renegotiate and modify the terms of their original bargain with the debtor,[95] it has to be remembered that not all creditors' claims arise out of agreement. Some claims are based on statutes.[96] Thus, while the creditors' bargain with the debtor may entitle them to any value attributable to the actions of the debtor and its management, it could also be argued that the roles played by other constituencies comprising the company in enhancing and preserving the value in question equally entitle them to a share in it.[97] Secondly, any external intervention in a company's insolvency carries with it apparent redistributive implications. There is hardly any collective procedure that does not redistribute value from one party to another. A collective regime even redistributes wealth.[98] Thirdly, the initiation of a collective procedure and any decision made by the court during the procedure implicates pre-insolvency entitlements held by the different parties. Insolvency courts are courts of equity. They are vested with powers to modify contractual relationships between debtors and creditors so as to ensure that complete justice is done.[99]

The CBT's perspective on insolvency can be described as a capitalist philosophy of insolvency law. This philosophy owes its origin to the shareholders' primacy theory in corporate governance. The shareholder orientation adopts the 'nexus of contracts' between and among the shareholders of the company and other constituencies to argue that the contracts entered into by the company and 'non-shareholders groups such as employees, managers, and creditors are explicit contracts that entitle them to fixed payments, such as salaries and interest payments.'[100] This approach goes on to argue that because shareholders rely on an implicit contract that entitles them to whatever remains after the company has met its explicit obligations and paid its fixed claims, they are the residual claimant and sole risk bearers of companies.[101] Therefore those entrusted with the running of companies should do so with the primary aim of maximising wealth for them.[102] In other words, this orientation sees the company, in its solvent state, as belonging to the shareholders.[103]

When the shareholder philosophy in corporate law is reversed, refined and applied to the company in the context of insolvency, the creditors become the legal owners of

the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chicago L. Rev. 97. A counter argument is that there is a significant change when a company is in formal bankruptcy proceedings. Thus, there are a lot of complex issues which make it appropriate to balance or consider interests that would not be taken into account otherwise. See e.g. Elizabeth Warren, Bankruptcy Policymaking in an Imperfect World (1993) 92 Mich. L Rev 336; Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997).

95 Anita F Hill, 'Bankruptcy, Contracts and Utilitarianism' (1991) 56 (3) Missouri Law Review 571, 573.

96 Ronald J Mann, 'Bankruptcy and the Entitlements of the Government: Whose Money is it anyway' (1995) 70 (5) New York University Law Review, 1040.

97 Ronald Mann, 'Bankruptcy and the Entitlements of the Government: Whose Money is it anyway' (1995) 70 (5) New York University Law Review, 1040.

98 Yaad Rotem, 'Pursuing Preservation of Pre-Bankruptcy Entitlements: Corporate Bankruptcy and Law's Self Executing Mechanisms' (2008) 5 (1) Berkeley Business Law Journal 79, 84.

99 Matthew Bruckner, 'The virtue in Bankruptcy' (2013) 45 Loyola University Chicago Law Journal 233, 234–35.

100 See Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (HUP, Cambridge, 1996) 36–39.

101 R E Freeman and W M Evan, 'Corporate Governance: A Stakeholder Interpretation' (1990) 19(4) The Journal of Behavioural Economics 337–359.

102 *Ibid.*

103 See e.g. Milton Friedman, 'The Social Responsibility of Business is to increase its Profits' New York Times, September 13, 1970, Section 6 (Magazine) 32; David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians and the Crisis in Corporate Law' (1993) 50 Washington & Lee L. Rev. 1373, 1374; L Mitchell, 'Groundwork of the Metaphysics of Corporate Law' (1993) 50 Washington & Lee L. Rev. 1477, 1485; L Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2006) 31 Journal of Corporation Law 675, 676; G Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace' (2007) 32 Journal of Corporation Law, 383, 386.

the company or of its assets because, according to the creditors' primacy theorist, it is the creditors' investments that are at risk and the company's assets are usually subject to their claims at this point. It could be argued that the creditors' bargain championed by the CBT is a bargain that would ensure that in the event of insolvency, the creditors (i.e. secured creditors or senior lenders) would be well positioned to control outcomes so that they can get everything from the debtor's estate. This bankruptcy practice advocated by the CBT evinces little or no desire at all of preserving going concern value in insolvent companies. This type of control is what has made critics of the theory to conclude that it is too creditors focused and biased.[104]

As far as economic[105] models for analysing corporate insolvency are concerned, the CBT has been able to establish itself as the dominant and most influential theory.[106] However, the theory cannot be said to have enjoyed a trouble-free reign. This is because the standard Jacksonian account of insolvency law as a solution to a collective action problem among similarly situated creditors whose self and collective interests are easily identifiable and homogenous has in recent times come under severe scrutiny and attack.[107] A lot of critical verbal and written salvos have been fired at the CBT. Surprisingly, most of these criticisms have come from scholars within the law and economics movement itself.[108] The CBT has been criticised for being too narrow because it focuses on wealth maximisation for only creditors with legal entitlements to assets of the debtor. The Traditionalists or 'Progressives'[109] have accused the CBT of not paying due regard to the rights of contract creditors such as managers, suppliers and the employees all of whom add value to the company in different ways but do not hold legal entitlements to it assets. Also, the CBT fails to take into account other public interest objectives such as environmental protection as a goal of insolvency law.[110]

[104] There exists a vast body of literature supporting the increased control creditors have in bankruptcy. See e.g. Harvey R Miller & Shai Waisman, 'The Erosion of Debtor Protections in the Face of Expanding Creditors Rights and Control' (2003) NYU Workshop on Bankruptcy and Business Reorganizations; E Warren & J L Westbrook, 'Secured Party in Possession' (2003) 22 Am. Bankr. Inst. J; D G Baird & R K Rasmussen, 'Chapter 11 at Twilight' (2003), the Chigcago Working Paper Series Index. Available online at http://www.law.uchicago.edu/Lawecon/index.html

[105] At a general level, the basis for applying economics approach to legal analysis rests on the assumption that those involved with the legal system act as rational maximisers of their individual satisfaction. Whereas there is the argument in the law and economics literature that the application of economics to legal analysis can help in designing more efficient reforms of the legal system (see e.g. Richard A Posner, 'The Economic Approach to Law' (1974–75) 53 Tex. L. Rev 761 -64), the analysis of law through economic lens has revealed that the legal system itself has from time always been strongly influenced by a concern with promoting economic efficiency. See J W Hurst, *Law and Social Process in United States History* (Da Capo Press, New York 1972) 4.

[106] Adam J Levitin. 'Bankrupt Politics and The Politics of Bankruptcy' (2012) 97 Cornell L. Rev. 1399, 1405.

[107] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 Uni. Chi. L Rev. 775; Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L Rev. 336–387; Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741. Some Scholars have argued that insolvency must be understood from a political as opposed to economic perspective because it is ultimately a distributional exercise, rather than a system to maximise returns to creditors. See Adam J Levitin. 'Bankrupt Politics and The Politics of Bankruptcy' (2012) 97 Cornell Law Review 1399, 1405.

[108] See generally, James W Bower, 'Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Policy and the Elementary Economics of Failure' (1990) 84 Mich. Law Rev., 2097–2150; Stuart C Gilson 'Transactions Costs and Capital Structure Choice: Evidence from Financially Distressed Firms', (1996) Journal of Finance; Lynn M LoPucki, & William C Whitford, 'Corporate Governance in the Bankruptcy Reorganizations of Large Publicly-held Companies'(1993) 141 University of Pennsylvania Law Review, 669–800; E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 333, 338; R J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies, 400, 443; *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005). In his review of Thomas Jackson's book, *The Logic and Limits of Bankruptcy Law*, David Gray Carlson commented that 'Thomas Jackson has written an unremittingly dreadful book.' See D G Carlson, 'Philosophy in Bankruptcy' (1987) 85 Mich. L Rev. 1341–1389. See further *v* Countryman, 'The Concept of Voidable Preference in Bankruptcy' (1985) 38 Vand. L Rev. 713, 823–5, 827; J L Westbrook, 'A Functional Analysis of Executory Contracts' (1989) 74 Minn. L Rev. 227, 251; T A Sullivan, E Warren & J L Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (OUP, New York 1989) 256.

[109] Marcus Cole, 'Limiting Liability Through Bankruptcy' (2002) 70 University of Cincinnati Law Review 1245, 1251.

[110] Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997); Elizabeth Warren,

THE TEAM PRODUCTION THEORY OF BANKRUPTCY REORGANIZATION

Dissatisfaction with the dominant creditors' bargain model has resulted in the proliferation of other analytical models that have been put forward by different persons to explain insolvency law. Professor Lynn LoPucki has made a very important contribution to the theoretical debates on insolvency law. He has developed an alternative normative theory of insolvency which he labels the 'Team Production Theory of Bankruptcy Reorganization.'[111] However, before analysing LoPucki's new insolvency theory, it is important to first explain the theory's superstructure and origin.

The antecedent of LoPucki's theory lies in the 'Team Production Theory' of corporate law,[112] which, in turn, owes its origin to the earlier concepts of 'team production' in the economics literature.[113] For decades, the literature on corporate governance was dominated by the view that the economy is driven by a single ideology: that the purpose of the firm was to increase the profits it delivered to its shareholders.[114] Although there were a few voices shouting from the margins that the firm had other purposes and that it should consider obligations to the society at large,[115] wealth maximisation for the shareholders continued to be the abiding goal of many a firm for decades.[116] Team production theory of corporate law takes a completely different view from the agency theory on what is traditionally regarded as the *raison d'être* of the firm and what corporate law in general ought to accomplish. It opposes the agency theory paradigm which holds that the primary goal of the firm is to maximise wealth for its shareholders. The proponents of team production theory of the firm argue that the shareholder primacy theory of the firm is flawed because the shareholders are evidently not the only group that contributes specialised inputs to corporate production.[117] The firm, they opine, is an aggregate of interests comprising,

'Bankruptcy Policy' (1987) 54 Uni. Chi. L Rev. 800–804; Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 778.

[111] Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2003) UCLA Law School Research Paper No. 3–12 <http://ssrn.com/abstract=397801> accessed 12 December 2009 .

[112] Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998–1999) 24 J. Corp. L. 743; 'A Team Production Theory of Corporate Law' (1999) 85 V. L Rev. 247.

[113] See e.g. A A Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization, (1972), 62 Am Econ. Rev.777–78; A. D. Chandler, Jr., Scale *and Scope: The Dynamics of Industrial Capitalism* (Belknap Press, Cambridge, MA, 1990) 13; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998–1999) 24 Journal of Corp. Law, 743, 745; 'A Team Production Theory of Corporate Law' (1999) 85 V. L. Rev. 247.

[114] Milton Friedman, 'The Social Responsibility of Business is to increase its Profits' New York Times, September 13, 1970, Section 6 (Magazine) 32; David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians and the Crisis in Corporate Law' (1993) 50 Washington & Lee L. Rev. 1373, 1374; L Mitchell, 'Groundwork of the Metaphysics of Corporate Law' (1993) 50 Washington & Lee L. Rev. 1477, 1485; L Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2006) 31 Journal of Corporation Law 675, 676; G Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace' (2007) 32 Journal of Corporation Law, 383, 386.

[115] See e.g. E M Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv. L R 1145, 1148; Peter Drucker, *Concept of the Corporation,* (Transaction Publishers, 1993); Thomas A Kochan and Saul A Rubinstein, 'Towards a Stakeholder Theory of the Firm: The Saturn Partnership' (2000) 11 Organizational Science, 367, 368; D G Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law, 277, 293.

[116] One of the key arguments often advanced in support of shareholder primacy is that shareholders are residual claimants as such they have the greatest stake in the outcome of the corporation. See J Macey, 'Fiduciary Duties and Residual Claims; Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 Cornell L Rev 1266, 1267. It follows that since they are residual claimants, the business should be run for their benefit while the corporation is solvent. See F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (HUP, Cambridge Mass, 1999) 36–39.

[117] Margaret M Blair, *Ownership and Control: Rethinking Corporate Governance For The Twenty First Century* (The Brookings Institute, Washington DC, 1995) 229; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998–1999) 24 Journal of Corp. L 743; 'A Team Production Theory of Corporate Law' (1999) 85 V. L. Rev. 247.

but not limited to, shareholders, creditors (secured and unsecured), employees and managers, all of whom make contributions to the firm in different ways.[118]

It is by refining and applying the Team Production Theory developed for analysing corporate law to explain bankruptcy reorganization of public corporations that LoPucki has been able to develop his Team Production Theory of Bankruptcy Reorganization.

TEAM PRODUCTION THEORY AND INSOLVENCY LAW

Like the CBT, the Team Production Theory (TPT) is Contractarian because its account is based on mutual self interest. The model looks at those forms of co-operative behaviour that would be mutually advantageous for self-interested parties in insolvency to engage in. However, unlike the CBT, which is based on a hypothetical contract, TPT is based on putative actual contracts. LoPucki claims that his model 'is an empirically testable hypothesis regarding the actual bargain among the constituent groups' that makes up 'the public corporation.'[119] By this LoPucki is implying that his theory is grounded on actual contracts entered into by those he labels 'team members' who make up large public companies.

The Team Production Theory starts by identifying the institutions that are economically efficient, it then makes assumptions that because these institutions are efficient contracting parties would choose these institutions. The theory contests the view advanced by the CBT that insolvency law is a regulation imposed by government on the stakeholders. Rather, insolvency law for TPT is a contract term to which stakeholders voluntarily agree to subordinate their legal rights for the preservation of going concern value in the business.

The company from TPT's perspective is an aggregation of participants. These participants which TPT characterises as 'team members' combine resources in a production unit. The team approach to production, TPT argues, is necessitated by the fact that the contracting parties that constitute the company realise that they cannot achieve the business results they desire if they seek those results separately and individually rather than as a team. Thus, team production, as the name of the theory suggests, results from the joint resources and efforts of the constituent groups that make up the team in the company. The resultant production is team production because the resources used in achieving it do not in strictly economic (as opposed to legal) sense all belong to one person.[120]

[118] Using the 'nexus of contracts' metaphor to explain corporate relationship in a slightly different way, others have argued that the corporation should be seen as 'a number of complex, private, consensual transactions or contract-based relations, either express or implied' consisting of different types of relationships expressed in terms of voluntary association with the corporation by the different persons that comprise it. See e.g. Keay (n 127);F Easterbrook and D Fischel, 'The Corporate Contract' (1989) 89 Colum L. Rev 1416, 1412; J R Boatright, 'Contractors as Stakeholders: Reconciling Stakeholder Theory with the Nexus-of-Contracts Firms' (2002) 26 (9) Journal of Banking and Finance 1837–1842; T Donaldson L E Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications' (1995) 20(1) Academy of Mgt. Rev. 65–91; K R Conner, 'A Historical Comparison of Resource-based Theory and Five Schools of Thought Within Industrial Organization Economics: Do We Have a New Theory of the Firm?' (1991) 17(1) Journal of Mgt. 121–154; R E Freeman and W M Evan, 'Corporate Governance: A Stakeholder Interpretation' (1990) 19(4) The Journal of Behavioural Economics 337–359; R E Freeman and R A Philips, 'Stakeholder Theory: A Libertarian Defense' (2002) 12 (3) Business Ethics Quarterly 331–349; H Hansmann, *The Ownership of the Firm* (HUP, 1996).

[119] Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2003) UCLA Law School Research Paper No. 3–12 <http://ssrn.com/abstract=397801> accessed 12 December 2009.

[120] See A A Alchian & H Demsetz, 'Production, Information Costs, and Economic Organization,' (1972) 62 American Economic Review, 777–95.

The basis of team productivity is mutual trust. The emphasis on mutual trust is what sets TPT apart from other contractarian theories such as the CBT (mutual advantage), in which trust is seemingly lacking. Thus, TPT is based on the hypothesis that team members, of their own volition, deliberately delegate the ultimate decision making authority over the company, the distribution of rents and surpluses, and the protection of certain non-contractual but legitimate expectations of the team, to the board of directors on trust. The delegated power transcends the company in its solvent state. The reason for doing this, according to TPT, is borne out of the inherent contractual difficulty of dealing with such matters through explicit contracts.

Regarding the question of which interests bankruptcy law should take into account, TPT's position is that a collective insolvency proceeding should account for the rights of all stakeholders that make up the company. This stance is anchored on the notion that in addition to contributing value to the company, team members also have various degrees of economic interests in the insolvent company. Thus, TPT could be described as an inclusive theory. The theory favours the inclusion and consideration of the interests of stakeholders or in TPT's parlance, team members such as the employees in insolvency because they make human capital contribution to the company. This position echoes the view articulated by one commentator elsewhere namely that suppliers of labour deserve to have their claims considered in the same way that suppliers of capital do in insolvency.[121] After all, the value of any company's commodity and, or of its services, *a la* Karl Marx in his labour theory of value, is ultimately derived from the labour used to create that commodity.[122] There is force in the argument also that in a business highly dependent on skills, knowhow and services (as opposed to capital assets) the investments made by the employees are wrapped up in the goodwill and going concern value of the company.[123]

A key objective of team production contract according to TPT is to permit the debtor to be reorganised when the need arises so that it could continue to trade. However, from an economic efficiency standpoint TPT articulates that the debtor should only carry on business if the total benefits accruable to the team members from it continuing to trade will exceed the benefits that would accrue if it were liquidated. The point here is that reorganisation should take place when it is beneficial to the team members as a group and not only when it is beneficial to, or serves the interests of the creditors as a group. Thus, contrary to other Contractarian models such as the CBT which favour the realisation of assets of insolvent companies in order to maximise value for the creditors without due regard to job protection for the employees, TPT favours bankruptcy reorganisation and continuity of team production contracts when the company is insolvent because team members intended this to be the case at the time they contracted to join the company.

Reorganisation is preferred by TPT because the team members had agreed in advance that continuity of the company, or of its business, would require some of them to remain in place and carry on team production during a reorganisation exercise. However, nothing prevents the company, in TPT's view, from making adjustments to the team as necessary. Thus, during going concern sales or reorganisations, the management may need to be fired and replaced by the team. Also, transferor employers

[121] David Milman, 'Priority Rights on Corporate Insolvency' in Alison Clark (ed.) *Current Issues in Insolvency Law* (Stevens, London, 1991) 57.

[122] Karl Marx, *Capital: A Critique of Political Economy Volume 1: The Process of Capitalist Production*, (Samuel Moore & Edward Aveling translation) Frederick Engels & Ernest Untermann (eds.) (Charles H. Kerr and Co, Chicago, 1909) Ch. 1.

[123] Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997).

are not prevented from firing some, but not all employees if doing so would ensure that the business rescued as a going concern so that at least some of the employees team members would remain and continue team production as contractually agreed prior to the company becoming insolvent.

Regarding the thorny issue of redistribution in insolvency, TPT differs with the 'Robin Hood' or 'robbing Peter to pay Paul' picture that has been painted of the practice by the creditors' bargain theorists. Rather, redistribution is considered one of the objectives of the team production contract. For TPT, redistribution is simply a way of honouring the commitments that the company made to the team members in order to entice them to join the team. The theory's position is that fulfilment by the company of its pre-insolvency agreed obligations to non-rightsholders' team members in insolvency reorganisations should not be affected by the company's insolvent status. This is because when the team members contracted to join the company, they unanimously mandated the company (technically through the Board of Directors) to honour its commitments to all team members without distinction whether the company is solvent or insolvent.

TPT accepts that the company in honouring its obligations or commitments to the team members in insolvency could cause the non-bankruptcy entitlements of the creditors to be altered, and some of their wealth taken away from them and redistributed to other team members. In other words, recourse could be had to bankruptcy law to reduce the company's formal obligations to the creditors' team members in order for the company to meet its legal obligations to the other team members. Granted, in honouring its commitments to non-rightsholders team members (such as the employees), the company might be portrayed as antagonising the creditors-team members in respect of their formal claims since their legal entitlements would be adjusted, altered or reduced in a way they might not approve of.

LuPocki disagrees, however, with the argument made by the creditors' bargain theorists that meeting obligations to non-rightsholders team members by insolvent companies would destroy the rights of the team members with legal rights against the debtor's assets. This is because this latter group was a party to the original team production agreement which directed the company's board to honour its team production obligations to all of them even when the company is insolvent due to the valuable contributions these groups have made to team production. Thus, in spite of the seeming tension between the team members whose formal rights may be reduced in insolvency, the company should continue to represent all of them as fiduciary *vis-a-vis* their team production entitlements.[124]

In sum, TPT is an inclusive theory. Its position on insolvency is completely at variances with that of the CBT. The theory advocates for the interests of all those affected by insolvency to be heard and their concerns addressed. TPT represents the position that insolvency policies should take into account the distributional impact of business failure on all stakeholders. This would apply to those with direct financial interests in the failed company as well as those with non-financial claims but still interests in the on-going business.[125] TPT is averse to the creditors' primacy theory

[124] Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 764..

[125] Professor LoPucki is not alone in calling for such a forum and role for insolvency law. See e.g. E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 336, 354–55; Nathalie D Martin, 'Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In' (1998) 59 *Ohio St. L. Rev.* 429; A Flessner 'Philosophies of Business Bankruptcy Law: An International Overview' in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency* Law (Clarendon Press, Oxford 1994) 27. On why bankruptcy might not be redistributional, see Ronald J Mann, 'Bankruptcy and the Entitlements of the Government: Whose Money is it anyway? (1995) 70 NYU L Rev. 993.

which projects the creditors' interests over and above those of the other team members in insolvency.

THE AUTHENTIC CONSENT MODEL

Discontentment with the CBT has continued unabated. The very idea that anyone could discover a coherent 'deep structure' of corporate insolvency as claimed by the CBT has been described as an exercise in futility.[126] This has led to new and alternative models being developed by scholars. The Authentic Consent Model (ACM) developed by Rizwaan Mokal may be attributed to the dissatisfaction with the CBT.

Upon careful examination of the defining features of the CBT namely the role of self-interest, consent and it's *ex ante* position, Mokal is of the view that the theory can neither explain nor legitimise the coercive collective liquidation regime in insolvency. Mokal also questions how the CBT identifies the proposition it claims the creditors would consent to in insolvency since parties to a hypothetical bargain do not give real or actual consent. Mokal also disapproves of the CBT's exclusive and narrow concerns which restrict participation in the *ex-ante* agreement to only those parties who have contracted for legal rights to the debtor's assets upon the happening of insolvency.[127]

The ACM is different from other insolvency theories. Apart from involving a movement away from traditional Contractarianism to a methodological Contractualism, Mokal believes the model he has developed (unlike Contractarian theories which though describe insolvency proceedings as collective proceedings yet do not practice collectiveness in reality), can give a voice to all parties in insolvency. Collectiveness requires that all creditors should have a say in the process or at least have their interests fairly protected. But in the real world, concerns have been expressed by some real life creditors about how the proceedings operate to deny them a voice in insolvency proceedings.

Contractualism which derives from Jean Jacque Rousseau's notion of social contract as propagated by the likes of Immanuel Kant,[128] Thomas Scanlon,[129] John Rawls,[130] and Donald Dworkin is an ethical theory based on the notion of agreement and equal moral status of parties to the agreement. Contractualist theories determine acts that are right or wrong as well as what reasons and forms of reasoning are justifiable.[131] It operates on the philosophy that what people do, and how they behave, in any given business relationship should be determined by the agreement reached between them. In other words, the general 'will' is what individuals will jointly 'will' if a perspective that

[126] D G Carlson, 'Philosophy in Bankruptcy' (1987) 85 Mich. L Rev. 1341–1389. Carlson argued at page 1341 that Jackson's book is unhelpful in solving hard and interpretative problems. He added that the book will no doubt find 'some admirers among people who think that bad law-and-economics is better than no law-and-economics...' See also *v* Countryman, 'The Concept of Voidable Preference in Bankruptcy' (1985) 38 Vand. L Rev. 713, 1389.

[127] Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005) 69.

[128] See e.g. I. Kant, *Groundwork of the Metaphysics of Morals,* H.J. Paton's translation, *The Moral Law* (Hutchinson, London 1984).

[129] T M Scanlon, 'Contractualism and Utilitarianism' in Amartya Sen and Bernard Williams (eds.) *Utilitarianism and Beyond,* (CUP, Cambridge,1982) 103–28; Scanlon, *What We Owe to Each Other* (HUP, Cambridge, MA, 1998); 'A Contractualist Reply' (2000) 66 *Theoria (3)*237–245; Scanlon, 'Replies' (2002) 28 *Social Theory and Practice (2)* 337–358; R J Wallace, 'Scanlon's Contractualism' (2002) 112 Ethics (3) 429–470; S Reibetanz, 'Contractualism and Aggregation' (1988) 108 *Ethics* (2) 296–311; David Alm, 'Contractualism, Reciprocity, Compensation' (2008) 2 Journal of Ethics and Social Philosophy .

[130] John Rawls, *A Theory of Justice*, (HUP, Cambridge MA 1971); *Political Liberalism,* (Columbia University Press, NY, 1993).

[131] Ibid.

all parties are free and equal can be adopted. Contractualism is trust and rationality-based theory. Rationality requires us to respect others in our dealings. Respect for persons in turn requires that moral principles be designed in a way that they can be justified to each person.

When Contractualism principles are applied to insolvency, an insolvency law theory modelled on Contractualism would base moral obligation on a tacitly implied social contract between hypothetical beings in an impartial setting. Such a theory would seek principles that rational and autonomous agents would accept and agree to issues raised by insolvency under certain idealised conditions. Thus, unlike Contractarianism in which self-interest is what motivates the actions of individuals in a contract, it is instead the standard of morality to which individuals or parties to an agreement will be held accountable that drives them to act under Contractualism. The reason is because the standards of morality exhibited by individuals in their dealings with others will have to be publicly justified. When the standard of morality argument is applied to insolvency, it means that a party who seeks to maximise his own interest in a bargain involving other participants must do so in a way that he can justify why he did what he did (his actions) to others who also have their interests to pursue in the same bargain.

Central to the ACM are the juridical notions of 'justice', 'fairness' and 'equality'. The theory is predicated on the view that all principles of corporate insolvency law can be meaningfully tested.[132] The ACM is designed to accommodate and reconcile the procedural goals of transaction cost efficiency[133] with the substantive goals of fairness in insolvency. In other words, the ACM is a theory that provides the means for testing whether principles in insolvency law are wasteful, or whether they are productively efficient in the procedural sense of achieving more output with the same amount or even less input.[134] Thus, the procedural goals of insolvency law would be tested against the extent to which the law has provided a means for a fair scheme of co-operation, and resolution of conflict between the stakeholders.

Reduced to fundamentals, the substantive goals of law are those goals which bestow justification on that part of the law. They advance the positive aspects of every branch of law. They demonstrate the need for having that branch of law and also accentuate the value of having and practicing that *corpus* of legal doctrine.[135] The procedural goals of law, on the other hand, are standards for the implementation of that law which enables its substantive goals to be achieved. The scarcity of social resources makes it a central procedural goal of virtually all parts of a legal system to implement its substantive goals in a way that minimises waste if its substantive goals are to be maximally implemented. It follows from the forgoing that a core substantive goal of insolvency law, according to the ACM, is the law to have a 'just' disposition to all stakeholders in insolvency proceedings. The institution of 'just' rules is required because in actual insolvency settings individuals are characteristically strong, weak or helpless in terms of their bargaining powers. Thus, without just rules regulating insolvency, the strong party (usually secured creditors/banks) would overwhelm and

[132] See R J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005).

[133] Reference to efficiency here is to 'productive' efficiency and not to 'allocative' efficiency. Efficiency is a procedural (and not a substantive) goal of law because it cannot, on its own, confer justification on any part of law. As a procedural goal of law, efficiency is indispensable because once a set of substantive goals of a given law has been externally specified, efficiency can be used to judge between the available schemes for implementing them. See e.g. R .J Mokal, 'On Fairness and Efficiency,' (2003) 66 MLR 452; *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005) 24–25.

[134] See Rizwaan J Mokal, 'Contractarianism, Contractualism, and the Law of Corporate Insolvency' (2007) Singapore Journal of Legal Studies<http://ssrn.com/abstract=1074745> accessed 12 October 2009.

[135] Paul Milgrom and John Roberts, *Economics, Organization & Management* (Prentice-Hall, New Jersey 1992) 22–30.

exploit the weak ones (e.g. employees and unsecured creditors) in insolvency proceedings.[136]

In contrast to a model such as the CBT which is a contractarian theory premised on a 'justice as mutual advantage'[137] principle - a principle which many believe is a fatally flawed theory of justice because it is too exclusive[138]- the ACM is a Contractualist theory that is based on a 'justice as reciprocity' principle. Justice within the ACM framework redresses the bargaining imbalance and advantages some stakeholders have over others in insolvency. The ACM-type justice calls for all stakeholders in insolvency to be treated as moral equals. It demands that equal weight of concern and respect should be shown to the interests of all affected by the debtor's insolvency in all insolvency proceedings.

Justice from the ACM perspective also implies that co-operation between the stakeholders in insolvency should be facilitated amongst them as moral equals. By co-operation, the ACM implies that those confronted by a set of issues peculiar to insolvency (i.e. the 'dormant' social, commercial, and legal circumstances unique to a company, and which are triggered only when it becomes insolvent) should work together, accept and be guided by the instituted legal rules and procedures that govern insolvency.[139] The type of co-operation envisaged by the ACM must however take place on terms that would be reasonably acceptable to all those with economic interests in the insolvent company and who are participating in the proceedings. This, according to the ACM, is because the justification for having a particular branch of law, condemnation or rejection of that law, are predicated on the extent to which the law in question promotes or detracts from the moral equality of those the law applies.

The ACM is also a 'justice-as-reciprocity' theory because its Contractualist bargain is driven also by consideration of reciprocity. Reciprocity in this context implies not making demands of others that if one were required to meet he would be unable to do so reasonably. What this means is that in all our dealings we must act in a way that can be justified to others, we must adopt principles no one can reasonably condemn or reject.[140] Given the fact that in the life of a company, insolvency is a rather remote event at the time contracts are bargained, the ACM calls for all the principles that will govern insolvency-related issues to be selected from their 'choice' or 'original' positions. This approach is reminiscent of the Rawlsian contract model which is usually aimed at setting a general social framework for a liberal society, rather than seeking to determine moral principles.[141]

[136] Rizwaan J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies 400, 414.

[137] Under the principle of 'mutual advantage', a rule for action, a policy, or an action is judged right if it serves the advantage of all concerned. In the context of insolvency, mutual advantage simply implies that the best way for a party to secure its self-interest is to secure the general mutual interest through establishing or maintaining general order. See David Hume, 'An Enquiry Concerning the Principles of Morals,' in L A Selby-Bigge and P H Nidditch (eds) David Hume: *Enquiries Concerning Human Understanding and Concerning the Principles of Morals,* (OUP, Oxford 1975) 195. See further works by R Hardin, 'Altruism and Mutual Advantage' (1993) 67 Social Service Review *(3); One for All: The Logic of Group Conflict* (Princeton University Press, Princeton 1995) Chs. 4 & 5;'Magic on the Frontier: The Norm of Efficiency' (1996) 144 U. Penn. L. Rev. 1987–2020.

[138] See e.g. Peter Vanderschraaf, 'Justice as mutual advantage and the vulnerable' (2011) 10 Politics, Philosophy & Economics 119–147.

[139] Rizwaan J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies 400, 416.

[140] T Nagel, *Equality and Partiality,* (OUP, London 1991).

[141] In order to achieve principles of justice and reflect his commitment to liberal neutrality, Rawls places his parties to a hypothetical agreement behind a 'veil of ignorance' which ensures that they are deprived of knowledge of key facts about their own identities. See John Rawls, *A Theory of Justice*, (HUP, Cambridge MA 1971); *Political Liberalism,* (Columbia University Press, NY, 1993).

By placing parties to the hypothetical agreement in a 'choice' position, the ACM argues that they become 'dramatically ignorant' (meaning that they are deprived of any knowledge of personal attributes). It is reasoned that the lack of knowledge by the contractors on what their interests and positions will be in the queue upon their common debtor becoming insolvent would make each and every one of them incline to act in an economically rational manner and according to a single set of criteria. The ACM articulates that the parties would anticipate various conceptions of the good that might come their way and would therefore be in a position to provide, rationally, the means through which such conceptions would be pursued in the insolvency principles they would choose.[142] In other words, when parties act in 'dramatic ignorance' of their personal attributes, this allows 'good' principles of insolvency law to be voluntarily agreed by them rather than these being imposed on them by the government.

The ACM is also able to demonstrate that due to the construction of the 'choice position' and the constructive attributes of the parties bargaining in that position, not only would the principles that will eventually be chosen by them be fair and just, but given these principles would have been chosen by them in exercise of their autonomy, their implementations will also be efficient. In essence, the ACM's 'choice position' is simply a means of ensuring that any given set of legal practices can be tested in terms of whether it is selective or non-selective, fair or unfair on those that the legal practices affect.[143] However, for a set of principles or rules to be fair to those it potentially affects, the ACM stresses that there has to be consistency in their application.

The ACM's position regarding the purpose of insolvency law and especially the interests the law should take into account differs from other theories. The ACM's position is that it is not only the parties with direct financial concerns in the insolvent company that fit the ′affected parties' label. Rather, the 'affected party' tag covers persons, irrespective of how remote, that can show that their interests are affected in a way that is peculiar to insolvency. Viewed against the backdrop of this stance, the ACM can be described as an inclusive theory because it makes for the participation of a wide range of stakeholders or parties which a model like the CBT excludes.

Conscious however of the danger of over-stretching the 'affected party' label, presumably for pragmatic rather than principled reasons, the ACM does not subscribe to the view canvassed by Professor Donald Korobkin that financial distress is a problem that affects virtually all persons in the society therefore all of them should have representation in the choice of principles[144] because it is too wide and open-ended regarding those whose interests insolvency law should cater for.[145] The difficulty faced by such an 'all inclusive' approach is that ascertaining how courts will weigh these interests against each other or against those of the creditors specifically would be difficult if not impossible.[146] However, it is submitted that having an inclusive insolvency regime will be welcomed by constituencies such as the employees because it would ensure that their interests are taken into account and accorded equal weight of consideration in the overall scheme of insolvency proceedings.

142 Mokal cites the 'automatic stay' on enforcement of claims as one of the principles in insolvency that parties would choose to put in place. See R J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005). Ch. 3.

143 Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005). Ch. 3.

144 Donald R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum. L. Rev. 717.

145 For opinions against the use of bankruptcy for expansive goals, see e.g. C W Frost, 'Bankruptcy Redistributive Policies and the Limit of the Judicial Process,' (1995) 74 N C L Rev. 75, 80.

146 See Barry S Schermer, 'Response to Professor Gross: Taking the Interest of the Community into account in Bankruptcy-A Modern Day Tale of Belling the Cat' (1994) 74 Wash. U. L. Q.1049.

IMPLICATIONS OF THEORIES FOR THE EMPLOYEES

Corporate insolvency is a universal problem that affects a wide range of interests. It is for this reason that governments in different jurisdictions have reacted by enacting legal measures that would facilitate how they intervene during critical periods when companies operating within their domain of authorities are experiencing financial difficulty. The governments' intervention to resolve what is 'ordinarily considered private and autonomous corporate events'[147] perhaps stems from their appreciation of the social issues implicated in insolvency.[148] It is no exaggeration to say that for a large percentage of the world's population employment of some kind is very important.[149] For the individual, while not being gainfully employed would raise concerns of a subsistence nature, job loss would be of even greater concern for several reasons.[150] Job loss is not just about the loss of income for the affected individual, it is also about the loss of the individual's sense of self-esteem.[151] Beyond this, job loss and unemployment are also associated with a myriad of other problems and pathologies.[152]

Some of the intervention measures put in place by governments in different jurisdictions are designed to rescue insolvent businesses and protect jobs for the employees. These measures lend support to the argument that extant insolvency laws do not adequately protect the interests of the employees when the employer is insolvent. If, as articulated,[153] the policies enacted by governments to cater for business failures are indeed an amalgam of factual assumptions and normative decisions, it means that they would, to some extent, be influenced by insolvency theories.[154] While theory may only offer very limited help in the legislative and rulemaking processes in the field of insolvency law,[155] it nevertheless is very useful in providing conceptual solutions to contentious issues arising in insolvency. Because theories help in identifying and bringing into focus the conflicting interests that are in play in insolvency and the differing weights given to these interests by different systems, it appears that if the insolvency policies of states were based on them, every theory would generate a different insolvency system with different implications for the employees of an insolvent company. The question therefore is what implications do insolvency theories have for the employees? The answer to this question would be provided by considering what the implications of the select theories discussed above are for the employees.

[147] Yaad Rotem, 'Pursuing Preservation of Pre-Bankruptcy Entitlements: Corporate Bankruptcy Law's Self-Executing Mechanisms' (2008) 5 (1) Berkeley Bus. L J. 79, 82.

[148] Lawrence Ponoroff, 'Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings' (1994) 23 Capital University Law Review 441.

[149] See OECD: 'The Role of Employment and Social Protection: Making Economic Growth more Pro-Poor' (2009) Policy Statement, Dac High-level meeting 27–28 May 2009 <http://www.oecd.org/dataoecd/63/9/43514572.pdf> accessed 13 August 2011.

[150] Rheyanne Weaver, 'Emotional Effects of Job Loss' (2010) <http://www.empowher.com/depression/content/emotional-effects-job-loss> accessed 8 February 2012.

[151] Richard H Price, 'Psychological Impact of Job Loss on Individuals and Families' (1992) 1 (1) Current Directions in Psychology Science 9–11; Leslie Hossfeld, 'The Economic and Social Impact of Job Loss in Robeson County, North Carolina 1993–2003' (2004) 2(2) Sociation Today <http://www.ncsociology.org/hossfeld.htm> accessed 01 July 2011.

[152] J E Stiglitz, 'Employment, Social Justice and Societal Well-being' (2002) 141 Int'l Labour Rev. 9–29.

[153] See T Sullivan, E Warren & J L Westbrook, 'The Use of Empirical Data in Formulating Bankruptcy Policy' (1987) 50 (2) Law and Contemporary Problems 195, 201.

[154] Mark Bradshaw, 'Comment: The Role of Politics and Economics in Early American Bankruptcy Law' (1997) 18 Whittier L. Rev. 739.

[155] See Philipp Schuchman, 'Theory and Reality in Bankruptcy: The Spherical Chicken' (1997) 41 (4) Law and Contemporary Problems 66, 68.

EMPLOYEES FROM THE LENS OF THE CBT

The CBT is a creditors' primacy theory. It is a theory that advances the cause of the creditors when insolvency strikes the company. Its primary concern is to ensure that the welfare of those with legal entitlements or claims against the debtor or its assets is maximised. The CBT gives support to secured credit. It is a theory that justifies security as an institution.[156] It is a theory that supports the view that security is an efficient institution therefore any alteration to it will reduce the creditors' aggregate wealth making the institution of secured credit economically inefficient.[157]

The CBT is a theory that would operate to remind those responsible for managing estates of corporate debtors that their duties are owed only to the creditors. The theory's implication for other stakeholders would be that if an insolvency system is based on the creditors' bargain model, the consideration of their interests would be limited. For the employees, this means that consideration of their interests and expectations in insolvency would be very limited and they would be denied a say in insolvency proceedings under a CBT generated system.

Given the CBT's proclivity to prioritise the creditors' interests, an argument can be made that the employees' position and the protection that would be offered to them in insolvency situations would be weak under an insolvency system modelled on it. In other words, the employees under a CBT-influenced system would continue to be vulnerable in insolvency. Their interests would be considered only to the extent they are creditors with claims against the debtor. Thus, if the employee has a subsisting contract of employment, or is owed back wages, only then would he would be deemed a legal claimant against the debtor or its assets under a CBT generated system. This position also implies that non-contractual expectations such as continuity of employment that the employees might have but which neither insolvency law nor contract law protects would not be taken into account by the CBT when their corporate employer is formally insolvent.[158]

As a creditors' primacy theory, it could also be inferred that any insolvency system that is based on the CBT's thesis on insolvency would be favourably disposed to liquidation (i.e. the conversion of the debtor's asserts into cash) than it would be to going concern reorganisations (in the sense of selling the debtor's business in order to enable it avoid liquidation) when the debtor is insolvent. What this means is that the CBT is a theory that would give birth to an insolvency system that promotes self-interest over common good. Because of the prominence the CBT gives to wealth maximisation for the creditors, this group of stakeholders would be less interested in saving insolvent businesses. Rather, they would be more concerned with whether the debtor has enough assets to satisfy their individual claims and how to realise the assets for that purpose.

Consequent upon this, it could be argued that the tendency to seize and realise assets of the debtor by the creditors would be higher under a CBT-styled insolvency system[159] with serious adverse consequences for the employees. The creditors would be indifferent

[156] Lynn M LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 Virginia Law Review 1888, 1889.

[157] Thomas H Jackson & Anthony T Kronman, 'Secured Financing and Priorities Among Creditors' (1979) 88 Yale Law Journal 1143.

[158] Vanessa Finch, *Corporate Insolvency Law: Perspective and Theories* (2002) 28. See also, Antonio J Morgado & Nuno Garoupa, 'Employment Policy and Bankruptcy Law – Does Legal Tradition Matter?' (2006) Available online at www.isne.org/ISNIE06/Papers06/01.3 accessed 9 November 2013.

[159] Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) Faculty Scholarship Series. Paper 303. Available online at http://digitalcommons.law.yale.edu/fss_papers/303 accessed 13 November 2013. See also Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale Law Review 1807.

to whether insolvent businesses are closed prematurely. They would not be bothered whether this results in the loss of going concern value in such businesses so long as the value of their individual claims is preserved.[160] The implication of assets grab for the employees is that it leads to piece-meal liquidations of businesses resulting inevitably in loss of jobs for them.[161] This result is not at all surprising. It aligns with the view of creditors' bargain theorists that job protection is not a legitimate goal of insolvency law[162] and that using the insolvency system to protect jobs for the employees is economically inefficient.[163]

CBT scholars are of the view that the rehabilitation of insolvent companies is not an independent goal of insolvency law. These scholars also argue that only those with legal entitlement to the debtor's assets should make decisions regarding which company should or should not be rehabilitated.[164] The implication of these twin notions is that if an insolvency system is modelled on the CBT, the system so generated would put the fate of the insolvent companies in the hands of secured creditors. The corollary of this notion is that given the theory's focus on debt collection, an insolvency system generated by it would not advance the 'rescue culture'.[165] There is no suggestion here that a CBT generated insolvency system would be averse to business rescue. Rather, the point is that such a system may only support going concern business sales if these would maximise value for the creditors.

The problem is that maximising value for the creditors in the context of a going concern sale of an insolvent business would impact significantly and negatively on the employees. It is no secret that when selling insolvent businesses as going concerns, employees are usually the 'sacrificial lamb.' Most financially challenged businesses see employees as a reducible cost. What this means is that an insolvency system that is influenced by the CBT philosophy would promote downsizing during sales of insolvent business so as to maximise value for the creditors. Sometimes to sell a financially distressed business as a going concern, it might be expedient to scale down the workforce by terminating some or all contracts of employment of the employees.

This was the type of practice engendered by the House of Lords' (HL) decision in *Nokes v Doncaster Amalgamated Collieries Ltd*[166] in which a business transfer automatically put paid to all contracts of employment. This was an acceptable practice in business sales situations as exemplified in *Secretary of State for Employment v Spence*[167] which sought to perpetuate the practice. *Spence* gave Insolvency Practitioners (IP's) the latitude to utilise the services of employees and keep businesses running up to the point when they were ready to dispose of the business before dismissing them.[168] However, TUPE has now made the use of the *Spence* strategy very difficult, if not

[160] Lemma W Senbet & James K Seward, 'Financial Distress, Bankruptcy and Reorganization' Financial Distress, Bankruptcy and Reorganization, in R A Jarrow *et al.* (ed*.), Handbooks in Operations Research and Management Science* (Vol. 9., Elsevier Science 1995) 992.

[161] See e.g. Daniel Keating, 'The Fruits of Labour: Workers Priorities in Bankruptcy' (1993) 35 Ariz. L. Rev 905, 907; Donald Korobkin, 'Employees' Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L. Rev. 5–6; Karen Gross, *Failure and Forgiveness: Rebalancing The Bankruptcy System* (YUP, 1997) 152.

[162] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 (5) Yale L. J. 857.

[163] Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale Law Review 1807.

[164] See Ted Janger, 'Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design' (2001) 43 Arizona Law Review 559, 566.

[165] 'Rescue culture' is a term that entered into the lexicon of English insolvency law following the case of *Powdrill v Watson* [1995] 2 AC 394 (Lord Browne-Wilkinson). For the meaning of the term, see Hunter Muir, 'The Nature and Functions of a Rescue Culture' (1999) JBL 491.

[166] [1940] AC 1014.

[167] [1986] ICR 651 (CA).

[168] The courts reacted to this practice in *Powdrill v Watson* [1995] 2 AC 394 (HL) in the context of of adoption of contracts of employment.

impossible, to apply.[169] TUPE's principle of compulsory transfer of the employees' contracts of employment[170] makes it very difficult to dismiss employees before or after an insolvent business transfer without liabilities if there is no economic, technical or organisational (ETO) justification.[171]

The inference that can be drawn from the above is that an insolvency system based on the CBT would not approve of any measure that is imposed on the structure of insolvency law and which is aimed at safeguarding employment for the employees such as TUPE which is currently the regime governing the rights of employees during the transfer of a business, or part thereof, from one person to another in the UK. This is because not only will a measure or regime such as TUPE restrict the transferor's freedom to manoeuvre the size of the workforce to meet the imperatives of the buyer, but also the creditors' ability to capture full going concern value from sales of insolvent businesses would be severely curtailed since such businesses would most likely always be sold at discounted prices.

The position taken by the CBT *vis-a-vis* employment protection for the employees in insolvency is not helpful to insolvent businesses. The CBT tends to discount the fact that safeguarding employment for the employees in insolvency could ensure that they do not abandon insolvent companies thereby speeding up their legal demise.[172] There is the view that in a business in which firm-specific human capital[173] is important, indifference to whether the workforce comprises the same personnel or whether there is a constant change in the workforce cannot be the case. Rather, given how essential employees are to the success of businesses,[174] continuity must be valued[175] and the relationship must be 'embedded in a protective governance structure lest productive values be sacrificed if the employment relation is unwittingly severed.'[176] This is because the firm-specific investments made by the employees in the company are informed by the implicit promise of job security which gives them a return on their investments.[177]

[169] See particularly the House of Lords decision in *Litster v Forth Dry Dock and Engineering Company Ltd* [1989] 1 All ER 1134, [1989] IRLR 161.

[170] TUPE 2006, Reg.4(2).

[171] Giuseppe S Massara, 'Transfer of Undertakings: Insolvency Proceedings in the United Kingdom and in Italy and the European Court of Justice Case Law' (2010) in *Compliance with Labour Legislation: Its Efficacy and Efficiency,* ILO Working Paper <http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---lab_admin/documents/publication/wcms_140685.pdf> accessed 18 March 2012; M Sargeant, 'Transferring Liabilit for Employee claims' (2000) JBL 188- 192; A Kastrinou, N Shah & O Gough, 'Corporate Rescue in the UK and Effect of the TUPE' (2011) 32 (5) Company Lawyer 131).

[172] Matthew L Seror, 'Analyzing the Inadequacies of Employee Protections in Bankruptcy' (2003)13 (1) Southern California Interdisciplinary Law Journal 143.

[173] Contemporary growth theory considers human capital an important growth factor. Human capital is the stock of competences, knowledge and personality attributes embodied in the ability to perform labours so as to produce economic value. It is the attributes gained by a worker through education and experience. It is a means of production into which additional investment yields additional output. Whilst human capital is substitutable, it is however not transferable like land, labour, or fixed capital. For further details on the notion of human capital, see e.g. Jacob Mincer, 'Investment in Human Capital and Personal Income Distribution' (1958) Journal of Political Economy. See also Gary S Becker, *Human Capital: A theoretical and empirical analysis with special reference to Education* (University of Chicago Press, Chicago 1964).

[174] Daniel Keating, 'The Fruits of Labour: Workers Priorities in Bankruptcy' (1993) 35 Ariz. L. Rev 905, 907.

[175] Gary S Becker, *Human Capital: A theoretical and empirical analysis with special reference to Education* (University of Chicago Press, Chicago 1964) 21.

[176] See O E Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting,* (Free Press, New York, 1985), 242–43. See also Oliver E Williamson & J Bercovitz, 'The Modern Corporation as an Efficiency Instrument: The Comparative Contracting Perspective' in Carl Kaysen (ed.) *The* American *Corporation Today,* (OUP, Oxford 1996); O E Williamson, M L Wachter, and J E Harris, 'Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange', (1975) 6 Bell Journal of Economics, 250–80.

[177] See Jonathan Macey & Geoffrey Miller, 'Corporate Stakeholders: A Contractual Perspective' (1993) 43 University of Toronto Law Journal 401; R Mitchell, A O' Donnell & I Ramsey, 'Shareholder Value and Employee Interests: Intersections Between Corporate Governance, Corporate Law and Labour Law' (2004) Legal Studies Research Paper No. 128, Melbourne Law School. Available online at http://ssrn.com/abstract=753904 accessed 05 January 2014.

By refusing to consider non-contractual expectations that the employees may have, it could be argued that the CBT sees the employees through the classical economic lens which equates labour with other factors of production with a market value.[178] No economic analysis of insolvency would consider non-economic matters such as social, moral, political and personal consequences. Thus, while a CBT influenced system would take into account those employees' entitlements that are based on pre-insolvency agreed contract terms, it would not consider non-contractual expectations such as continuity of employment post rehabilitation of insolvent companies. Still, this does not detract from the fact that employees do have other legitimate interests and expectations in the debtor that can be affected by insolvency[179] deserving of consideration, but which contracts cannot and do not guarantee.

In conclusion, the implications of the CBT for the employees are hardly surprising given the theory's pre-disposition to value maximisation for the creditors. It would be safe to conclude that the CBT is a theory premised on a capitalist philosophy of insolvency which holds that when the company is insolvent its assets are subject to the claims of the creditors as the legal owners.[180] In other words, the insolvency transfers interests in the company's assets to the creditors as rightsholders in those assets.[181]

EMPLOYEES FROM THE VIEWPOINT OF TPT

TPT has implications for the employees. TPT is a theory whose core theme centres on striking a balance between the competing interests of all constituencies affected by insolvency. It advocates giving equal weight of consideration to the interests of team members in insolvency settings. Thus, the implication of TPT for the employees is that they would be better off in an insolvency system that is based on its principles. Based on these, it could also be argued that TPT is a theory that would generate an insolvency that would consider interests other than those of the creditors. Thus, rather than seeking to prioritise the interest of a particular team member, TPT would advocate for the interests of the 'weak' team members (employees) that are often inevitably pit against those of their 'strong' team member counterparts (secured creditors) to be balanced in insolvency.[182]

[178] See generally David Ricardo, *Principles of Political Economy* (1817); Karl Marx, *Capital; A Critique of Political Economy* (1867); Adams Smith, *The Wealth of Nations* (1776). This view has been vehemently challenged and refuted. See e.g. P O' Higgins, 'Labour is not a Commodity' (1997) 26 IL.J 225.

[179] T Donalson & L Preston, 'The Stakeholder theory of the corporation- concepts, evidence, and implications' (1995) 20 Academic Management Review (1) 65–91.

[180] It is an incontestable fact that when a company is formally insolvent, the shareholders' interests are usually supplanted by the creditors' interests. . In *Brady v Brady* [1987] 3 BCC 535, 552 (Nourse LJ), - a case that was decided in the context of directors' duties in insolvency - the court held that 'where the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone'. This principle which was established in the earlier Commonwealth case of *Kinsella v Russell Kinsella Pty Ltd* [1986] 4 NSWLR, was given judicial credence in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, 252–53. In subsequent English cases, the courts have adopted this approach. See e.g. *Re Pantone 485 Ltd* [2002] 1 BCLC 266, 69; *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74; *Re MDA Investment Management Ltd* [2004] EWHC 42 Ch.; *Re Cityspan Ltd* [2008] BCC 60. However, there are other circumstances in which the directors' duties to the shareholders might be required to shift to the creditors. These, according to case law, include where the company is perceived variously as approaching, nearing, on the verge of, or on the borderline of insolvency (see e.g. *The Liquidator of Wendy Fair (Heritage) Ltd v Hobday* [2006] EWHC 5803, 66; *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74; *Gillespie, Airdrie North Limited* [2010] CSOH 132, 22), doubtfully solvent (see e.g. *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74), or where the company subject to a risk of insolvency (see e.g. *Kinsella v Russell Kinsella Pty Ltd* [1986] 4 NSWLR; *Winkworth v Edward Baron Development Ltd* [1986] 1 WLR 1512).

[181] See Barry E Adler and Lawrence Weiss, 'The Debacle of Corporate Bankruptcy' (1992) The Cato Review of Business & Government <http://www.cato.org/pubs/regulation/regv15n3/reg15n3-adler.html> accessed 23 November 2013.

[182] Bruce G Carruthers & Terence C Halliday, *Rescuing Business: The Making of Bankruptcy Law in England and the United States* (OUP, Oxford 1998) 303. 303.

Given that TPT gives credence to the claim that the company is an aggregate of interests, and that the employees are not just the most important of its assets[183] but are also one of the constituencies with a substantial nexus to the company,[184] it seems that apart from the traditional or normal entitlements of the employees, an insolvency system modelled on the TPT would be favourably disposed to taking into account non-contractual interests and expectations of the employees' team members in insolvency. It follows that TPT would generate an insolvency system that supports corporate reorganisations because this ensures maximisation of the joint welfare of all team members that make up the insolvent company.

The reason why a TPT-influenced system might support going concern sales of insolvent businesses is not because the creditors, as LoPucki asserts, would willingly agree to subordinate their legal rights to the preservation of the going concern, but because of the potential this has to make the different team members of the insolvent company collectively better off than they would be if the company were to be liquidated piecemeal.[185] Going concern sales of insolvent businesses would preserve at least some jobs for the employees without detrimentally affecting the interests of other team members.

Given that the sale of an insolvent business as a going concern does not on its own guarantee continuity of employment,[186] it could be argued that TPT would favour any employment protection regime capable of protecting the employees against unfair dismissals during sales. TPT takes the view that laws aimed at limiting the freedom employers enjoy from arbitrary and sometimes abusive usages are an age long practice.[187] In the context of insolvency, there is inevitably a tension between saving businesses that are in financial distress and providing adequate protection to the employees of those businesses. Whilst from an insolvency law perspective, the focus of legislative attention in recent years has been on enacting legislation and providing procedures capable of supporting companies experiencing financial difficulty, there has, on the other hand, equally been intensive legislative output from the labour and employment law domain aimed at supporting and protecting the rights of the employees when the companies they work for become insolvent and their businesses are sold to third party purchasers as going concerns. It follows therefore that TPT would endorse employment protection regimes such as the ARD and TUPE which is currently the law protecting the rights of employees in business transfer situations in the UK.

TUPE offers greater protection to employees impacted by business transfers where there is a change of employer. TUPE provides, *inter alia,* for the automatic transfer of the employees' contracts of employment from the transferor to the transferee. The regime is not designed to deliberately prevent business owners from restructuring their businesses whenever the economic need to do so arises.[188] Rather, what TUPE does is ensure that relevant employers do not walk over the rights of the employees during sales of insolvent businesses.[189] The mandatory nature of TUPE makes it difficult for parties to have arrangements, however mutually desirable, to circumvent the regime's

[183] Luigi Zingales, 'In Search of New Foundations' (2000) 55 Journal of Finance, 1643.

[184] K Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997) 19.

[185] Lynn M. LoPucki, 'TheTeam Production Theory of Bankruptcy Reorganization' 57 Vand. L. Rev. 765–67.

[186] See *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014.

[187] In most cases, TUPE is not about this. However, the Regulations do seek to prevent abusive and improper dismissals by way of scrutinising whether an ETO reason exists for the dismissals of employees.

[188] David Burdette, 'Formalities for the Transfer of Insolvent Business: Obligatory Transfer of Employees in South Africa and the United Kingdom' (2007) 3 INSOL International Technical Services Issue, 1.

[189] Roger Tynan, 'TUPE and Insolvency: Interpreting the Regulations' (2009) Employers' Law Magazine <http://www.personneltoday.com/articles/2009/07/07/50077/tupe-and-insolvency-interpreting-the-regulations.html> accessed 14 May 2012.

effects in transfer situations.[190] The proponent of TPT would agree with the French philosopher Montesquieu that:

> The freedom of commerce is not a power granted to the merchants to do what they please: this would be more properly its slavery. The constraint of the merchants is not the constraint of commerce. It is in the freest countries that the merchant finds innumerable obstacles; and he is never less crossed by laws, than in a country of slaves.[191]

Thus, the legal constraints TUPE places on the transferor's ability to freely shed the workforce during the sale of an insolvent business would be applauded by TPT. This is because not only does TUPE vindicate employment protection in insolvency, but it also gives credence to the notion that where employees commit firm-specific human capital investments to team production (which makes it difficult, if not impossible, for them to be redeployed to alternative uses[192]), but are vulnerable to management caprices[193] especially during insolvent business sales, legislation guaranteeing them a certain degree of protection against arbitrary treatment or dismissals by transferors of businesses would be appropriate and justifiable. TUPE ensures continuity of employment relationship between the business transferred and, at least, some of the employees who will carry on the business. After all, the going concern value of any business resides in employment relationships.[194]

TPT's support for exogamous employment protection for the employees in the context of going concern sales of insolvent businesses resulting in a change in employer is, arguably, recognition that there is a *lacuna* in commercial, contract as well as insolvency laws regarding employees' rights and the protection of those rights in insolvency generally and in going concern sales of insolvent businesses particularly.

To illustrate, it could be argued that while commercial law gives the insolvent company a 'second chance' of survival through a going concern sale to a new owner, this branch of law does not cater for employees' issues arising as a result of the sale. In a similar vein, contract law provides the employees with very few grounds on which to challenge or limit the powers of employers regarding downsizing of the workforce in insolvency.[195] The employees are unable, for example, to extract contracts from their employers in advance that would guarantee them job security (and on the existing terms and conditions) when the business employing becomes insolvent and is sold to

[190] On transfers and the effect of TUPE on structuring a transfer to circumvent TUPE, see the House of Lords decisions in e.g. *Litster v Forth Dry Dock and Engineering Co Ltd* [1990] 1 AC 546; *Celtec Ltd v Astley* [2006] IRLR 635 *; G4S Justice Services (UK) Ltd v Anstey* [2006] IRLR 588. On changes in the contractual terms of employment, see *Foreningen AF Arbejdsledere I Danmark v Daddy's Dance Hall A/S* [1988] IRLR 315. Contrast this with the House of Lord's decision in *Power v Regent Security Services Limited* [2007] IRLR 226.

[191] Baron de Montesquieu, *L' esprit des lois,* (1748) Book 20, Chapter 12, (Thomas Nugent translation: 1751), quoted in Beth A Ahlering and Simon Deakin, 'Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complimentarity?' (2005) ECGI Working Paper No. 72/2006 <http://ssrn.com/abstract=898184> accessed 14 March 2009.

[192] Margaret M Blair, 'Firm-Specific Human Capital and Theories of the Firm', (2003) Georgetown University Law Center Business, Economic and Regulatory Policy Working Paper No. 167848 <http://papers.ssrn.com/abstract=167848> accessed 30 November 2009; M Blair & L A Stout, 'Director Accountability and the Mediating Role of the Corporate Board,' (2001) 79 Wash. U L Q. 403, 416.

[193] M O' Connor, 'The Human Capital Era' (1993) 78 Cornell L Rev 889, 905–917. Simon Deakin & Frank Wilkinson, 'Labour Law and Economic Theory: A Reappraisal' (1998) ESRC Centre for Business Research University of Cambridge Working Paper (No. 92) <http://www.cbr.cam.ac.uk/pdf/wp092.pdf> accessed 29 October 2011.

[194] Lynn M. LoPucki, 'The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's The End of Bankruptcy' (2003) 56 Stan L. Rev. 652.

[195] M Trebilcock and R Howse, 'Protecting the Employment Bargain' (1993) 43 University of Toronto Law Journal 751, 756.

a third party purchaser as a going concern.[196] There is the view that the existence of protective labour legislation is in itself testament to the fact that employment relationships entered into between the employee and the employer is an unequal one. Thus, the primary role of labour law is to counteract the inequality or asymmetry in bargaining power that is inherent in the employment relationship.[197]

On its part, insolvency law has not gone far enough in protecting employees' rights. Insolvency law provides very limited protection to the employees during transfers out of insolvency globally. Granted, the legislative history of the 1978 Bankruptcy Reform Act in the United States indicates that protection of the employees is one of the key purposes of Chapter 11 bankruptcy reorganisation,[198] and the administrator under the UK Insolvency Act of 1986 is statutory directed to pursue its duties with the primary purpose of rescuing the company as a going concern[199] (probably because it has the potential of saving jobs for the employees too), it is submitted that these are not robust enough.

Given the importance of job security for the employees and the absence of robust protection by contract and insolvency laws, the application of a special regime other than the ordinary rules of contract law that is capable of providing job security for the employees would be necessary by TPT. It matters not that the protection is endogenous in the sense that it emanates from within insolvency law itself, or exogenous in that it originates from another body of law as is the case with TUPE (which an aspect of employment law). What matters is that the employment protection *lacuna* left by contract and insolvency laws respectively has been filled extraneously by employment law through the use of labour standards as basic legal intervention technique.[200] A good example of how TUPE protects jobs for the employees is *Litster v Forth Dry Dock and Engineering Company Ltd*[201] in which the House of Lords noted that the automatic transfer provision under Regulation 4 (3) not only applies to workers employed *immediately* before a transfer, but that the rule also applies to employees who are able to show that they would have been so employed had they not been unfairly dismissed for a reason connected with the transfer[202] in accordance with Regulation7(1) TUPE 2006).[203] *Litster* represented a strong philosophical commitment to upholding

[196] Janis Sarra, 'Corporate Governance Reform: Recognition of Workers' Equitable Investments in the Firm' (1999) 32 Can. Bus. L J 384; Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee claims' (2008) in P J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, 2008) 49.

[197] Paul Davies and Mark Freedland, *Kahn Freund's Labour and the Law* (3rd edn., Stevens, London 1983) 14–26; Simon Deakin & Wanjiru Njoya, 'The Legal Framework of Employment Relations' (2007) Centre for Business Research, University of Cambridge Working Paper No. 349 <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167...> accessed 04 April 2012.

[198] See Elizabeth Warren, 'The Untenable Case for Repeal of Chapter 11' (1992) 102 (2) Yale L. J. 437, 468; Chrystin Ondersma, 'Employment Patterns in Relation to Bankruptcy' (2009) 83 Am. Bankr. L. J. 237, 241.

[199] Insolvency Act 1986, Schd. B1 para. 3(1).

[200] J Gruber, 'The Wealth of the Unemployed' (2001) 55 Industrial and Labor Relations Review, 79–94; C Ruhm, 'Are Workers Permanently Scarred by Job Displacements?' (1991) 81 American Economic Review, 319–23; A. H Stevens, 'Persistent Effects of Job Displacement: The Importance of Multiple Job Losses, (1997) 15 Journal of Labour Economics, 165–88; M Stephens, 'The Long-Run Consumption Effects of Earnings Shocks' (2001) 83 The Review of Economics and Statistics, 28–36; J E Stiglitz, 'Employment, Social Justice and Societal Well-being' (2002) 141 Int'l Labour Rev. (No. 1–2), 9–29, 9; Hugh Collins, K D Ewing & A McColgan, Labour Law: Texts and Mate*rials*, (2nd edn., Hart Publishing, Oxford 2005) 1; Mary Ann S Bartlett, 'Employees' Rights in Mergers and Takeovers-EEC Proposals and the American Approach,' (1976) 25 Int'l & Comp. L Quarterly (3) 621, 626.

[201] [1989] 1 All ER 1134, [1989] IRLR 161.

[202] This position is in consonant not only with the terms of the ARD, but also with the jurisprudence of the ECJ developed in relation to the ARD especially in *P Bork International A/S v Foreningen af Arbejdslederen i Danmark* [1989] IRLR 41.

[203] In fact, the change in approach following the *Litster* decision was such that in the case of *G4S Justice Services (UK) Ltd v Anstey and others* [2006] IRLR 588 EAT, the EAT was able to hold that even employees dismissed for gross misconduct prior to a TUPE transfer, but whose appeals are subsequently upheld, would be deemed employed 'immediately before' the transfer, meaning that their employment contracts would transfer to the transferee.

and developing EU-derived employment rights. It reflected the English courts' intent to construe implementing legislation purposively to accord with the spirit and letter of EU Directives.[204]

TPT does not advocate for absolute-non-derogation employment protection. It acknowledges the fact that when the corporate employer is insolvent the legal entitlements of the team members may have to be reduced or derogated if a going concern rescue of its business is to be achieved. For TPT therefore, rescuing an insolvent business may sometimes warrant the loss of some, but not all jobs because the retention of some of the employee-team members is necessary to continue the business post-rehabilitation. However, what TPT is against is that loss of employment in the context of insolvent business transfers should not be at the pleasure of the company's management. Equally, the workforce should not be downsized if no valid economic reasons or exigencies for doing so exist. This, LoPucki and admirers of his TPT would argue, is what TUPE does. TUPE constrains transferors from pursuing creditors' welfare maximisation at the expense of other team members such as the employees. In other words, the transferor's capacity to increase creditors' wealth through a reduction of labour costs during insolvent business sales is limited by the extent to which TUPE imposes rigidity on shedding the workforce.

EMPLOYEES FROM THE PERSPECTIVE OF THE ACM

Inherent in the ACM are the juridical notions of fairness, equality and justice. Given the model's disposition for 'equal concern' for all those affected by insolvency, it is safe to conclude that the ACM is a theory that would not generate an insolvency system that prioritises the interests of one constituency to the exclusion of all the others. It is equally a theory that would not give rise to a system that would allow 'strong' parties to oppress 'weak' ones in insolvency. Rather, the ACM would engender a system in which all those affected by insolvency would be regarded as equals and their interests given equal care and concern when their common debtor is insolvent.

Given that in an ACM-induced insolvency system the parties who reach *ex ante* agreement with the debtor would do so behind a 'veil of ignorance,' this would make them conscious of the fact that they could end up belonging to the disadvantaged category or class of stakeholders when their mutual debtor becomes insolvent. It would therefore give these parties the necessary incentive and impetus to conclude agreements that would give *equal* concern to all insolvency-related issues affecting all parties without exception. The implication is that the ACM is a theory that would generate an insolvency system that is inclusive and one that would take into account the wider interests of stakeholders. Such a system would also give greater protection to 'weak' and vulnerable constituencies in insolvency.

Because the employees are considered weak and vulnerable in the literature on corporate insolvency,[205] it could be that argued parties contracting behind the 'veil of ignorance' or 'natural ignorance' in an ACM-generated system would not bias the principles they select. Rather, they would agree to principles that would accord greater *ex post* protection to this class of claimants just in case they end up members of this particular class in an actual or real life insolvency situation. Thus, the employees, it seems, would fare well under an ACM-influenced insolvency system.

[204] See e.g. *Von Colson and Kamann v Land Nordrhein-Westfalen*Case 14/83 [1984] ECR 1891 para 28.

[205] Bruce G Carruthers & Terence C Halliday, *Rescuing Business: The Making of Bankruptcy Law in England and the United States* (OUP, Oxford 1998) 303.

The notion of equal respect for the concerns of all those affected by peculiar issues in insolvency inherent in the ACM could also be construed as meaning that contracting parties would take into account such employees' concerns as the continuation of their employment contracts when the debtor becomes insolvent and rescue takes the form of a going concern sale to a third party purchaser. It is common knowledge that the employees would prefer the business that employs them to be rescued rather than be liquidated when it becomes insolvent. However, given that the sale of an insolvent business on a going concern basis does not guarantee jobs for the employees, it could be argued that an ACM-generated system would welcome any legal regime, within or without the insolvency law framework, capable of preserving at least some jobs for the employees. It follows that the ACM is a theory that might support the type of protection TUPE gives to the employees during going concern sales of insolvent businesses or undertakings. Also, for those employees who lose their jobs, the ACM would impress upon the contracting parties the need to select principles that would make available some form of social security safety net for them.

However, it is pertinent to note that rescuing an insolvent business under the ACM would be dependent on whether it is cost efficient for all parties to do so. In other words, an ACM-generated system would not pursue business rescue just because it preserves jobs. Rather, rescue would only be desirable if, through rescue actions what is gained would be worth more than what would be lost. This is because while a regime such as TUPE may be substantively fair when judged under the ACM, it may be procedurally inefficient in that it shifts costs to the purchaser thereby making buying insolvent businesses as going concerns very expensive and discouraging. Where that is the case, it would not only hinder the achievement of a substantively fair outcome but could hinder the rescues of insolvent businesses too and ultimately imperil the employees' job security.

CONCLUSION

This paper has analysed three representative theories of insolvency law. The paper concludes that each holds a different perspective on what the legitimate province of insolvency law is. The paper has also considered what type of insolvency system each of these theories would generate and the implications these would have for the employees in the context of insolvency.

Based on the three theories analysed in this paper, it is evident that employees of an insolvent company would fare differently under the different insolvency systems influenced by each one of them. This is due to the differences of opinions existing among the theorists and theories on what the goals that insolvency law should accomplish are. While some theories are exclusive, in the sense of the limited interests they want insolvency law to take into account, others are very inclusive in nature. What this means in effect is that the extent to which the interests and expectations of employees would be considered in insolvency would depend on the particular theory to which policymakers in a given jurisdiction subscribe and the type of insolvency system the theory in question generates therein.

Thus, the paper has been able to show, for example, that in an insolvency system generated by a theory such as the CBT, the employees would always play second fiddle to the creditors in terms of consideration of their interests in insolvency proceedings. The employees would continue to be the lost souls in insolvency. On the other hand, the employees are likely to find favour *vis-a-vis* consideration of their interests and expectations in insolvency in a TPT-generated system because not only does TPT consider them important to the success and continuation of the company, but the theory values the human capital contributions of the employees in the company. It is a theory in which the system it generates would favour giving greater protection for the rights of the employees especially during going concern sales of insolvent businesses. The same would be true of an insolvency system that would be generated by the ACM. Given this theory's fairness, respect and equal weight of concern disposition for the interests of parties affected by insolvency, an argument could be made that the employees would have a voice in insolvency.

It appears that for employees to have a voice in insolvency proceedings that are opened in relation to their employers, insolvency systems of all jurisdictions would have to be designed in a way that will not only increase their participation, but also vest in them the statutory right to be consulted on business decisions made by their employers in the context of insolvency. In other words, in order for employees' voice to be heard in insolvency situations involving their employers, use their firm-specific knowledge to contribute and enhance the employer's recovery process, both extant and potential employee voice mechanisms in all jurisdictions would have to be re-assessed by policymakers.

ESTABLISHING MINIMUM STANDARDS ON THE RIGHTS, SUPPORT AND PROTECTION FOR CRIME VICTIMS WITH SPECIFIC PROTECTION NEEDS.

LOUISE TAYLOR and JO ANN BOYLAN-KEMP***

INTRODUCTION

The EU *Directive establishing minimum standards on the rights, support and protection of victims of crime* (the 'Directive')[1] was adopted on the 25th of October 2012. With an aim of ensuring that 'victims of crime receive appropriate information, support and protection and are able to participate in criminal proceedings',[2] the Directive replaces the 2001 *Framework Decision on the standing of victims in criminal proceedings* (the 'Framework Decision'),[3] the implementation of which the Commission had previously condemned as being largely ineffective.[4]

In many respects the Directive goes beyond the scope of the Framework Decision with its preamble stating that it is intended to 'amend and expand'[5] the terms of that document. With a view to achieving effective minimum EU harmonisation on provision for crime victims the Directive has been drafted as a much more detailed instrument than its predecessor, removing a great deal of the discretion that had been afforded to the Member States under the Framework Decision. Adding to this the increased legal clout afforded to directives as a result of their being subject to the full jurisdiction of the Court of Justice of the EU (CJEU)[6] and the potential for their provisions to be directly effective within the national systems of the Member States,[7] and it is anticipated that Directive 2012/29/EU will be a much more effective instrument in securing rights, support and protection for victims than has ever previously been the case within the EU.

This paper focuses on Articles 22–24 of the Directive, which outline the minimum standards of provision expected in respect of victims with specific protection needs. Here we explain the extent of these obligations and assess the suitability of our English domestic law in meeting these aspects of the Directive.[8]

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[1] Directive 2012/29/EU of the 25 October 2012 [2012] OJ L 315/57.

[2] The Directive, Art 1. All references to 'Art; Articles' are to the Articles of the Directive.

[3] Framework Decision 2001/220/JHA of 15 March 2001 [2001] OJ L 82/1.

[4] European Commission Impact Assessment SEC/2011/580 of 18 May 2011, 6.

[5] Preamble to the Directive, para 65.

[6] A major change introduced by the Treaty of Lisbon (amending the Treaty on European Union and the Treaty Establishing the European Community [2007] OJ C 306/01) was to extend the competence of the CJEU in the area of Freedom, Security and Justice with the effect that the competence of the court is now unrestricted in respect of all new EU criminal law instruments (including Directive 2012/29/EU).

[7] For some time the possibility that provisions of directives could achieve direct effect has been recognised. See case 41/74 *Van Duyn v Home Office* [1974] ECR 1338.

[8] Art 27(1) of the Directive requires that Member States implement the laws, regulations and administrative measures necessary to transpose the Directive into their domestic law by the 19th of November 2015.

ARTICLE 22 – INDIVIDUAL ASSESSMENT OF VICTIMS TO IDENTIFY SPECIFIC PROTECTION NEEDS.

Article 22(1) requires that Member States 'shall ensure that victims receive a timely and individual assessment. . .to identify specific protection needs and to determine whether and to what extent they would benefit from special measures in the course of criminal proceedings. . .due to their particular vulnerability to secondary and repeat victimisation, to intimidation and to retaliation'.

While Member States are permitted significant flexibility in the way that they conduct this individual assessment[9] it is clearly intended that the assessment takes place at as early an opportunity as possible,[10] and that it should be updated throughout criminal proceedings if the elements that form its basis have changed significantly.[11]

In conducting the individual assessment the Member States are required by Article 22(2) to pay particular attention to the personal characteristics of the victim and to the type, nature and circumstances of the crime. The only group specifically identified as having presumed protections needs are child victims,[12] but even here the Member States remain obliged to conduct an individual assessment to assess the nature and extent of any special measures required.[13] Beyond child victims the preamble to the Directive also identifies other vulnerable groups such as victims of human trafficking, terrorism, and domestic violence as being at high risk of secondary and repeat victimisation, intimidation and retaliation, with a presumption that these victims will also benefit from special protection measures.[14] To a lesser extent this presumption is reflected within the wording of Article 22(3) itself.[15]

In the English jurisdiction, the Youth Justice and Criminal Evidence Act 1999 (as amended by s.98 of the Coroners and Justice Act 2009) (the 'YJCEA 1999') sets out the eligibility criteria for witnesses with specific protection needs, known under the legislation as vulnerable and intimidated witnesses. Section 16 YJCEA 1999 concerns the eligibility of witnesses for assistance by special measure on the grounds of age or capacity. Under this section witnesses aged 18 or under[16] at the time of the hearing are deemed to be automatically eligible for assistance.[17] Additionally, if the court concludes that the quality of evidence given by a witness is likely to be diminished due a mental or physical disorder, or other significant impairment, then that witness will also be deemed eligible for assistance by virtue of this section.[18] Section 17 then provides that a witness identified by the court as being intimidated, in that the quality of their evidence is likely to be diminished due to fear or distress, is eligible to access special measures to aid them in giving evidence.[19] Victims of sexual offences, victims of human trafficking for exploitation, and any witness in a case involving a 'relevant offence',

[9] This is evident in Art 22(1) where Member States are permitted to conduct the assessment 'in accordance with national procedures' and in Art 22(5) where the extent of the individual assessment can be varied 'according to the severity of the crime and the degree of apparent harm suffered by the victim'.

[10] Preamble to the Directive, para 55.

[11] Art 22(7).

[12] Art 22(4).

[13] *Ibid.*

[14] Preamble to the Directive, para 57.

[15] Art 22(3) only requires that: 'victims of terrorism, organised crime, human trafficking, gender-based violence, violence in a close relationship, sexual violence, exploitation or hate crime, and victims with disabilities shall be *duly* considered' (emphasis added).

[16] Prior to the amendments made by the Coroners and Justice Act 2009 Act this limit had been set at age 17.

[17] S 16(1)(a).

[18] S 16(1)(b).

[19] S 17(1).

currently defined to include homicide offences and other offences involving a firearm or knife, are automatically categorised as eligible witnesses under s. 17.[20]

On initial consideration this categorisation appears to be somewhat limited in its classification of those people who may be eligible for special protection and assistance when interacting with the criminal justice system. This is so, as inherent within the design of the domestic legislation was a focus on the needs of witnesses, rather than specifically on the needs of victims. This overlooks the fact that many victims will never appear as witnesses in court but may still require special measures of support and protection during their other interactions with the Criminal Justice System. In this respect the legislation is geared towards the crime control objectives of the Criminal Justice System rather than the support and protection needs of victims, and this seems somewhat at odds with the underlying thread of the Directive.

Of course to offer a fair assessment of the English position, the provisions of the YJCEA 1999 must be considered in light of other initiatives in this field, most notably, the recently revised *Code of Practice for Victims of Crime* (the 'revised Code').[21] The original version of the Code was issued in 2006 (the '2006 Code')[22] which, for the first time, placed on a statutory footing the minimum levels of service that a victim could expect to receive from criminal justice agencies.[23] In subsequent years however, the Code had attracted growing criticism, much of it levied at the fact that it was process orientated,[24] which often resulted in ineffective targeting of resources towards victims who were not in need of protection and support whilst overlooking those that were.

Following two consultations on proposals for reform[25] the Government published the revised *Code of Practice for Victims of Crime* in October 2013 (the 'revised Code'). The intention behind this revised edition is clearly to bring the domestic approach in line with that of the Directive, and this is particularly evident in relation to victims with specific protection needs. Within the revised Code the police are now obligated to conduct an initial needs assessment with victims and the expectation is that this will take place as soon as a crime reference number is issued and prior to any witness statement being taken.[26] This is a significant change to the previous approach under the 2006 Code,[27] and one which addresses the requirement under Article 22(1) that Member States conduct both an individual and timely assessment of victims to identify specific protection needs.

Furthermore, the categories of victims now eligible under the revised Code to access enhanced services to support and protect them throughout the criminal justice process has increased to include victims of the most serious crimes; persistently targeted victims; and vulnerable or intimidated victims, with this last category of entitled victims being based upon the eligibility criteria provided in ss. 16 and 17 of the YJCEA 1999.

20 S 17(4).

21 Ministry of Justice (The Stationery Office 2013).

22 Office for Criminal Justice Reform, *The Code of Practice for Victims of Crime* (VictCode/1, 2005).

23 A Code of Practice for Victims of Crime was provided for under s 32 of the Domestic Violence, Crime and Victims Act 2004 but note that s 34 of that Act makes it clear that any breaches of the Code by criminal justice agencies do not give rise to legally enforceable rights for victims.

24 Ministry of Justice, *Improving the Code of Practice for Victims of Crime* (2013) para 5.

25 Ministry of Justice, *Getting it Right for Victims and Witnesses* (Jan 2012) and Ministry of Justice, *Improving the Code of Practice for Victims of Crime* (March 2013). See also the Government's responses: Ministry of Justice, *Getting it Right for Victims and Witnesses: The Government Response* (July 2012) and Ministry of Justice, *Improving the Code of Practice for Victims of Crime* (Oct 2013).

26 This ordering of this process is outlined in the revised Code (n21) in the Victim's journey through the Criminal Justice System flowchart, p 5.

27 Under para 4.11 of the 2006 Code (n 22) the police were charged, alongside the other criminal justice agencies, with identifying victims who were vulnerable or intimidated but there was no specific requirement for the police to conduct any early stage needs assessment with victims.

Additionally the revised Code also recognises that victims of particular crimes, such as terrorism, domestic violence, hate crimes, human trafficking and attempted murder may warrant access to enhanced services despite the fact that they may not fall within the specific parameters set down by the current legislative provisions.[28] This wider inclusion appears to align the English domestic position with the requirements under Article 22 of the Directive, with the Code replicating many of the example offences set out in Article 22(3) itself.

That said, the English authorities still face significant practical challenges if they hope to meet the identification requirements under Article 22 due to the documented existence of a notable identification deficit in respect of victims with specific protection needs. While it is appreciated that identification practices may have moved on significantly[29] since the leading research by Burton et al[30] was conducted in 2006, the extent to which the rights under Article 22 will be guaranteed in this jurisdiction cannot be determined in the absence of updated research into the effectiveness of current identification practices.

ARTICLE 23 – THE RIGHT TO PROTECTION OF VICTIMS WITH SPECIFIC PROTECTION NEEDS DURING CRIMINAL PROCEEDINGS.

Article 23 divides measures available to victims who have been identified as being in need of specific protection during criminal proceedings into two categories: those measures which should be available during criminal investigations,[31] and those measures which should be available to victims participating in court proceedings.[32]

Measures relating to criminal investigations.

Article 23(2) of the Directive sets out three general measures that Member States should make available during criminal investigations to victims identified as having specific protection needs. The first requirement, that interviews should be carried out in specially designed or adapted premises, is well met by current police practice in England. Indeed, the Ministry of Justice in their *Achieving Best Evidence in Criminal Proceedings,*[33] place a great deal of focus on pre-interview planning and specifically require that active consideration should be given to the location of the interview and the layout of the room in which it is to take place. This requirement is similarly reflected in the revised Code.[34]

The second requirement under Article 23(2), that interviews should be carried out by or through trained professionals, is also well met by current English standards with the Association of Chief Police Officers issuing a *National Investigative Interviewing Strategy*[35] in 2009, which sets down national occupational standards for investigative interviewers and explains the service-wide structures that are required to support the

[28] The revised Code (n 21) ch 1, para 1.8.

[29] For guidance on current identification practice see: Ministry of Justice, *Vulnerable and Intimidated Witnesses: A Police Service Guide* (2011) and Office for Criminal Justice Reform, *Working with Intimidated Witnesses: A Manual for Police and Practitioners Responsible for Identifying and Supporting Intimidated Witnesses* (2006).

[30] Mandy Burton, Roger Evans and Andrew Sanders, *Are Special Measures for Vulnerable and Intimidated Witnesses Working? Evidence from the Criminal Justice Agencies* (Home office 2006).

[31] Art 23(2).

[32] Art 23(3).

[33] Ministry of Justice, *Achieving Best Evidence in Criminal Proceedings: Guidance on Interviewing Victims and Witnesses, and Guidance on Using Special Measures* (2011).

[34] n 21 Ch 2, part B, para 1.6.

[35] National Policing Improvement Agency, *National Investigative Interviewing Strategy* (ACPO 2009).

training of those conducting investigative interviewing. This approach is echoed in *Achieving Best Evidence in Criminal Proceedings* with paragraph 1.30 of that document additionally requiring the development of specialist training for interviewers conducting interviews with witnesses with particular needs.

The third requirement in Article 23(2) is that all interviews with a victim should be conducted by the same person. This approach is well reflected in current English practice with *Achieving Best Evidence in Criminal Proceedings* placing a great deal of emphasis upon the importance of rapport building with witnesses,[36] which is likely to be best achieved where the number of interviewers is kept to a minimum. The requirement that the same person conducts all interviews with the victim, where possible and if appropriate, is also highlighted in the revised Code as one of the duties incumbent upon police.[37]

Additionally, where a victim has suffered a crime of sexual violence, gender-based violence or violence in a close relationship, Article 23(2)(d) requires that Member States make specific provision for interviews to be conducted by someone of the same sex as the victim. While there are acceptable operational and practical constraints which mean that this requirement may not always be met in practice, [38] it is clearly the intention of the English authorities that this will be accommodated where possible. This is evidenced by the indication in *Achieving Best Evidence in Criminal Proceedings*[39] and in the requirements under the revised Code[40] that due regard should be had to the gender of the witness and to any preference on the witness's part as to the gender of the interviewer, when decisions about the choice of interviewer are being made.

Measures relating to court proceedings.

Paragraph 53 of the preamble to the Directive makes it clear that Member States should provide as wide a range of measures as possible to prevent distress to victims during court proceedings. Article 23(3) states that these should include:

1. measures to avoid visual contact between victims and offenders;
2. measures to ensure that the victim may be heard in the courtroom without being present;
3. measures to avoid unnecessary questioning concerning the victim's private life not related to the criminal offence; and,
4. measures allowing a hearing to take place without the presence of the public.

Under English law, once a victim has been identified as either vulnerable or intimidated in terms of the YJCEA 1999, a range of measures, known collectively as 'special measures', may become available to assist them in giving their best evidence in court.[41] These measures are contained within ss. 23 – 30 of the YJCEA 1999 and include: the provision of screens in court;[42] evidence via live link;[43] evidence given in

[36] n33 para 3.8.

[37] n 21 Ch 2, part B, para 1.6.

[38] Article 23(1) indicates that certain operational or practical constraints may make provision of certain special measures impossible and that this does not constitute a breach of the obligation under the Article.

[39] n33 para 2.180–2.181.

[40] n 21 Ch 2, part B, para 1.5.

[41] It should be noted that identification of potential eligibility does not mean automatic access to special measures, but rather that the utilisation of them by a victim may be granted at the court's discretion.

[42] S 23.

[43] S 24.

private;[44] removal of wigs and gowns;[45] video-recorded interviews which can be admitted as evidence-in-chief;[46] video-recorded cross-examination;[47] the use of an intermediary;[48] and, the use of communication aids.[49]

The revised Code includes, but does not expand upon, the list of special measures available under the YJCEA 1999 as, on its face, the legislation appears comprehensive in meeting the Directive's requirements. Currently absent from inclusion in the revised Code, however, is a reference to s 28 of the YJCEA 1999, a provision that allows for the pre-recording of cross-examination evidence,[50] but which has previously been unavailable in practice. A pilot study of the implementation of this provision is currently underway[51] and it is anticipated that it will be included in the revised Code if the pilot is deemed to have been successful. However, any failure on the part of the Government to roll out the pilot nationally, or to roll out an amended version based on the data received from the pilot if it is not successful in its current form, by the date of the Directive's implementation in 2015 should be viewed as a missed opportunity to better support vulnerable victims subjected to cross examination and, in turn, to better meet the requirements under the Directive.[52]

ARTICLE 24 – THE RIGHT TO PROTECTION OF CHILD VICTIMS DURING CRIMINAL PROCEEDINGS.

In addition to the general measures of protection that child victims may access under Article 23 they are also eligible to access three further measures by virtue of Article 24.

Article 24(1)(a) requires that all interviews conducted with child victims during the criminal investigation may be audio-visually recorded and that such recordings may then be available as evidence in criminal proceedings. As discussed above, the provisions of the YJCEA 1999 support this approach and current English practice is to audio-visually record investigative interviews conducted with child victims in order that these may be used as the child's evidence-in-chief at any subsequent trial.[53]

Article 24(1)(b) then makes provision for the availability of special representatives for child victims where there is a conflict of interest between the child and the person with parental responsibilities, or where the child is estranged from their family, and Article 24(1)(c) similarly makes provision for the child to have access to legal

[44] S 25.

[45] S 26.

[46] S 27.

[47] S 28.

[48] S 29.

[49] S 30.

[50] The anticipated benefactors of this provision will be child witnesses although the wording of s 28 extends to intimidated and vulnerable witnesses generally.

[51] This six month pilot study commenced in December 2013. See: Ministry of Justice, 'Press release: Victims to be Spared from Harrowing Court Cases' (*Gov.UK*, 11 June 2013) <https://www.gov.uk/government/news/victims-to-be-spared-from-harrowing-court-cases> accessed 15 January 2014.

[52] This discussion predominately relates to the requirements under Article 23(3)(a) and (b) that Member States make provision to provide victims identified as having specific protection needs with the opportunity to give evidence whilst avoiding visual contact with the offender and without having to be present in the courtroom itself. However, Tomas Lonigs, Sohail Wahedi and Tjalling Waterbolk in 'The European Union's Approach toward Child Victim Testimonies in Criminal Proceedings Compared to the Right to Fair Trial: *summum ius, summa injuria?*' 2013 6(4) Journal of Politics and Law 14, 18, indicate that the requirement under Article 24(1)(a) may also be relevant here. As we discuss in our next section, Article 24(1)(a) requires that all interviews conducted with child victims should be audio-visually recorded in order to be used as evidence in criminal proceedings and Lonigs, Wahedi and Waterbolk contend that this may give rise to a general right, beyond that provided under Article 23, for child victims who are called to testify in court to provide audio-visually recorded evidence.

[53] n33 para 2.31.

representation in their own right where there may be a conflict of interest between the child victim and the holders of parental responsibility. While it is often the case within the English jurisdiction that child victims will be supported by advocates or specialist workers during their interactions with the English Criminal Justice System, in real terms the rights contained in Articles 24(1)(b) and (c) lie dormant in this jurisdiction where victims are not recognised as parties to criminal proceedings in need of legal or special representation.[54]

LIMITING THE RIGHTS AFFORDED UNDER ARTICLES 22–24 – THE PROBLEM OF DISCRETIONARY WORDING.

What we have in the Directive is the removal of a great deal of the discretionary language that had afforded the Member States too many opportunities to avoid their obligations under the Framework Decision. Of course some discretionary language necessarily remains in order to facilitate the harmonisation of rights, support and protection of victims of crime across the separate Criminal Justice Systems operating within the EU, and this discretionary approach is particularly evident in Articles 22–24.

In respect of the individual assessment required under Article 22, the Directive leaves the mechanisms by which this is to be achieved to be determined according to the national procedures of the Member States[55] and affords the Member States significant discretion in varying the extent of such an assessment dependent on the perceived severity of the crime and the degree of harm suffered by the victim.[56]

On the face of Articles 23 and 24 the measures that Member States are to make available to victims identified as having specific protection needs appear extensive. That said, the wording of the Directive seems overly generous to States in some respects with the effect that significant limitations may be placed on the availability of measures in certain circumstances. For example, Article 23 allows for the restriction of certain special measures of protection in circumstances where such provision may prejudice the rights of the defence,[57] where the rules of judicial discretion require it,[58] if operational or practical constraints make its provision impossible,[59] or where to do so would prejudice proceedings[60] or run contrary to the good administration of justice.[61]

The possibility that the Member States will limit their provision under this part of the Directive by reliance on these various caveats may result in a wide variation in the type and extent of the individual assessment conducted, and to the type and extent of any special measures of protection afforded to victims within the EU. By providing such discretion to the Member States there is a danger that, just as was the case with the Framework Decision, the overarching aim of the Directive will be undermined.

[54] That this will be the position within Member States such as our own is accommodated by the wording of the Directive. Indeed, Article 24(1)(b) relates to the appointment of special representatives 'in accordance with the role of victims in the relevant criminal justice system', and Article 24(1)(c) relates to the right to legal advice and representation 'where the child victim has the right to a lawyer'.

[55] Art 22(1).

[56] Art 22(5).

[57] Art 23(1).

[58] *Ibid.*

[59] *Ibid.*

[60] Arts 23(1) and 23(2)(d).

[61] Art 23(2)(c).

CONCLUSION.

Articles 22–24 of the Directive seek to achieve minimum EU harmonisation on the rights, support and protection afforded to crime victims with specific protection needs. As a result of the amendments made to the *Code of Practice for Victims of Crime* and due to the various recent improvements in the treatment of such victims in practice, the English jurisdiction seems well placed to meet these minimum requirements by the date of the Directive's implementation in November 2015, providing, that is, that the English government does not seek to avoid its obligations by exploiting the discretionary language employed within Articles 22–24.

The task ahead in achieving all of this presents no mean feat, but any efforts involved in meeting (and hopefully exceeding) the minimum standards set down in the Directive will be repaid immeasurably if real improvements can be secured for the most vulnerable of crime victims within our society.

A Welcome to the Nottingham Insolvency and Business Law e-Journal (NIBLeJ)

*PAUL OMAR**

The articles that appear in this issue of the Nottingham Law Journal are from the first edition of the Nottingham Insolvency and Business Law e-Journal (NIBLeJ).[1] This is an exciting new venture by the Nottingham Law School (NLS) and, particularly, the Centre for Business and Insolvency Law within NLS. The NIBLeJ is a peer-reviewed academic journal featuring contributions relevant to the research fields of insolvency and business law broadly defined. Submissions on related themes are also welcome, including interdisciplinary work. The scholarly rigour and contribution to the development of legal scholarship serve as criteria for acceptance of submissions. All contributions will be subject to anonymous review by expert referees. The contributions that appear here come from Bolanle Adebola (University College London) on the topical issue of administrators' powers and their obligation to seek directions, Hamish Anderson (Visiting Professor in NLS) on bankruptcy proofing and the limits of non-petition clauses, a joint piece by Andrew Campbell (Leeds) and Paula Moffatt (NLS) on the continuing saga of bank insolvency and depositor protection as well as Donna McKenzie Skene (Aberdeen) on the effect of devolution on insolvency law developments in Scotland. It is hoped that the appearance of the NIBLeJ to promote contemporary themes within the insolvency law field, which these articles clearly represent, will further stimulate the advance of legal scholarship and will be warmly received by the insolvency and business law communities across the globe. Those interested in submitting material for the journal should address themselves in the first instance to the Editor at:<paul.omar@ntu.ac.uk>.

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DISCRETION OR OBLIGATION TO SEEK DIRECTIONS: THE ADMINISTRATOR AND REJECTED PROPOSALS

*BOLANLE ADEBOLA**

INTRODUCTION

The administration regime was reformed in 2002 to give creditors greater participation in the rescue process. Unlike the administrative receiver who drafts and executes a plan without consulting with the unsecured creditors, the administrator is required to set his or her proposals before the unsecured creditors for approval. The reformed Insolvency Act 1986 (the "Act") in Schedule B1 directs the administrator not to deviate from the approved plans unless the changes made are not substantial, the creditors have given subsequent approval or the court has granted its imprimatur, as appropriate. The Act permits the creditors to reject the proposals where the requisite majority is dissatisfied with its contents. It also permits the court to make orders necessary to facilitate the resolution of the situation following the rejection of the proposals. However, Paragraph 55 of Schedule B1 which regulates the post-rejection procedure does not expressly instruct the administrator to seek a court order after the event. Consequently, the paragraph appears open to interpretation. Both insolvency experts and the courts provide contrasting views on the correct interpretation of the paragraph. This paper outlines these opinions. To provide broader understanding of the purport of Paragraph 55, the paper examines the context in which it was introduced. For that reason, it explores the background to its enactment, teases out the purpose of proposals, highlighting their pivotal role in regulating the relationship between the administrator and the unsecured creditors.

This article is divided into 2 parts. Part I examines the provisions of the Insolvency Act 1986. It sets out the relevant provisions of the Act and the interpretation given to the provisions by insolvency experts and the courts. Part II delves into the history of Schedule B1 and the changes that took place at the 2002 reforms. It seeks to propose a purposive understanding of Paragraph 55 in light of the spirit of the reforms.

PART I: THE INSOLVENCY ACT 1986

The Insolvency Act 1986 on Rejected Proposals

With the reforms to the Insolvency Act 1986 in 2002, which came into effect in 2003, administration replaced administrative receivership as the regime of choice for the rescue of distressed companies or their businesses under the aegis of the law. Contrary to the administrative receivership procedure, which limited the participation of creditors in the formulation of the rescue plan, the administration procedure generally invites the participation of the body of creditors by requiring a vote on the proposed plan.[1] The plan is presented to the creditors as the *Administrator's proposals*.

* Dr Bolanle Adebola is a teaching fellow at University College London (UCL). Profound thanks to my PhD supervisor, Professor Ian Fletcher, who commented on earlier drafts of the paper while it was a part of my thesis. I am also grateful to the practitioners who responded to my questions on the Insolvency Today group on LinkedIn. I especially acknowledge Gary Petit, who helped me understand how the process works in practice. The comments contained in the paper are my opinion.

[1] With the exception of the circumstances expressly permitted by the law, in which their opinion may not be sought.

Administrators' proposals are accorded prime importance by Schedule B1 of the Insolvency Act 1986.[2] Paragraph 68(1) instructs the administrator to manage the affairs of the company according to the terms of proposals that have been approved by the creditors.[3] The proposals may be those approved by creditors at the initial creditors' meeting, or those approved at a subsequent meeting after substantial revisions to the original proposals have been made by the administrator.[4] The Act specifies the circumstances in which an administrator may execute his or her proposals without the express approval of creditors. One such occasion is when the administrator executes proposals that have previously been approved by creditors, but subsequently modified with changes that the administrator does not consider substantial.[5] The administrator may also execute revised proposals, which have not received subsequent approval of creditors, with the imprimatur of the court. This may be granted if considered appropriate to the present circumstances of the company.[6] The administrator may also execute his or her proposals without the express approval of the creditors when he or she thinks that the company has sufficient funds to repay all the creditors in full, or that the unsecured creditors are unlikely to receive distributions.[7]

Within eight weeks of appointment, the administrator is to draft his or her proposals for achieving the stated purpose of the administration.[8] After notices compliant with the relevant statutes have been sent, he or she must present the proposals to the creditors for their vote.[9] The administrator may also send revised proposals to the creditors, if he or she thinks that the original requires substantial changes before it can be executed.[10] The creditors may approve the original or revised proposals entirely or approve them subject to modifications that are acceptable to the administrator.[11] Alternatively, the creditors may reject the proposals entirely.[12] The administrator is to inform the court, the Registrar of Companies and other prescribed persons on the outcome of the meeting.[13] Though the Act does not expressly instruct the administrator to seek the directions of the court after submitting the outcome of the meeting, it lists the orders the court may make in the circumstances.[14] Paragraph 55(2) states that the court may order the termination of the administrator's appointment at a specified time, adjourn the hearing, order the winding up of the company if a petition was suspended at the initiation of the administration, or make any order it deems appropriate in the circumstances.[15] The questions that arise in these circumstances, and with which this article is concerned, centre on the nature of the administrator's duty when his or her proposals have been rejected: is his or her duty to seek directions from the court

[2] L Sealy and D Milman, *Annotated Guide to the Insolvency Legislation (Volume 1)* (14th ed) (Sweet & Maxwell, 2011), at 576.

[3] Schedule B1, Insolvency Act 1986, paragraph 68(1)(a)–(b).

[4] *Ibid.* See also paragraphs 53(1)(a)–(b) and 54(5).

[5] *Ibid* paragraph 68(1)(b).

[6] *Ibid* paragraph 68(3)(c).

[7] *Ibid* paragraph 52(1); however, they may receive distributions under the prescribed part.

[8] *Ibid* paragraph 49(1), (5).

[9] *Ibid* paragraph 51.

[10] *Ibid* paragraph 54.

[11] *Ibid* paragraphs 53(1) and 54(5).

[12] Outright rejection may be premised on the administrator's rejection of their proposed modifications.

[13] Schedule B1, Insolvency Act 1986, paragraphs 53(2) and 54(6).

[14] *Ibid* paragraph 55(2).

[15] G Lightman *et al.*, *The Law of Administrators and Receivers of Companies* (5th ed) (Sweet & Maxwell, London, 2011), at 367–8 (paragraph 12-048).

obligatory? Or, is his or her duty merely discretionary; in which case he or she may choose not to seek the court's directions?

Expert Opinion on Rejected Proposals

Lightman and Moss identify two sources of the administrator's power to seek directions from the court.[16] One is the express provisions of the Insolvency Act 1986 and the other flows from his or her status as an officer of the court. The power to seek directions, they assert, should not be interpreted as a duty to seek directions. In effect, in those circumstances, the administrator has the discretion to refrain from seeking directions, and it will not be improper for him or her to act without directions. Further, they list the circumstances in which the administrator has a duty to seek directions from the court.[17] The latter list includes circumstances in which the administrator's original proposals or proposed revisions have been rejected by the creditors' meeting.[18] The Lightman and Moss opinion can be stated thus: when the administrator's original proposals or subsequent revisions are rejected by the creditors, it is mandatory, not discretionary, for the administrator to seek the court's directions.

Sealy and Milman hold a contrary opinion. They observe that the Insolvency Act 1986 gives the court discretionary powers in the event that the proposals or subsequent substantial revisions are rejected by the creditors' meeting.[19] They construe the court's ostensible powers to be limited, though broad. They state, for example, that the court may not impose a set of proposals on the creditors to which they have not agreed.[20] They assert, however, that the court's authority to make an order is premised on the administrator's application for directions.[21] They insist, nonetheless, that the administrator, though he or she has a duty to report the rejection of the proposals or revisions to the court, does not have a subsequent duty to seek the court's directions. Essentially, they argue that the administrator's duty to file a report indicating the rejection of the proposals, and the court's power to make an order if one is sought, do not transform the administrator's discretion to seek directions into an obligation to do so. In the parlance of Lightman and Moss, the administrator's role in this instance would, in the opinion of Sealy and Milman, fit into the *right to act* column, and not that of a *duty to act*.

The Court on Rejected Proposals

Even a cursory census of administration cases reveals that the court has had to determine the administrator's obligations prior to the approval of proposals many more times than it has had to determine his or her obligations after his or her proposals have been rejected. It is settled law that the administrator is not obliged to seek the directions of court merely because no proposals have been approved.[22] The administrator, being a professional and an officer of the court, does not need to consult the court to perform his or her administrative responsibilities.[23] Most of the decisions to be taken in such instances are commercial in nature which the administrator is better suited than the court to take. There have been comparably fewer instances in which the

[16] *Ibid* paragraph 12-048.

[17] *Ibid* paragraph 12-047 (where a list may be found).

[18] *Ibid* paragraph 12-047(ii).

[19] *Ibid* Sealy and Milman, at 571.

[20] *Ibid* at 572.

[21] *Ibid.*

[22] *Re T&D Industries plc* [2000] 1 WLR 646, at 656–657; *Re Transbus International Ltd* [2004] EWHC 932 (Ch), [2004] 1 WLR 265, at paragraph 14.

[23] See also *RAB Capital plc v Lehman Brothers International (Europe)* [2008] BCC 915, at paragraph 4.

court has been invited to determine the nature of the administrator's obligations where the proposals have been rejected. The two main cases in which this question has been considered are examined below.

Re Stanleybet[24]

Stanleybet UK Investment Ltd ("SUKI") was placed in administration on the application of one of its creditors.[25] The administrators, in compliance with the relevant statutory provisions, sent their reports and proposals to the creditors along with a notice for an initial creditors' meeting. The administrators received two offers to purchase SUKI's properties, which consisted mainly of shares in other companies. The offerors were both connected parties; one of whom was SUKI's largest creditor. As a result of the protracted negotiations, the offer from the largest creditor was withdrawn. The administrators proposed to execute the sale according to the terms of the remaining offer, but the largest creditor was unsatisfied with the terms. It claimed that the administrators did not do enough to market SUKI's assets – the shares. As a result, it voted against the proposals; for which reason, they were ultimately rejected by the initial creditors' meeting. The administrators believed that their proposals offered the best resolution to the company's problems. However, the largest creditors, purportedly relying on an alternative expert opinion, did not agree with the proposals. As a result of the impasse, the administrators decided to apply under paragraph 55(2) for the court's directions.

The administrators requested an order terminating their appointment and directing them to place the company in voluntary liquidation.[26] The court advised itself on its powers according to paragraph 55(2) of the Insolvency Act 1986. Then, it considered, briefly, the powers of the administrators in those circumstances. It surmised that administrators are not (completely) bound by the decision of the creditors in meeting.[27] It stated that the administrators could disregard the creditors' decision and execute the proposals, if they believed that option to be in the best interests of the company as a whole. Notwithstanding this, administrators are to have due regard for the decisions of creditors. Ultimately, the court decided that it could make the order requested by the administrators.[28]

This case focused on the scope of powers granted to the court by paragraph 55(2) of Schedule B1. The question before the court was how it should direct itself when invited by administrators to give directions. Though the court was not invited to decide on the nature of the administrator's duty after his or her proposals have been rejected by the creditors, the administrators in this case having already applied for directions, its statements provide pertinent indications of its opinion on the nature of the administrator's duty. The court asserted that administrators have the right to decide whether or not to go ahead with the rejected proposals after the conclusion of the initial meeting.

> That put the joint administrators in a quandary. They were not formally bound by the vote at the creditor's meeting and so could have proceeded with the sale

[24] *In Re Stanleybet UK Investments Ltd* [2011] EWHC 2820 (Ch), [2012] BCC 550.

[25] *Ibid* paragraph 4.

[26] *Ibid* paragraph 11.

[27] *Ibid* paragraph 8.

[28] *Ibid* paragraph 20.

> to SIB[29]. . .It would be unusual, though not legally impossible, for administrators to proceed with a course which 87 per cent of creditors were opposed to.[30]

The court did not suggest that the administrator may proceed with his or her decision only after obtaining prior approval from the court. Consequently, it may be inferred that the court in this case shares the Sealy and Milman opinion that the administration has the discretion but not the obligation, to seek directions following the rejection of his or her proposals.[31]

Re BTR[32]

BTR (UK) Ltd ("BTR") was insolvent. Mr Swindell was appointed as administrator by an administration order. Before the initial creditors' meeting was scheduled, he completed a sale of some of BTR's assets to ITAS Global Ltd.[33] Subsequently, the administrator sent out his proposals to the creditors. In the proposals, he stated that there would be no distributions to unsecured creditors; so a creditors' initial meeting was not required. Nonetheless, at the request of creditors holding more than 10% of the company's debts, a meeting was convened. The creditors rejected the administrator's proposals. In addition, more than 50% of them voted for a resolution to place the company in compulsory liquidation. Eight of BTR's creditors, who were suspicious of events prior to the commencement of the administration, presented an application to the court for conversion of the administration to compulsory liquidation.[34] The administrator also (cross)-applied for directions from the court on whether to permit the administration to terminate automatically following the effluxion of time or whether to petition for winding up.

The court was invited to decide on the duty of the administrator when his or her proposals have been rejected by the creditors, as well as the scope of the court's powers in that regard. Counsel for the creditors argued that paragraph 55(2) obliges the administrator to seek the court's directions if the proposals are rejected by the creditors at the meeting.[35] In support of his opinion, he cited Lightman and Moss, as well as the opinion of Mann J in Platinum Developers.[36] Conversely, counsel for the administrator argued that the duty to apply for directions is discretionary.[37] In support of his opinion, he cited Sealy and Milman, as well as the opinion of Sales J in Re Stanleybet.

After considering the arguments presented to him, Behrens J aligned his view with the perspective that there was an obligation.[38] He stated that paragraph 55 does not indicate the nature of the administrator's duty in these circumstances. Nonetheless, he surmised that paragraph 55(2), on which the court's discretion is based, implies that "there must be a hearing" which can only commence on an application for directions.[39] He asserted that the administrator was to make the application, but noted that the creditors may do so where the administrator fails to do so.

[29] *Ibid* paragraph 8.
[30] *Ibid.*
[31] *Ibid* Sealy and Milman, at 572.
[32] *In Re BTR (UK) Ltd (Lavin v Swindell)* [2012] EWHC 2398 (Ch).
[33] *Ibid* paragraph 2.
[34] *Ibid* paragraph 6.
[35] *Ibid* paragraph 57.
[36] *Platinum Developers Ltd v Assignees Ltd* (Unreported) 5 October 2009.
[37] *Re BTR*, above note 32, at paragraph 58.
[38] *Ibid* paragraph 63.
[39] *Ibid* paragraph 64.

The court also examined the nature and role of proposals in administration. Behrens J observed that the Act directs the administrator to manage the affairs of the company in the best interests of the creditors as a whole, and in accordance with the proposals they approve at a meeting properly conducted. He could not reconcile the argument that the administrator's duty was discretionary with what he considered as the clear provisions of the law; "if, therefore, the proposals are rejected by the creditors it is difficult to see how the Administrator can manage the Company's affairs in accordance with paragraph 68 without making an application to Court.".[40]

Nevertheless, Behrens J distinguished the circumstances facing an administrator, whose proposals have been rejected at the initial meeting, from those facing an administrator, whose revisions are rejected by creditors at a subsequent meeting.[41] In his opinion, while the administrator in the former situation has an obligation to apply for directions, one facing the latter may be considered to have a mere discretion to apply for directions. In essence, an administrator whose revised proposals have been rejected may still continue to manage the company according to the original proposals, but one whose initial proposals are rejected must apply to the court for directions.

PART II: THE 2002 REFORMS AND CHANGES

(Rejected) Proposals, Unsecured Creditors and the Administrator's Duty

The preceding sub-sections outline the statutory stipulations on the administrator's duties and how these provisions have been interpreted by insolvency experts and courts. The opinions catalyse further thoughts about the purpose of proposals and how they ought to regulate the relationship between administrators and creditors. Our understanding of the purpose of proposals that was conceived in the reforms leading to the 2002 reforms, and the role it was hoped they would play, may elucidate our understanding of the administrator's duty when they are rejected, and clarify paragraph 55. The result of this line of inquiry is also pertinent to another question fleetingly considered in *Re Stanleybet* and discussed above.[42] In the course of resolving the principal matters before him, the judge considered whether or not the administrator could disregard the opinion of the creditors expressed in vote at the meeting.[43] It was held that the administrator could.[44] The subsections that follow examine the opinion of the Government in relation to the proposals and a statement on the role of proposals.

Understanding Paragraph 55

In the late-1990s, the Government sought to reform the insolvency law of England and Wales.[45] This effort was congruent with the Government's vision of an enterprise-driven economy. Pursuant to this, in 1999, a group was commissioned to review the existing insolvency system at the time.[46] The review group was to focus, in particular, on the aspects of the law that related to corporate rescue.[47] One of the items considered

[40] *Ibid* paragraph 66.

[41] *Ibid* paragraph 68.

[42] See above note 25 *et seq*. and associated text.

[43] *Re Stanleybet*, above note 24, at paragraph 8.

[44] *Ibid.*

[45] For an overview of the history of the law, see I Fletcher, *The Law of Insolvency* (4th ed) (Sweet & Maxwell, 2009), Chapter 1, at 15–26, paragraphs 1–027–1-045.

[46] Department of Trade and Industry, *A Review of Company Rescue and Business Reconstruction Mechanisms* (2000).

[47] *Ibid* paragraph 17.

was the relationship and tensions between the allegedly appointor-skewed administrative receivership procedure, and its presumably more collective counterpart: administration.[48]

The review group observed that unsecured creditors were typically unable to hold the administrative receiver to account, despite the novel procedures introduced by the Insolvency Act 1986.[49] The Act instructs the administrative receiver to notify and inform unsecured creditors of their appointment and subsequent activities.[50] It permits the latter to appoint committees endowed with the power to summon the receiver for some questioning.[51] The essence of the provisions, nonetheless, was only to give the unsecured creditors the right to information; they did not give them the right to consultation, or to veto the receiver's decisions. In any case, committees were rarely established, and so creditors rarely availed themselves of these limited powers.[52] The court is another potential source of control over the actions of administrative receivers. The review group observed that the existing case law on the duties of the receiver showed that the duties, as enforced by the courts, were inadequate to provide the unsecured creditors with much control over the choices made by receivers during the pendency of the receivership.[53] The review group recommended collective regimes, under which a duty of care would be owed to all creditors, and all creditors would be permitted to participate in the proceedings, as essential to the rescue culture that the Government sought to champion.[54] On this premise, the group recommended that the right of the floating charge holder to veto the collective administration procedure in favour of the more skewed administrative receivership ought to be mitigated.[55]

The Government followed the review with a white paper detailing its proposals for reform.[56] In it, the then Secretary of State for Trade and Industry indicated the Government's desire to give greater input to other interests on the fate of the distressed company.[57] Consequently, it proposed that the theoretically more collective administration regime, albeit its streamlined version, should replace the more skewed administrative receivership regime as the primary rescue mechanism.[58] As was recommended by the review group, and echoed by the Secretary of State, the white paper proposed to give greater participatory rights to unsecured creditors.[59] The Government was particularly concerned about the practitioner's duty to account to other interests in the company which it believed has important consequences; in particular, on the receiver's incentive to maximise recoveries and minimise the costs of the receivership.[60] The Government's conception of collectivity was one in which all creditors participated, a duty to account was owed to all creditors and all creditors could hold the practitioner accountable for his dealings with the company's assets.[61] Concurrently, the Government sought to continue to provide the secured creditors with

[48] *Ibid* paragraphs 72–75.
[49] *Ibid* paragraph 68.
[50] Insolvency Act 1986, sections 46, 48.
[51] *Ibid* section 49.
[52] DTI Review, *op cit*, at paragraph 68.
[53] *Ibid* paragraph 68.
[54] *Ibid* paragraph 72.
[55] *Ibid* paragraph 75.
[56] The Insolvency Service, *Productivity and Enterprise: Insolvency – A Second Chance* (Cmnd 5234, 2001).
[57] *Ibid*, in the Foreword.
[58] *Ibid* paragraphs 2.5, 2.7 and 2.18.
[59] *Ibid* paragraph 2.5.
[60] *Ibid*.
[61] *Ibid*.

adequate protection of their interests but with due regard for the interests of other creditors.[62]

Discretion or Obligation to Act?

One may infer from the opinions expressed in the review and the ensuing white paper that the Government intended for proposals to play a pivotal role in administration proceedings. It was intended that the administrator would consult with the creditors who would evidence their opinion collectively, by voting in favour of, or rejecting the proposals. The opinion of the creditors is to play a considerable role in the administration process because it is the main mechanism by which they can, within limit, ultimately control the outcome of the administration by controlling the actions of the administrator. It is particularly because proposals directly influence recoveries, which the Government believed that the creditors should be able to influence, that it is submitted that the intention was not for the administrator to have the discretion to disregard the creditors' opinion.

The Insolvency Act 1986 expressly requires the administrator to act in the best interest of the creditors, but the Government assumed that the creditors would be aware of the outcome that would be in their best interest. Where the creditors and the administrator can reach a compromise, the proposals would typically be passed with modifications. It is typically in the cases where no compromise can be reached between the creditors and the administrator that an outright rejection of the proposals results. Though the administrator may continue to execute basic administrative functions, he or she ought not to deal decisively with the company's business in a manner that is contrary to the expressed opinion of the creditors in those circumstances. It follows, converse to the suggestion made in *Re Stanleybet,* that the administrator ought not to decide unilaterally to execute proposals which have been rejected by the creditors. For these reasons, the administrator should seek the directions of the court.

It may be argued, as was suggested by the *Re Stanleybet* case and the Sealy and Milman opinion, that the opinion that the administrator is obliged to seek directions when the proposals have been rejected is not consistent with the provisions of the Insolvency Act which permit the administrator to act on his proposals without consulting with the creditors. Paragraph 68 permits the administrator to dispose of the company's assets and even business before the initial meeting is held.[63] In these cases, the administrator can decide not to convene an initial meeting unless requested by the requisite majority or ordered by the court.[64] The administrator does not require the directions of the court to act in these circumstances; a discretion that is authorised by insolvency law and recognised by courts.[65]

It is submitted that paragraph 68 and the case law are not inconsistent with the opinion that administrators are obliged to seek the directions of the court in cases where they wish to act contrary to the expressed opinion of the creditors. Paragraph 68 and the listed opinions merely indicate the situations in which the administrator can disregard the opinion of the creditors. These instances can be described as the exceptions to the main rule. The Insolvency Act 1986 prescribes the circumstances in which the administrator can act in that manner. They are limited to those in which he or she thinks that the unsecured creditors are out of the money, where they will be paid in full. Interestingly, to emphasise the importance of the opinion of the creditors, the

[62] *Ibid* paragraph 2.6.

[63] See also *Re Transbus International Ltd*, above note 22, at paragraph 14.

[64] Schedule B1, Insolvency Act 1986, paragraph 56(1)(a)–(b).

[65] *Ibid* paragraph 68(3)(a); *Re T&D Industries plc*, above note 22, at 656–657.

Act also stipulates that even where the administrator thinks that a meeting is unnecessary for the stated reasons, he or she must convene one, notwithstanding, when so directed by the requisite majority of the creditors – as was the case in BTR. It follows, that if the creditors disagree with the administrator's proposals at that stage, then he or she must seek directions if he or she is to act otherwise.

CONCLUSION

Though paragraph 55 of Schedule B1 to the Insolvency Act 1986 does not expressly instruct the administrator to seek the directions of the court when his or her proposals have been rejected by the unsecured creditors, it should be interpreted as requiring him or her to seek the directions of the court in those circumstances. Contrary to the suggestion of the court in *Re Stanleybet*, the administrator may not act, at his or her discretion, contrary to the opinion of the unsecured creditors expressed in the vote taken at the creditors' meeting. The administrator's proposals were intended to be pivotal to the relationship between the administrator and the unsecured creditors following the reforms of 2002. The Act expresses, quite clearly, the circumstances in which the administrator may act without consulting with the unsecured creditors. Even in those circumstances, the Act empowers the unsecured creditors to demand consultation where desired, by requesting a meeting as long as the statutory threshold is met. It is submitted that paragraph 55 should be interpreted in light of the role played by proposals in the reformed Insolvency Act 1986. For that reason, it should be interpreted as requiring the administrator to seek directions when his or her proposals have been rejected.

NON-PETITION CLAUSES

*HAMISH ANDERSON**

INTRODUCTION

How far it is possible to insulate a company from the possibility of insolvency proceedings is an open question. The question is not new but has only rarely come before the courts and academic views differ.[1]

It has gained an increased commercial importance because of the prevalence of clauses in inter-creditor agreements restricting unilateral action by finance creditors and because of the importance attached to "bankruptcy remoteness" by the rating agencies when rating structured finance products. Such clauses need to be reconsidered in the light of the decision of the Court of Appeal in *Fulham Football Club*.[2]

For the purposes of this article, a "non-petition" clause is a contractual term which purports to prevent the inception of any form of insolvency proceedings at the instigation of a creditor, whether or not involving recourse to the courts. Clearly, in any given case, the drafting of the clause will determine precisely what is potentially being restrained, but this article is concerned with the applicable legal principles and the extent, if at all, to which non-petition clauses offend public policy.

Public Policy

There are two potential public policy objections to non-petition clauses: first, that they purport to oust the jurisdiction of the courts (thereby interfering with the course of justice) and, secondly, that they represent an attempt to contract out of insolvency law. Both are recognised strands of public policy which are capable of striking down contractual arrangements (and there is a measure of overlap) but neither is absolute. It is therefore not enough to engage a public policy objection that the practical effect of a non-petition clause is to prevent a company from being wound-up.

Curiously, in the case in which public policy was most clearly argued in this context, *Colt Telecom*,[3] the objection appears to have been put on the basis that exposure to the risk of liquidation is the price attached by the law to the privilege of limited liability. Although support for that proposition (which was rejected in *Colt Telecom*) can be found in *Peveril Gold Mines*,[4] it founders on the simple counter-proposition that the insolvency jurisdiction is not confined to legal entities whose members enjoy limited liability. A public policy objection, if it exists, must be more broadly grounded than that apparently asserted in *Colt Telecom*.

Not all agreements which oust the jurisdiction of the court offend public policy. The best and most obvious example of a permissible agreement is an arbitration agreement covering a contractual dispute, but the statutory support for such arbitration agreements, now contained in the Arbitration Act 1996, clouds the issue of public policy in that context. Maintenance agreements are another frequently chosen example, but there too the issue is clouded by statutory recognition. The true principle, at

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[1] Contrast, for example, D French, *Applications to Wind Up Companies* (2nd ed) (2008, OUP, Oxford), at paragraph 3.2.4.6 and AR Keay, *McPherson's Law of Company Liquidation* (3rd ed) (2013, Sweet & Maxwell, London), at paragraph 3.017.

[2] *Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855, [2012] Ch 333 (CA).

[3] *Re Colt Telecom Group plc (No.2)* [2002] EWHC 2815 (Ch), [2003] BPIR 324.

[4] *Re Peveril Gold Mines Ltd* [1898] 1 Ch 122 (CA).

common law, appears to be that it is not permissible to exclude the jurisdiction of the courts to decide questions of law, but that it is permissible, at least to some extent, to confer power on a non-judicial body to determine questions of fact.[5] However, this formulation does not readily assist consideration of non-petition clauses and the validity of agreements purporting to disapply statutory remedies.

In that respect, the question of whether it was open to the parties to a contract for the sale of land to exclude the power of the court to order the return of a deposit under section 49(2) of the Law of Property Act 1925, which was addressed in *Aribisala*,[6] provides an analogy. It was held that it was not possible to exclude the jurisdiction under section 49(2). Two points are important for present purposes: first, the court treated section 49(2) as conferring a jurisdiction on the court to grant relief thereby distinguishing it from a right to the performance of a statutory duty (which can be waived)[7] and, secondly, the court recognised that legislation conferring jurisdiction could permit contracting out (which, as a matter of construction, it had not done in that case). So far as ouster is concerned, the question as regards non-petition clauses is whether they go to the jurisdiction of the court, as opposed to the powers of the parties, and, if so, whether the relevant provisions of the Insolvency Act 1986 can be construed as permitting contracting out.

The latter consideration leads directly into the second applicable limb of public policy, namely the more general prohibition on contracting out of insolvency law. The principle undoubtedly exists and has recently been recognised by the Supreme Court in *Belmont Park*[8] as the basis of the anti-deprivation rule and the *pari passu* principle. The practical effect of applying the principle to strike down non-petition clauses would be to treat the power to present a petition as being inalienable. The question is therefore whether public policy requires that result in circumstances where Parliament has made no express provision to that effect.[9]

On analysis therefore, public policy considerations are engaged in relation to non-petition clauses if it can be shown either that inhibiting the presentation of a petition deprives the court of its winding-up jurisdiction or that the power to present a petition cannot be voluntarily surrendered. Those questions have nothing to do with whether the debtor or its members have limited liability.

Fulham Football Club

The importance of this decision is indirect, but it is nonetheless convenient to take it as an up to date starting point. The issue was whether unfair prejudice proceedings commenced by a shareholder under section 994 of the Companies Act 2006 should be stayed under section 9 of the Arbitration Act 1996 on the basis that the matters in dispute were covered by arbitration agreements. The petition was stayed for reasons which are instructive and, at first sight, adverse to the validity of non-petition clauses.

It was held that a petition under section 994 was not an application for a class remedy and that a complaint which did not involve the making of a winding-up order

[5] *The Glacier Bay* [1996] 1 Lloyds Rep 370 (CA).

[6] *Aribisala v St James Homes (Grosvenor Dock) Ltd* [2007] EWHC 1694 (Ch).

[7] F Bennion, *Bennion on Statutory Interpretation* (5th ed) (2008, LexisNexis, London), section 11: "Where the case is within the principle quilibet potest renuntiare juri pro se introducto (a person may renounce a right introduced for his benefit), a person entitled to the performance of a statutory duty can effectively waive performance of the duty by the person bound, and that person can effectively contract out of performing the duty."

[8] *Belmont Park Investments Pty v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383 (SC).

[9] Contrast, for example, section 203, Employment Rights Act 1996:
"Restrictions on contracting out: (1) Any provision in an agreement (whether a contract of employment or not) is void in so far as it purports. . . (b) to preclude a person from bringing any proceedings under this Act before an employment tribunal".

was capable of being decided by an arbitrator. On the other hand, winding-up proceedings, which do involve a class remedy, are different:

> Companies are undoubtedly the creations of statute and operate in accordance with the provisions of the Companies Act 2006 which governs their registration; the rights of their members; and the duties of their directors. In the event of insolvency, they become subject to the statutory regime set out in the Insolvency Act 1986 which places their assets under the control of a liquidator and invests him with the statutory powers to get and realise those assets for the benefit of the creditors. He is empowered to take proceedings against the former directors for fraudulent or wrongful trading and to apply to the court for orders setting aside transactions between the company and third parties at an undervalue or dealings with creditors which amount to preferences: see sections 238 to 239 of the 1986 Act.
>
> There is no doubt that many aspects of this regime are immune from interference by the members of the company whether by contract or otherwise. They cannot override the provisions of the 1986 Act which apply on liquidation by agreeing between themselves or with a particular creditor that property which belongs to the company in liquidation should be dealt with other than in accordance with the Act: see British Eagle International Airlines Ltd v Cie Nationale Air France [1975] 1 WLR 758. The same must go for the exercise of the liquidator's powers under sections 238 to 239 of the Insolvency Act 1986. They involve an exercise of a statutory power to intervene in and set aside transactions with third parties in the context of the insolvency regime. These are rights vested in the liquidator for the benefit of the creditors as a whole and cannot be overridden by a contract entered into by the company prior to its liquidation.
>
> [A winding-up order] lies within the exclusive jurisdiction of the court and the discretion as to whether or not to make that order is for the court, not the arbitrator to exercise.[10]

In other words, the court was distinguishing winding-up proceedings but it was doing so in the context of determining the permissible limits of an arbitration agreement. Although the court was clearly holding that the making of a winding-up order could not be referred to arbitration (even in the context of minority relief proceedings which were otherwise covered by a binding reference),[11] it was dealing with the exclusive jurisdiction to the court to make orders not voluntary constraints on the making of applications for orders.[12] *Fulham Football Club* therefore does not deal with the validity of non-petition clauses as such.

Fulham Football Club did however remove what was otherwise significant support for any attack on the validity of non-petition clauses. In another case of an application for a stay to give effect to a reference to arbitration, *Exeter City*,[13] it had been held

[10] *Fulham Football Club*, above note 2, at paragraphs 73, 74 and 76 (*per* Patten LJ).

[11] *Ibid* at paragraphs 76 (*per* Patten LJ) and 103 (*per* Longmore LJ).

[12] The earlier case of *Best Beat Ltd v Rossall* [2006] EWHC 1494 (Ch), [2006] BPIR 1357 does not appear to have been drawn to the attention of the court in *Fulham Football Club*. Although the court in *Best Beat* had refused to stay a winding-up petition in order to allow for a reference to arbitration, the decision was taken without consideration of the relevant authorities and was grounded instead on the scope of the supposed arbitration agreement and the proper interpretation of section 9. It therefore had not addressed the more fundamental question of the arbitrability of winding-up proceedings.

[13] *Exeter City Association Football Club Ltd v Football Conference Ltd* [2004] EWHC 831 (Ch), [2004] 1 WLR 2910.

that the right[14] of a member to seek relief under the statutory predecessor of section 994 was inalienable and could not be diminished or removed by contract. If that were the law in respect of section 994 petitions the law in respect of winding-up petitions would be *a fortiori*. However, the Court of Appeal in *Fulham Football Club* held that *Exeter City* had been wrongly decided.

Interfering with the Conduct of Insolvency Proceedings

There is long-standing authority that the courts will not give effect to contracts which interfere with the conduct of insolvency proceedings. Thus, for example, in *Hall v Dyson*,[15] it was held that an agreement to pay a creditor in order to procure the withdrawal of his opposition to a debtor's discharge was void as being contrary to insolvency legislation and a fraud on creditors. *Hills v Mitson*[16] is to like effect. In *Elliott v Richardson*,[17] the court held that an agreement whereby a shareholder would endeavour to postpone the making of a call and support the admission of a creditor's claim was contrary to the policy of the Winding-up Acts. The case is noteworthy for the breadth of the following passage from the judgment of Keating J:

> . . .when a shareholder or creditor makes a secret agreement by which the assets may be disposed of otherwise than they would be in the ordinary course of a winding-up, such an agreement ought not to be enforced, because it is against the spirit of the Act.[18]

However, read in context, the judgment is not commenting on the validity or otherwise of agreements which predate the commencement of insolvency proceedings and which do not seek to interfere with due process, but rather to avert the possibility of such process taking place.

Contrary to submissions made in *Cadbury Schweppes*,[19] the principle that the courts will not give effect to agreements which subvert the conduct of insolvency proceedings survives the enactment of the Insolvency Acts 1985 and 1986. On the contrary, the principle operates in tandem with the provisions of the legislation.[20] In *Cadbury Schweppes*, a secret collateral agreement with dissenting creditors which resulted in the withdrawal of their objections to an individual voluntary arrangement was held to justify a bankruptcy order being made under section 276(1)(b) of the 1986 Act. Judge LJ said:

> The principles laid down in the cases decided in the 18th and 19th centuries, accurately summarised by the judge below, have not, as he rightly put it, 'become outmoded or unnecessary in modern times'.[21]

A similar question arose in *Kapoor*,[22] where an equitable assignment of part of a debt was made for the sole purpose of securing the approval of an individual voluntary

[14] The so-called "right" is not a right in the Hohfeldian sense of a right in respect of which there is a correlative duty. It is merely a power. This is a point which has some relevance in connection with the general principles applicable to contracting out of statutes - see above note 8.

[15] *Hall v Dyson* (1852) 17 QB 785.

[16] *Hills v Mitson* (1853) 8 Ex 751.

[17] *Elliott v Richardson* (1869 -70) LR 5 CP 744.

[18] *Ibid* 751.

[19] *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615 (CA).

[20] Indeed, the principle can be seen to underlie some provisions in the legislation, for example section 164 of the 1986 Act and rule 4.150 of the Insolvency Rules 1986 (SI 1986/1925).

[21] *Cadbury Schweppes*, above note 19, at paragraph 44.

[22] *National Westminster Bank Plc v Kapoor* [2011] EWCA Civ 1083, [2011] BPIR 1680 (CA).

arrangement that would otherwise have been rejected. This was held to have resulted in a material irregularity and the approval was revoked. Etherton LJ said:

> The arrangement given effect by the Assignment in the present case was patently intended, and intended only, for the purpose of subverting [the rules on connected votes]. . .It is at one extreme end of a spectrum of transactions of questionable legitimacy. . .The Assignment was not a sham, but it does not fall far short of it.[23]

The importance of these modern voluntary arrangement cases is two-fold. First, they concern agreements relating to the entry of a debtor into insolvency proceedings and, secondly, they do not involve the possible distinctions between agreements enshrined in articles of association and private agreements (an issue addressed in the next part of this article). However, the cases are easily distinguished from the issues raised by non-petition clauses because they are concerned with attempts to force a collective insolvency proceeding on one or more unwilling creditors. They are not concerned with voluntary agreements by individual creditors to forego powers that they might otherwise enjoy to bring about the commencement of such proceedings ,which do not, and do not even purport to, interfere with the rights of creditors who have not given similar undertakings.

Articles of Association

There is an established distinction to be drawn between what can be agreed by members under private contracts and what shareholders' powers can be restricted by provisions in the company's constitution. In *Russell v Northern Bank*, Lord Jauncey said:

> My Lords while a provision in a company's articles which restricts its statutory power to alter those articles is invalid an agreement dehors the articles between shareholders as to how they shall exercise their voting rights on a resolution to alter the articles is not necessarily so.[24]

In support of this proposition he cited *Welton v Saffery,* a case concerning articles purporting to authorise the issue of shares at a discount. In *Welton v Saffery*, Lord Davey had said:

> Of course, individual shareholders may deal with their own interests by contract in such way they may think fit. But such contracts, whether made by all or some only of the shareholders, would create personal obligations, or an exception personalis against themselves only, and would not become a regulation of the company, or be binding on the transferees of the parties to it, or upon new or non-assenting shareholders. There is no suggestion here of any such private agreement outside the machinery of the Companies Acts.[25]

Welton v Saffery had earlier been relied on by the Court of Appeal in *Peveril Gold Mines*. *Peveril Gold Mines* concerned a provision in that company's articles of association which purported to restrict the right of a contributory to present a winding-up petition. A contributory presented a petition and two other shareholders applied for it to be stayed. The application was dismissed and the judge's decision was upheld on appeal. Lindley MR said:

[23] *Ibid* paragraph 68.

[24] *Russell v Northern Bank Development Corporation Ltd* [1992] 1 WLR 588 (HL), at 593B (the other members of the panel delivered judgments agreeing).

[25] *Welton v Saffery* [1897] AC 299 (HL), at 331.

> I do not intend to decide whether a valid contract may or may not be made between the company and an individual shareholder that he shall not petition for the winding up of the company. That point does not arise now. But to say that a company is formed on the condition that its existence shall not be terminated under the circumstances, or on the application of the persons, mentioned in the Act is to say that it is formed contrary to the provisions of the Act, and upon conditions which the Court is bound to ignore.[26]

The express reservation of questions as to the validity contracting out by agreements made outside the company's constitution was repeated by Chitty LJ in the only other reasoned judgment.

There is therefore a formidable line of authority to the effect that companies cannot be incorporated on terms that are at variance with provisions of the very legislation making their incorporation possible. The question is to what extent that inhibition extends to other restraints on the presentation of winding-up petitions i.e. the question expressly left open by the judgments in *Peveril Gold Mines*.

Agreements to Which the Company is a Party

The authorities already mentioned establish that a company cannot preclude the exercise of its statutory powers by terms embodied in its own constitution. Those authorities equally demonstrate that there is no objection to agreements between shareholders as to the exercise of shareholder rights which will, in practice, preclude the exercise of those powers. The question therefore arises as to whether a company can by private agreement agree that which it cannot provide for in its constitution and, by extension, whether that renders invalid non-petition clauses in agreements to which the putative respondent company was a party.

The first part of this question was addressed in *Russell v Northern Bank*, where Lord Jauncey said:

> [The company]. . .agreed that its capital would not be increased without the consent of each of the shareholders. This was a clear undertaking by [the company] in a formal agreement not to exercise its statutory powers for a period which could, certainly on one view of construction, last for as long as any one of the parties to the agreement remained a shareholder and long after the control of [the company] had passed to shareholders who were not party to the agreement. As such an undertaking it is, in my view, as obnoxious as if it had been contained in the articles of association and is therefore unenforceable as being contrary to the provisions of [the applicable companies legislation]. [The company's] undertaking is, however, independent of and severable from that of the shareholders and there is no reason why the latter should not be enforceable by the shareholders inter se as a personal agreement which in no way fetters [the company] in the exercise of its statutory powers.[27]

The point of importance to note in this extract from the judgment is its focus on the restraint by the company of its own statutory powers. That would undoubtedly be relevant to any purported restriction upon the company's own power to put itself into liquidation but that is not ordinarily the purpose or effect of a non-petition clause. Indeed, such a restriction could seriously embarrass the directors of an insolvent

[26] *Peveril Gold Mines*, above note 4, at 131.

[27] *Russell v Northern Bank,* above note 24, at 594G–595A.

company who wished to protect themselves from the risk of wrongful trading proceedings under section 214 of the Insolvency Act 1986.

The restraint of creditors who have voluntarily undertaken not to exercise a remedy which might otherwise be available to them is clearly distinguishable. If such a restraint is not "*obnoxious*", it should not make any difference whether the company either is or is not a party to the relevant agreement, nor is there any need to have recourse to severance in order to preserve the effect of the agreement as between creditors.

Colt Telecom

In *Colt Telecom*, Jacob J upheld the validity of a "no-action" clause in bonds issued under New York law when dismissing an application for an administration order. This appears to be the only decision directly in point but there are a number of reasons for treating it with a degree of caution. First, not all the authorities and principles addressed in this article were considered in *Colt Telecom* (the reasons for which include, not least, the fact that some of the significant authorities post-date the decision). Secondly, the decision on the non-petition clause was only one of a number of reasons for the dismissal of the application in a judgment where Jacob J's distaste for the petitioner's case is very clear. Thirdly, the judgment proceeds from a starting point that a contrary decision would have the "*startling*" result of largely precluding English companies from accessing the New York bond market (instead of first determining the applicable principle before considering the effect of that principle on the bond market). Fourthly, the curious characterisation of the potential public policy issues in the submissions to Jacob J (as being related to the privilege of limited liability) and, fifthly, a willingness to treat any public policy objections as being capable of being overridden by the choice of a more favourable foreign law. It remains possible that the conclusion was right even if some of the reasoning is difficult to support.

As stated above, the public policy objection, if such objection there be, cannot be grounded on considerations of limited liability. Nor can the 21st century practices of the New York bond market be determinative of English public policy concerning access to the English courts. The policy objection must relate either to ousting the jurisdiction of the courts or to contracting out of the statutory scheme. Moreover, if there is indeed a public policy objection, it is difficult to see how it could properly be disregarded. In this connection Jacob J said (*obiter)*:

> [Counsel] submits that even if English law does take the view that no-action clauses are invalid if governed by English law, they do not have such an inherent vice that English law would not respect a foreign law which permitted such clauses. I agree. The vice, if contrary to my view it is such, is one of the utmost technicality. I see no reason why English law should elevate it to the status of 'ordre public' with the effect that English companies could not raise money by contracts governed by New York law with the same freedom and on the same terms as is routinely done by US and other non-UK companies.[28]

It is, with respect, difficult to see why, on the hypothesis that it is contrary to English public policy for a creditor to contract out of its power to present a winding-up petition to the English court, it should make any difference whether the agreement is governed by English law or not. It would be a bizarre result if parties could disapply English public policy by the simple expedient a choosing a more liberal foreign governing law - quite possibly to govern solely that aspect of their bargain.

[28] *Colt Telecom*, above note 3, at paragraph 76.

On whether there is any such English public policy objection, Jacob J observed:

> As to [counsel for the applicants'] point about there being an overriding public policy striking down any contractual obstacle to presentation of an administration petition (or indeed winding-up petition) there are several answers. First, if right there would be no exception of any sort, personal or otherwise. The Companies Court would not be accepting on a regular basis (as it does) undertakings not to present a petition. . .

Re A Company (No. 00928 of 1991)[29] affords an example of just such a disposal. The case involved a second petition based on the same petition debt where the first petition had been dismissed by consent. It was submitted that there was an estoppel against the petitioner but Harman J preferred to regard it as a contractual term by implication. Harman J ordered that the petition be removed from the file and put an end to the proceedings. Whist it is not necessarily impossible to draw a distinction between restraints on petitioning arising in such circumstances and the generality of non-petition clauses (which are usually agreed well in advance of any issue having arisen), there is force in Jacob J's observation in that the authorities do not identify any grounds on which such a distinction might be drawn.

Jacob J distinguished *Peveril Gold Mines* on the ground that it was not concerned with public policy. However, that case was decided on the basis that it was not possible to preclude a contributory's petition by a provision in the company's articles of association which, since that is about contracting out of the Companies Acts, is a public policy objection. The more cogent reason for not applying *Peveril Gold Mines* was that submitted by counsel in *Colt Telecom,* namely that the case does not deal with external contracts with third parties. In other words, it is an example of the *Russell v Northern Bank* and *Welton v Saffery* line of authority.

Jacob J's third point was that the statutory provision enabling a creditor to present a petition was permissive. This is the most compelling point. No creditor is ever under an obligation to exercise any available remedy, let alone bring about the commencement of insolvency proceedings. The crucial feature of non-petition clauses is that they restrain individual creditor action; they do not even purport to deprive the court of its jurisdiction. This distinguishes non-petition clauses from the ouster of jurisdiction which was held to have occurred in *Aribisala.* If it is the case that, in general, a person who has the right to the performance of a statutory duty can waive the performance of that duty if it is for private benefit, then it should follow that it is equally permissible for a person who has a mere power to have recourse to a statutory remedy to waive the exercise of that power.[30]

It has to be acknowledged that there is no express statutory power to contract out such as features for example in the rules relating to limited liability partnerships.[31] However, there are two points to be made in that respect. First, the relevant provision relates to members' rights to present unfair prejudice applications and is more properly regarded as a derogation from the *Russell v Northern Bank* and *Welton v Saffery* line of authority. Secondly, the Court of Appeal in *Fulham Football Club* refused to draw any inferences from that provision in the law on limited liability partnerships as regards other questions on contracting out.

[29] *Re A Company (No. 00928 of 1991), ex parte City Electrical Factors Ltd* [1991] BCLC 514.

[30] *Ibid* n8 and n15.

[31] Section 994(3), Companies Act 2006, as modified by regulation 48, Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804).

CONCLUSIONS

The conclusion reached in *Colt Telecom*, that non-petition clauses are valid, was correct even if some of the reasoning is problematic. The subsequent decision in *Exeter City*, which would have supported the opposite conclusion, can now be disregarded because in *Fulham Football Club* the Court of Appeal held *Exeter City* to have been wrongly decided. Although the reasoning of the Court of Appeal in *Fulham Football Club* involved drawing clear distinctions between unfair prejudice and insolvency proceedings (for the purpose of upholding agreements between members preventing the commencement of the former), it does not follow that non-petition clauses resulting from private agreements are objectionable.[32] Such agreements do not oust the jurisdiction of the courts to open insolvency proceedings[33] or purport to delegate decisions about the opening of proceedings to arbitration or any other alternative forum. Voluntary restraint does not involve contracting out of the statutory scheme. There is therefore no public policy objection to such clauses. *Peveril Gold Mines* is distinguishable on the ground that it is part of the *Russell v Northern Bank* and *Welton v Saffery* line of authority dealing with the internal regulation of companies by their constitutional documents and non-petition clauses do not involve the company contracting out of its statutory powers.[34]

[32] Both *Exeter City* and *Fulham Football Club* were decided without reference to *Colt Telecom*.

[33] Not least because of the jurisdiction of the court to act of its own volition: *Lancefield v Lancefield* [2002] BPIR 1108.

[34] An agreement which purported to bind the company not to exercise a power to present its own petition would raise different considerations because such an agreement would clearly seek to interfere with the company's own statutory powers.

PROTECTING BANK DEPOSITORS AFTER CYPRUS

ANDREW CAMPBELL and PAULA MOFFATT***

INTRODUCTION

During the recent financial crisis in the Republic of Cyprus,[1] in March 2013,[2] the government proposed taking a percentage of all bank deposits. Despite the fact that the proposal was not pursued, it raised a number of questions about the current nature of depositor protection. The particular question that was asked after the Cypriot proposal was: what is the point of a deposit guarantee system if a government can simply decide to remove funds from guaranteed deposit accounts because the country is in a state of financial crisis? But in the wider context of depositor protection and the movement from "bail-out" to "bail-in" for failing banks, this question should be re-framed to ask whether depositor protection should apply only where an institution is declared to be insolvent and unable to repay its depositors or whether it should apply in a wider set of circumstances.

It has long been an article of faith amongst deposit insurance experts that deposit insurance schemes[3] play a crucial role in ensuring the stability of the financial system and in protecting depositors.[4] The rationale behind deposit insurance schemes is that they work because a limit is set determining the extent to which depositors' funds will be protected and depositors' funds are then protected up to that limit. Depositors then have the certainty that, in times of financial turbulence, their funds are protected against bank failure up to this limit, so giving them confidence in the financial system as a whole. The Cypriot government did not appear to have considered the possibility that their proposal might have implications for the Cypriot depositor protection scheme and so it is unsurprising that questions were immediately asked. Fortunately, the proposal was quickly withdrawn in relation to deposits which came within the level of protection provided in all Member States of the European Union[5] under the EU Deposit Guarantee Schemes Directives.[6]

In the discussion that follows, it is important to be clear that the authors are concerned only with the protection of depositors' funds up to the insured limit. It is

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1 The authors would like to thank Gillian Garcia for her invaluable comments in helping to shape this article.
This is the Republic of Cyprus which has been a Member State of the European Union since 1/5/04 and is hereafter referred to as Cyprus / Cypriot. It is not to be confused with the Turkish Republic of Northern Cyprus.

2 It is not entirely clear whose idea this was. The government in Cyprus was in negotiations with the so-called "Troika", the International Monetary Fund, the European Commission and the European Central Bank. According to the Eurogroup Statement on Cyprus of 16 March 2013, the Eurogroup welcomed "the Cypriot authorities' commitment to take further measures mobilising internal resources . . . [including]. . . the introduction of an upfront one-off stability levy applicable to resident and non-resident depositors." (See http://eurozone.europa.eu/newsroom/news/2013/03/eg-statement-cyprus-16-03-13). The plan presented to the Cypriot parliament exempted savers with less than €20,000 in their accounts, but savers with deposits up to €100,000 were to be charged 6.75% and savers with sums above this amount, 9.9%. The plan was ultimately rejected by the Cypriot parliament see http://www.bbc.co.uk/news/world-europe-21842966 (accessed 25 July 2013).

3 This is the term most commonly used internationally but other terms are sometimes used. In EU law the term used is deposit guarantee.

4 Discussed below and recently reiterated in the Financial Stability Board's *Thematic Review on Deposit Insurance Systems – Peer Review Report* 8 February 2012 at p8, available at http://www.financialstabilityboard.org/publications/r_120208.pdf.

5 Hereafter EU. See the Eurogroup Statement on Cyprus of 25 March 2013 http://eurozone.europa.eu/newsroom/news/2013/03/eg-statement-cyprus-25–03–13.

6 Directive 94/19/EC L 135 (hereafter the "1994 DGSD") as amended by Directive 2009/14/EC L 68/3 (hereafter the "2009 DGSD").

accepted that, once the insured limit is reached, any surplus funds held in depositors' accounts will be available to the liquidator, receiver or other manager of an insolvent bank. These surplus funds may then be legitimately applied to meet the bank's debts in the event that other capital adequacy measures, such as bail-ins, provide insufficient funds to do so.

The potential damage which the Cypriot proposal could have caused to financial stability throughout the EU had not been adequately considered before it was made public. The proposal was ill-thought through from the start, since it would have had the effect of imposing a "tax" of 6.75% even on deposits guaranteed under the DGSD. Since the financial crisis began in or around September 2007, its impact on public trust and confidence in banks and bankers has become a matter of real concern. Trust in bankers has been severely eroded and the Cypriot government's proposal is unlikely to have done anything to improve matters. As Ian Henderson remarked "when trust in the banking sector is at an all-time low according to the Edelman Trust Barometer, and people all around the Eurozone periphery are watching nervously to see what happens to Cyprus because it may be their bank going under next, who but the wilfully blind would do the thing guaranteed to collapse any remaining trust in their banks?"[7]

As has been identified at the beginning of this article, it is significant that the levy on deposits was to be charged even though no Cypriot bank had actually failed. This begs the question as to what it is that we are trying to protect through deposit insurance schemes? One of the most important reasons for the introduction of the DGSD was to ensure that all bank depositors, up to a particular limit, would know that their deposits were totally safe. Guaranteed, in fact, by EU law. But what does the term guarantee actually mean in this context? Is it a guarantee only against bank insolvency or is it a guarantee that depositors' funds will be protected in a wider financial crisis including a situation where their bank does not actually fail? Does the retraction of the Cyprus levy mean that depositors now have confirmation that deposits will be guaranteed up to the DGSD protected limit, in all situations? Or is the imposition of a levy still a possibility in a future case? If so, what checks would there be to prevent the government of a Member State from deciding to take a much higher percentage than the 6.75% identified by the Cypriot Ministry of Finance?

This article seeks to explore the nature and extent of the protection offered to depositors in the EU context. What are the circumstances in which a deposit will be insured or guaranteed within the EU? In a wider context, the terms "deposit guarantee" and "deposit insurance" tend to be used synonymously, but is there a distinction between them? The paper will also consider the question as to what will happen when a government-backed depositor protection scheme is not, itself, "good for the money" (as was the case in Cyprus) where a country is on the brink of bankruptcy. It seems clear that the Cypriot proposal damaged confidence in deposit guarantee systems within Europe (and quite possibly beyond it) and this situation needs to be repaired. There may be lessons to be learned from the authorities in New Zealand where the deposit guarantee scheme has, somewhat controversially, been abolished. This paper neither pretends to have definitive answers to the issues it raises nor does it seek to make any recommendations: rather, its purpose is to raise awareness of these matters for international consideration by policy makers.

[7] "From Cuba to Cyprus" in *Chartered Banker*, June/July 2013, p. 50 (The Edelman Trust Barometer measures trust in institutions, industries and leaders).

A SHORT HISTORY OF DEPOSITOR PROTECTION

In order to understand why depositor protection has a role in financial stability, it is worth considering its development during the late nineteenth and early twentieth centuries in the US and its more recent history beyond the US.

The Development of Depositor Protection in the US

According to the "*History of the FDIC*",[8] the protection of bank depositors became a matter of the business of the nation on the 9th of March 1933. Between the October 1929 Wall Street crash and the cessation of banking operations across the US on the 3rd of March 1933, over 9,000 banks in the US had failed and the Great Depression was well under way. But it was the failure of 4,000 banks in the first three months of 1933 that prompted President Roosevelt to declare a bank holiday that March. The closures had caused "panic. . . The financial system was on the verge of collapse and both the manufacturing and agricultural sectors were operating at a fraction of capacity".[9] Clearly, the government had to do something to restore public confidence and it went for deposit insurance. Why? What was it seeking to achieve?

The concept of a federal system of deposit protection was not new within the US in 1933. A number of states had introduced deposit insurance systems to prevent bank runs with varying degrees of success from as early as 1829.[10] Although the state run systems generally proved to be unworkable, the role deposit insurance could play in maintaining stability in the sector, was recognised and from 1866 onwards a number of requests were made to Congress to adopt a federal system. What seems to have been different in 1933 was the sheer scale of the banking failure and the devastating impact it had on the day-to-day lives of US citizens: it seems that it was public opinion that led to the Banking Act of 1933[11] which established the FDIC and the federal system for the protection of deposits.[12]

Thus the 1933 Act was passed despite significant opposition which came not only from members of the Senate Banking Committee and those in the banking industry but even, at the early stages of the process, the President himself. The arguments ranged against depositor protection then are familiar today: deposit insurance would be expensive and would, effectively, protect banks that were badly managed. This latter argument is the argument against "moral hazard". It has two aspects. First, why should a bank look after depositors' money carefully if it knows that it will be bailed out however high risk its activities? Second, why should depositors take care about where to deposit their money if they know it is protected by a deposit insurance scheme? Those who argued that the increase in moral hazard should prevent the introduction of deposit insurance lost.[13]

[8] FK Pesek, *The First Fifty Years – A History of the FDIC 1933–1983* (Federal Deposit Insurance Corporation, Washington DC, 1984) iii.

[9] *Ibid* 3.

[10] *Ibid* Chapter 2.

[11] Hereafter the 1933 Act.

[12] *Ibid* n8 iii, Chapters 1 and 3 Senator Glass is quoted on p41 as saying that the "voters wanted the guarantee [deposit insurance]" (Presumably, on the basis of the principle adopted by Bill Clinton in his 1992 election strategy "it's the economy, stupid" - if people cannot run their businesses with any hope of success or are starving in the streets as was the case in the US at this time, they will feel less inclined to vote for you.).

[13] This article does not focus on the moral hazard issue and readers are referred to , Campbell, A. and Cartwright, P. *Banks in crisis: the Legal Response* (Ashgate, Aldershot, 2002) Chapter 7 and Garcia, G.G.H. *Deposit Insurance – Actual and Good Practice* IMF Occasional Paper No. 197 (International Monetary Fund, Washington, D.C.,2000) p. 10 on this topic. Arguably, however, a well designed depositor protection scheme coupled with an effective system of supervision and regulation can effectively limit moral hazard.

The US deposit insurance system was set up as a system whereby banks paid for their potential failure in advance. In 1933, a temporary fund was set up funded by the US Treasury and twelve Federal Reserve Banks. Insured deposit taking banks were then assessed and required to pay half their assessment to the FDIC with the rest due if the FDIC called upon it. Individual depositors were immediately protected for deposits of up to $2,500. Within two years, a permanent plan was put into operation and the protected amount increased to $5,000.[14] Things improved quickly. During 1934, deposits in US banks increased by 22%. In the same year, the rate of bank failure declined significantly, with "only" nine insured banks and 52 uninsured banks suspending operations.[15] The message that banks were safe had been given to, and received by, the public: insured banks were required to display the fact that they were insured and it seems likely (from the strength of public feeling at the time) that the public was well aware that the US Treasury was ultimately behind the scheme. So the deposit insurance system worked because it gave depositors the confidence that if they put their money into an insured bank they would not lose it. This, in turn, gave them confidence in the wider financial system: there were gradually fewer and fewer bank runs as confidence rose. There is some evidence to suggest that the economic climate improved in 1934, but it seems clear that at least a significant share of the credit for the reduction in bank failure during this period should go to the introduction of the deposit insurance scheme.[16]

The FDIC was set up in recognition that "measures of a *national* scope"[17] had become necessary to alleviate the problems caused by bank failures: only with the funding power of the Federal Reserve Banks behind it could the FDIC insurance system provide sufficient confidence to the public. The US state system of deposit insurance during the nineteenth century could be likened to the current situation in the EU, where individual Member States have their own depositor protection systems in place.

It is worth noting here that the US system was then, and still is, described as a system of deposit "insurance". This is different from the current language of the DGSD, which talks about deposit "guarantee" schemes.[18] The terms "guarantee" and "insurance" tend to be used synonymously in the context of depositor protection, yet little thought appears to have been given as to whether there is a legal distinction between these terms.

Depositor Protection Beyond the US

The second half of the twentieth century saw a growing, international trend to introduce schemes to protect bank depositors and many countries beyond the US started to introduce their own schemes. Some examples are Canada in 1967, Nigeria in 1988, Brazil in 1995, Australia in 2008, France in 1999, Russia in 2004 and Malaysia in 2005. In fact, by 1995 forty seven countries had formal deposit protection schemes.[19] Within Europe, some individual states had already introduced their own schemes before there was an EU response. In the UK, the Banking Act 1979 introduced the first scheme which came into effect in 1982. The 1994 DGSD introduced mandatory deposit guarantee schemes for all Member States of the EU and required a minimum level of

14 *Ibid* n8 Chapter 3.
15 *Ibid* n8 49.
16 *Ibid* n8 Chapter 2.
17 *Ibid* n8 Chapter 1 p3.
18 Directives 94/19/ EC L 135 and 2009/14/EC L 68/3.
19 www.iadi.org.

cover throughout the EU. By the time this came into force in 1995, virtually all Member States already had their own schemes in place.[20]

The design and scope of the schemes varied considerably, even within the Member States of the EU, in regard to such matters as level of cover, types of funding, method of compensation payments and the use of co-insurance.[21] The actual scope and role of the deposit insurance agency also varied greatly from country to country. These ranged from the very broad, such as the FDIC which has both regulatory and receivership responsibilities as well as responsibility for managing the deposit insurance fund, to very narrow so-called "paybox" schemes which are restricted to collecting contributions to the fund and to making compensation payments where required.

Depositor Insurance Today

The importance of deposit insurance in contributing to public confidence in the financial system was acknowledged by the Basel Committee on Banking Supervision's[22] Core Principles for Effective Banking Supervision in 2006, although it did not draft any guidance at that time. In 2008, however, the BCBS sought the assistance of the International Association of Deposit Insurers[23] in developing and publishing a set of Core Principles for Effective Deposit Insurance Systems.[24] This was an important development which has assisted many countries in assessing the effectiveness or otherwise of existing schemes and which has also given guidance for reform post-crisis. The fact that the Core Principles have been drafted in conjunction with the BCBS gives them an international legitimacy which serves to assist countries which are considering introducing schemes for the first time. In addition to IADI, Europe has its own organisation, the European Forum of Deposit Insurers,[25] which was established in 2002 with the support of the European Commission.

It is worth observing that the Core Principles are not prescriptive and reflect the fact that policy makers have various choices available to them as to how they protect depositors. Having said that, the Executive Summary notes that although such choices exist, the introduction of a system of explicit deposit insurance has become the preferred choice when compared to other options, such as reliance on implicit protection.[26]

All the major economies now have deposit insurance systems in place, except for China which is in the process of developing a system.[27] The international trend in recent years has clearly been in favour of the use of formal, explicit schemes to protect depositors as recommended by IADI. That is what makes the decision by New Zealand to abolish its deposit insurance scheme all the more interesting.

[20] For further information on this see A Campbell, & P Cartwright, *Banks in Crisis – the Legal Response* (Ashgate, Aldershot, 2002) pp.179 – 181.

[21] Co-insurance is where the depositor has to take a share of the loss. Its use in the UK, and subsequent removal is discussed below.

[22] Hereafter BCBS.

[23] Hereafter IADI. The role of IADI is discussed below.

[24] Basel Committee on Banking Supervision & the International Association of Deposit Insurers *The Core Principles for Effective Deposit Insurance Systems* (Bank for International Settlements, Basel, 2009). Hereafter the Core Principles – these are discussed later in this article.

[25] Hereafter EFDI. For details of what EFDI dose see www.efdi.net.

[26] Executive Summary para 3.

[27] According the IADI website, as at 30 June 2013, 112 jurisdictions have set up an explicit deposit insurance scheme, China is listed as one of 41 jurisdictions which are studying or considering the implementation of an explicit system: it has not yet got as far as constructing one (see: http://www.iadi.org/di.aspx?id=68 accessed 25 July 2013).

WHAT ARE THE CIRCUMSTANCES IN WHICH A DEPOSIT WILL BE INSURED OR GUARANTEED?

Having considered why depositor protection is considered to be important for the purposes of financial stability, it becomes necessary to consider the circumstances in which a deposit will be insured or guaranteed. Is a depositor protection scheme meant only to protect depositors in a bank which has failed or is it a guarantee against all eventualities? This brings us back to the Cyprus issue and the EU position under the DGSD.

The purpose of the 1994 DGSD was to ensure that Member States had deposit guarantee schemes in place and it was recognised that different Member States would achieve this in different ways. The Preamble recognises the need for harmonisation of the amount of depositor protection across the EU to prevent unfair competition and also reflects the fact that depositor protection is an important part of the prudential framework. [28] Although the 1994 DGSD does not define the term "guarantee", it states that it can be invoked "in the event of deposits becoming unavailable".[29] Deposits are "unavailable" .when they are "due and payable but [have] not been paid by a credit institution under the legal and contractual conditions applicable thereto" in two situations. Either "the relevant competent authorities have determined that . . . the credit institution concerned appears to be unable . . . for reasons which are directly related to its financial circumstances, to repay the deposit and to have no current prospect of being able to do so"[30] or "a judicial authority has made a ruling for reasons which are directly related to the credit institution's financial circumstances which has the effect of suspending depositors' ability to make claims against it".[31]

From this, the most obvious circumstances in which deposits would be "unavailable" will be those where a bank becomes insolvent and does not have the money to pay its depositors. But could deposits also become "unavailable" during the process of a wider, national debt restructuring? Would "unavailable" include the removal of a portion of a protected deposit by a government, for example, through the imposition of a levy such as the Cypriot authorities suggested? Arguably, it would not. Although a protected portion of the deposit would be "unavailable" to the depositor, it would not necessarily follow that the competent authorities would have determined that the bank in question was unable to repay the deposit – indeed, it might be in the interests of the competent authorities *not* to make such a determination if they thought that they could take a levy and not have to subsidise the guarantee.[32] It may also be the case that, by deducting such a levy, the competent authorities would have greater confidence that the bank could, in fact, repay depositors.

But if deposits are not fully protected against all possible eventualities how can depositors have trust in the system? In the Cyprus case the authorities quickly withdrew the proposal to "tax" guaranteed bank deposits, but what if they had not?

In the wider, international context, it is also worth considering whether there is a distinction between deposit insurance scheme ("insurance" being the term used by IADI) and a deposit guarantee scheme ("guarantee" being the term used in the

[28] The Preamble states that "it is indispensable to ensure a harmonised minimum level of deposit protection" and that "deposit protection is as essential to the prudential rules for the completion of a single banking market".

[29] Article 7(1).

[30] Article 1(3)(i).

[31] Article 1(3)(ii).

[32] The 2009 DGSD does not change this position as its purpose was to increase and harmonise the coverage level and reduce payout delays. Article 1(3)(i) of the 1994 DGSD was amended to reduce the time for making the determination from 21 to working five days.

DSGD). It is beyond the scope of this article to consider anything other than the English law understanding[33] of the terms "guarantee" and "insurance" in this context, but the identification of the English law distinction serves to provide a useful example of how terms which may seem to have a similar commercial effect can result in different legal effects.

As a matter of English law, guarantees and insurance contracts fall within the category of contracts of suretyship;[34] a guarantee is an undertaking to make good another's default and is, therefore, a secondary obligation. Essentially, with a guarantee the guarantor[35] is only called upon to deliver on the guarantee when there is a default by the person whose obligation has been guaranteed. In contrast, an insurance contract provides an indemnity against loss and, because it is not dependent upon another party's default, it is a primary obligation of the insurer. This means that the insurer is required to pay up under the contract of insurance if loss is suffered, regardless of whether there has been a default or not.[36] Does this mean then, that without a bank default a "guaranteed" deposit is not protected, whereas, if the deposit were subject to a deposit "insurance" scheme it would be? In the latter case, the protection would come from the insurer's primary obligation to pay the depositor and so it would not depend upon the bank defaulting first. In other words, if it were possible to impose a levy without triggering a default, the guarantor would not have to pay, whereas the insurer would.

Internationally, there is a shift towards a consensus that failing banks should be "bailed in" and remain operational through an Open Bank Resolution process[37] rather than closed and "bailed out" by governments (and therefore the taxpayer). Broadly, this means that regulators and/or central banks will actively intervene to prevent a bank from defaulting by pumping in certain shareholder funds (and possibly a level of subordinated debt) to protect the general, unsecured depositor. If a bank never defaults, it may well be the case that a DGSD guarantee cannot be called.

As this article has sought to demonstrate, the general, international understanding of the role of deposit insurance and deposit guarantee schemes in the context of the financial safety net has been rooted in a belief that such schemes promote financial stability and protect those most likely to be disadvantaged by bank failure – ordinary people, doing ordinary jobs who put money into banks to keep it safe. Trust and confidence in the system can only be maintained where there is a degree of certainty that the money of ordinary depositors is secure. It may be a matter of semantics that some schemes are described as insurance schemes and others as guarantee schemes, but the fact remains that it is not clear how they would operate if a government levy were to be imposed and it seems at least arguable, that the DGSD would not protect depositors in every case. Consequently, there is an urgent need for clarification as it seems that a DGSD guarantee may not, in fact, be a guarantee when you (as a depositor) want or need it to be.

[33] Other EU Member States will doubtless have their own jurisprudence in this area and the authors are not qualified to comment upon it. The English law position is only presented to illustrate the possibility that there may be a distinction between the legal effect of these terms and to ask the question: does this matter for the purposes of determining the scope of depositor protection?

[34] C Bamford, *Principles of International Financial Law* (2011) OUP p240.

[35] The guarantor is the person giving the guarantee.

[36] See the discussion on analogous transactions in R Goode, *Commercial Law* 3rd Ed (2004) Penguin Books p800.

[37] Hereafter OBR.

IS THE IMPORTANCE OF DEPOSIT PROTECTION A TRUTH UNIVERSALLY ACKNOWLEDGED?

The importance of depositor protection in promoting financial stability was described above as an article of faith. Its importance in restoring stability in the years after the Wall Street Crash has been explained in this article and its importance as a mechanism within the financial safety net was recently reiterated by the Financial Stability Board in its 2012 Thematic Review on Deposit Insurance Systems.[38] Yet not all countries have decided that protecting depositors through a deposit insurance scheme is the most appropriate course of action. One country which has decided to move in the other direction and remove its existing deposit protection scheme is New Zealand.[39]

The New Zealand government decided not to renew its deposit guarantee scheme when it expired at the end of 2011. The reasons given were that it was hard to price and that it blunted any incentives both for depositors and bankers to manage risks (the moral hazard argument)[40]. It is intended to be replaced with an OBR regime and, in June 2013, the Reserve Bank of New Zealand[41] issued a document setting out the OBR policy and the pre-positioning requirements for banks (the ‘‘Policy’’).[42] The Reserve Bank is New Zealand’s central bank and the prudential regulator for New Zealand’s banks.

The OBR is described as a tool for responding to bank failure and all New Zealand incorporated banks holding retail deposits of more than NZ $ 1 billion will be required to take part in the scheme. It is intended that, should a bank become insolvent and be put into a statutory management process, the OBR regime will enable the bank to be open for business the next working day. By using the OBR process, there will be minimal disruption to customers who will be able to access their deposits the next working day.

But herein lies the rub. Depositors may not, in fact, be able to access *all* of their deposits. According to clause 5(1) of the Policy, OBR is an option that provides the ability to allocate losses to *creditors* (in other words, depositors) of the failed bank after losses have first been allocated to shareholders and subordinated creditors (in that order).

The mechanism works as follows. The initial losses of the bank are identified, access channels to the bank are closed and the bank is placed in statutory management. A determination of the amounts owed to each customer is made and those liabilities which fall into the category of ‘‘pre-positioned liabilities’’ are identified. Pre-positioned liabilities are, essentially, the kinds of liabilities that would be insured under a deposit insurance system, so include products such as transaction accounts, savings accounts, overdraft facilities and credit balances on credit cards. Non pre-positioned liabilities are those liabilities which are not in the nature of customer liabilities and would include derivative financial instruments and some money market transactions.

Once the pre-positioned liabilities have been identified, a *de minimis* amount is determined. This is an amount of money which is protected from the allocation of losses and which will remain fully available to the account holders. It is defined as ‘‘unfrozen funds’’. Any surplus to this amount that an account holder has in his or her

[38] At p8: ‘‘A financial safety net typically consists of prudential regulation and supervision, an emergency lender of last resort, problem bank insolvency frameworks and deposit insurance’’.

[39] on 11 March 2011. See the statement from the New Zealand Finance Minister available at: http://www.beehive.govt.nz/release/maintaining-confidence-financial-system.

[40] *Ibid* n13.

[41] Hereafter the Reserve Bank.

[42] Available at: http://www.rbnz.govt.nz/regulation_and_supervision/banks/banking_supervision_handbook/5341478.pdf.

account is then subjected to a "partial freeze". This is effectively a suspension by the bank of its obligation to pay the sum in excess of the *de minimis* amount to the deposit holder. It is anticipated that the unfrozen funds will be guaranteed by the New Zealand government. Any non pre-positioned liabilities will be automatically frozen.

Although it is envisaged that the frozen funds will be gradually released to account holders if it becomes clear that they are not needed to cover losses, potentially, they may never be. At first blush, this looks remarkably similar to the Cypriot deposit levy. But it may, in fact, prove to be closer to the deposit insurance model. Clause 11(8) of the Policy makes it clear that a customer with a balance up to or below the specified *de minimis* is exempt from the partial freeze. This means that if, for example, the *de minimis* were to be set at the NZ$ equivalent of €100,000, then New Zealand depositors would be no worse off than depositors in the EU.

The approach taken by the OBR policy appears to be one where you work from the "bottom up" as opposed to the "top down" approach of the limit set in the 2009 DGSD. This is meant in the sense that, presumably, the lowest possible figure for the *de minimis* amount will be set under the OBR in order to minimise the New Zealand government guarantee obligation in respect of the unfrozen funds and so minimise the cost to tax payers. This contrasts with the DGSD approach, where a relatively high limit is set above which deposits will not be protected. This would suggest that depositors in New Zealand will be more likely to lose something on a bank insolvency under OBR than depositors in the EU would be under the DGSD. The corollary is, of course, that the New Zealand government would, presumably be better off than the governments of the EU Member States and would know that it could afford the guarantee that it gave.

It is worth exploring how OBR might be compared with the Cypriot levy on deposits. The Cypriot proposal indicated that depositors in Cyprus with less than €20,000 were to be exempt from the levy. It is possible to envisage a situation where there may prove to be little difference between the level of protection given to New Zealand depositors under OBR and the level of protection available to Cypriot depositors under the levy. This would always depend, however, upon the OBR *de minimis* level and the ultimate losses of the failing New Zealand bank that creditors would have to absorb.

What is clear, however, is that the OBR is a fairer system than the Cypriot levy for the following reason. The New Zealand government has made a series of public statements over the last two years explaining that it was going to close down its deposit guarantee scheme and indicating how it was going to replace it. Statements have been made which explain how OBR works. Even if depositors don't like it, at least they have been told about it. This enables them to take an informed decision as to whether to bank with a New Zealand bank or not. In contrast with the OBR regime in New Zealand, the Cypriot levy was sprung on depositors in a situation where a deposit guarantee system was already in place. Depositors thought that they already understood the level of risk to their deposits. They had no prior warning of the new system and had not had the opportunity actively to determine whether to deposit money with the Cypriot banks in the light of what was, effectively, an increased level of risk.

Despite this, there is a flaw in the OBR system as has been identified in the June 2013 Organisation for Economic Co-operation and Development's[43] Economic Survey of New Zealand. These points out that OBR on its own "may not be enough to

[43] Hereafter OECD.

prevent bank runs in all circumstances, as once OBR is applied to one bank, depositors may fear contagion to the others".[44] One of the OECD's key recommendations was to introduce permanent deposit insurance to reduce this risk. The OECD also considered that a degree of moral hazard already existed, since New Zealand had introduced a deposit insurance scheme as matter of urgency during the financial crisis in 2008.

Although the description of OBR as an option which enables losses to be allocated to creditors of a failed bank may make the blood of depositors run cold, it may prove to be less Draconian an idea than it first appears. It is unlikely that the *de minimis* threshold will ever be as high as the DGSD limit, but the idea of trying to make an accurate assessment of the level of cover to be provided by the New Zealand government is, we believe, consistent with IADI Core Principle 9.[45] It is also possible that, in the event of a bank collapse, the New Zealand government will set an OBR *de minimis* level that is sufficiently high to give the public confidence in the system and so prevent a bank run.

What is important to note is that the Head of Prudential Supervision at the Reserve Bank has stated publicly that, with regard to deposit insurance and OBR "It is not a case of choosing between one or the other – they have different objectives and can work alongside one another if need be".[46]

THE APPROACH TO THE PROTECTION OF DEPOSITORS POST-CRISIS: FUNDING AND COVERAGE

In this section we unavoidably cover some ground that has already been the subject of much attention. We think that this is necessary in order to bring together a number of important issues, particularly but not exclusively, because of the crises in Cyprus, Iceland, Greece and elsewhere.

One of the immediate effects of the financial crisis of 2007 and beyond was to prompt the governments of many countries around the world to issue a blanket state guarantee of all bank deposits in their jurisdictions[47]. It is significant that blanket state guarantees were given by a number of countries where a deposit insurance scheme was already in place suggesting that, in these countries, depositors did not feel adequately protected by existing schemes. Gradually, the blanket guarantees were withdrawn and most were replaced by new or enhanced deposit insurance schemes, almost invariably with the level of cover having been increased from the pre-crisis level.

Some countries had what is referred to as "co-insurance" as a feature of their deposit insurance schemes and this proved problematic. One notable example was the scheme in the United Kingdom[48] which only provided total protection up to the relatively low limit of £2,000. Deposits above that amount received 90% protection up to a ceiling of £35,000 and deposits above £35,000 were not protected at all. During the Northern Rock crisis depositors with the bank clearly demonstrated their combined dislike and

[44] OECD Economic Surveys New Zealand June 2013 Overview p16.

[45] Discussed above.

[46] "Handling banking failures": A speech delivered to the Institute of Directors in Wellington on 11 April 2013 by Toby Fiennes, Reserve Bank of New Zealand Head of Prudential Supervision, available at: http://www.rbnz.govt.nz/research_and_publications/speeches/.

[47] This had happened in previous crises so was not very surprising. It explains why guidance from both the International Monetary Fund and IADI had sections on removing a blanket guarantee. See, for example, GGH Garcia, "On Instituting and Removing a Full 'Blanket' Guarantee" *Deposit Insurance: Actual and Good Practice* Occasional Paper 197 (International Monetary Fund, Washington, D.C., 2000) pp. 44 -54.

[48] Hereafter UK.

lack of understanding of co-insurance.[49] The 1994 DGSD was subsequently amended so that co-insurance is no longer permitted within the EU.[50] Depositors made it clear by their actions that they expected deposits in a bank, at least up to a reasonable amount, to be totally safe. A large percentage of Northern Rock depositors had balances in excess of £2,000 and the run which took place actually increased in intensity once the details of the UK's Financial Services Compensation Scheme[51] became known.[52] The public perception was clearly that the level of protection provided was insufficient.[53]

From the EU perspective, it became clear that although all Member States had deposit guarantee schemes in place,[54] a number of countries would have encountered serious problems in meeting claims from depositors of failed banks. Iceland, although not an EU Member State, provided a classic example of a country whose banking sector had become so huge that a bank failure would essentially "bankrupt" the country. The situation that developed more recently in Cyprus was very similar in many respects, although in other respects it was different. It is apparent that its deposit-taking banking sector had grown too quickly and had become far too large in relation to the size of the country's economy but one of its major problems came from the fact that it had invested in Greek government bonds. Although investments in government bonds were generally seen as the right type of investment for EU governments to have been making, the choice of government and country turned out to be wrong: as it transpired, Greece was not the safest place to invest depositors' funds.

Although the latter part of the crisis saw many deposit insurance schemes revisited and changes made, the changes tended to relate to the amount of cover, the speed of payout and, in the EU, the removal of co-insurance. A number of questions have not been addressed, however, including questions as to the appropriate level of cover offered under the guarantee and the extent to which governments can actually afford to fund the schemes at all. IADI has played a key role in influencing the changes to date.

The Role of IADI[55]

Since its inception, IADI has undertaken much research into all aspects of deposit insurance and has published a significant amount of material to assist with the operational effectiveness of deposit insurance systems.[56] Perhaps the most significant achievement has been the publication of the Core Principles (referred to above) in June 2009, in conjunction with the BCBS. The Executive Summary to the Core Principles recognises that deposit insurance is only part of the toolkit to be used in financial

[49] For more on this see: House of Commons Treasury Committee, *Fifth Report of Session 2007–08 The Run on the Rock* (January 26,2008) at p 89; Financial Services Authority, *The Turner Review: A Regulatory Response to the global banking crisis* (March 2009) at p74 (http://www.fsa.gov.uk/pubs/other/turner_review.pdf).

[50] Directive 2009/19/EC L 68/3.

[51] Hereafter FSCS.

[52] Prior to the Northern Rock crisis depositors in the UK appear to have given virtually no thought to the safety of deposits in UK banks and building societies.

[53] The depositors of Northern Rock were not only unhappy about the low ceiling at which full protection was provided and the existence of co-insurance, but also with the potential delay in receiving compensation.

[54] As required by the relevant Directive.

[55] IADI was established in 2002 "to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation" (see www.iadi.org). IADI has developed significantly and now has 69 member countries and nine associate members. Associate Members are entities that do not fulfil all of the criteria to be a Member, but are considering the establishment of a deposit insurance system, or are part of a financial safety net and have a direct interest in the effectiveness of a deposit insurance system.

[56] See www.iadi.org/Publications.aspx.

crises, noting that "a deposit insurance system is not intended to deal, by itself, with systemically significant bank failures or a 'systemic crisis'".[57] In such situations the safety-net members will need to work together.

The Executive Summary also recognises that the introduction of a system of deposit insurance is most likely to be successful when certain preconditions exist.[58] Four are listed as being necessary for the introduction of an effective deposit insurance system:

- An ongoing assessment of the economy and the banking system;
- Sound governance of agencies comprising the financial system safety net;
- Strong prudential regulation and supervision; and
- A well developed legal framework and accounting and disclosure regime.[59]

There is little doubt that these are sensible preconditions and it would be extremely risky and costly to the public purse to introduce deposit insurance in a country which does not satisfy these criteria. In reality, however, new systems are more likely to be introduced, or changes made to existing schemes, in the immediate aftermath of a banking crisis (as has happened in the last few years) regardless of the preconditions and often these preconditions will not be met.

A Reflection on Some of the Core Principles

IADI and BCBS identified eighteen Core Principles. It is beyond the scope of this paper to examine the Core Principles in detail, so we have concentrated on the five which are most relevant to this article.[60]

Core Principle 8

Principle 8 considers the issue of Compulsory Membership. It provides that "Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection".

It is clear from this that the focus of the protection is on the individual customer: it is about protecting the average depositor. It is not beyond the bounds of possibility to think that a failure to protect individual depositors could lead to real human suffering and, or potential political unrest, so the importance of this protection should not be underestimated.

Core Principles 9 and 10

Principles 9 and 10 address the amount of cover to be provided and the question of blanket guarantees. Principle 9 provides that "Policymakers should define clearly in law, prudential regulations or bye laws what an insurable deposit is. The level of coverage should be limited and be credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features".

It is worth noting that this Principle does not attempt to define exactly what types of event are covered.

[57] *Core Principles* Executive Summary Page 1.

[58] *Ibid* para 4.

[59] *Ibid* para 7.

[60] However, we do not wish to give the impression that the other Core Principles are less important.

Principle 10 is concerned with the transition from a blanket guarantee to a limited coverage deposit insurance system; a topic which has been very much to the forefront in the last few years. It provides that

> When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as the country's circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably [an increase in] moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.

While this approach is a sensible one, it raises the potential problem of actually managing to convince the public that their protection is now limited. Empirical research undertaken by one of the authors has demonstrated that a large percentage of bank depositors in the UK do not believe that protection would actually be limited in a crisis. [61] When the Northern Rock crisis took place the then Chancellor of the Exchequer's knee-jerk reaction was to provide a blanket guarantee. It is unlikely that this has been forgotten.

Of course, the current level of protection is so much higher than it was in September 2007 that very few depositors are likely to have deposits beyond the level of protection now guaranteed. Those who have savings above the protected limit will generally have sufficient financial acumen to be aware of the need to ensure protection and, therefore, take action to ensure that savings are spread around different institutions to ensure that all of their savings remain fully covered.

Principle 9 refers to cover being "limited but credible". But what does this actually mean? Immediately following the onset of the financial crisis we witnessed blanket guarantees of all deposits being rapidly introduced. After things had appeared to settle down the trend was to increase the level of cover. In the US this went up to $250,000 and in 2009, the EU limit was increased to €100,000, or in the case of the UK £85,000.

Consistent with Principle 10, the Financial Stability Board recommends that its members should review their level of cover "to ensure that it strikes an appropriate balance between depositor protection and market discipline and that it promotes financial stability".[62] Where jurisdictions have high levels of protection in place, they should have other measures in place to mitigate moral hazard. Specifically, it recommends that unlimited protection (i.e. blanket guarantees) should be avoided for this reason.

It is the authors' view that the current EU limit is higher than is strictly necessary. It would be interesting to know what is the average amount of money held in protected accounts across the EU in order to make a realistic assessment; something that is beyond the scope of this article to determine.

Core Principle 11

Principle 11 is concerned with the funding of schemes. This subject has proved to be problematic both during the crisis and in the post-crisis period. Principle 11 deliberately avoids being prescriptive, but in the supporting guidance it is noted that "sound funding arrangements are critical to the effectiveness of a deposit insurance system"

[61] Campbell carried out random questioning about this in the UK during the period 2008 to March 2011. The respondents were mostly professional people who were still in employment but some were retirees.

[62] Financial Stability Board *Thematic Review on Deposit Insurance Systems – Peer Review Report* p6 (8 February 2012) available at http://www.financialstabilityboard.org/publications/r_120208.pdf.

and it is difficult to avoid drawing the conclusion that upfront funding[63] must be the preferred system as this ensures that those banks which fail will have contributed towards the cost of compensation payments. In the absence of upfront funding it is likely that, as in the UK, it will be necessary to borrow money from HM Treasury or an equivalent body. The problem with requests for such funding is that, realistically, they are likely to come at a time where there are many other calls for financial assistance. Accordingly, although the Core Principles do not advocate a particular system, the majority of countries now use systems which collect upfront payments.

It is the authors' view that the affordability of the current systems remains an issue that has not properly been addressed.

Core Principle 12

Principle 12 addresses the issue of public awareness. In many countries there was virtually no public awareness of the deposit insurance arrangements until the financial crisis hit. This was certainly true at the time of the failure of Northern Rock in the UK. Principle 12 states that "In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the limitations of the deposit insurance system".

Nout Wellink, Chairman of the BCBS and Governor of De Nederlandsche Bank, has made the point that "one of the lessons of the financial crisis is that deposit insurance is instrumental in recovering and maintaining financial stability"[64] and the reason for this is that it provides confidence to depositors and will have an effect on their behaviour by removing the need to rush to withdraw their deposits at the first sign of trouble. Of course, this will only work where there is an appropriately designed deposit insurance scheme in place and a public awareness of the scheme together with a general acceptance that it is well designed and meets the needs of most depositors. As has been seen, the run on Northern Rock in the UK, provided the clearest possible demonstration of what is likely to happen when the public perception is that a scheme is flawed.

In the US, as previously discussed, awareness of the level of protection provided by the FDIC scheme has always been high since it was introduced in 1933. This was certainly not the case within the EU, although things have improved considerably since Northern Rock collapsed. The deposit insurance agencies in many countries have been doing much to raise awareness of what protection is actually provided and IADI has been particularly important in assisting them to do this.[65] It seems likely that the Cypriot proposals for a levy on deposits will have caused damage in this respect as it may now be the case that depositors have lost confidence in the level of cover they actually have.

What Type Of Product Is Protected?

The question of public awareness also raises the issue of what exactly is, or should, be protected. What is a deposit for the purposes of protection? Recent problems at the Co-operative Bank in the UK have highlighted this issue. Some customers, whose

[63] Frequently referred to as "ex-ante".

[64] Address by Mr Wellink at the joint Conference of the Financial Stability Institute/International Association of Deposit Insurers/Basel Committee on Banking Supervision, Basel, 23/9/09.

[65] For example, the Financial Services Compensation Scheme in the UK ran a series of television advertisements to raise awareness.

products are considered to be a form of bond and not a deposit, are not covered by the UK's FSCS and are being subjected to bail-in.[66]

As members of the depositing public will not generally understand the difference between what is described as a "bond" rather than as a "deposit", it becomes vital that it is made clear which products are protected and which are not. It will often be the case that some products described as bonds will actually be deposits and this can cause further confusion. It is therefore important that all deposit-taking institutions make it clear to customers who are depositing money whether or not the type of product is classified as a deposit for compensation purposes as recommended by Core Principle 9.[67]

CAN WE ACTUALLY AFFORD OUR DEPOSIT PROTECTION SYSTEMS?

As has been discussed, the Cypriot proposal for a levy on deposits was made in the context of a country in a state of financial crisis. Cyprus had to demonstrate that it was trying to put its finances in order before it could receive bail-out funds from the EU and the levy was one of a number of mechanisms proposed to help to achieve this. But this leads to another important question, raised by Professor George Kaufman: what happens when a country which provides cover under a deposit guarantee scheme is not itself in a sufficiently stable financial position to be able to meet any claims it may face under the scheme?[68] While it is one thing to pass a law saying that something is protected it is another to be able actually to provide that protection if required to do so. There seems little doubt that in the EU the increased level of cover under the 2009 DGSD was introduced without any serious consideration having been given to the affordability issue despite the example of Iceland, which had, effectively, become bankrupt when its banks failed.

There are now proposals at an EU level for a pan-European deposit guarantee scheme which would be funded by a levy on the banks in each country and operated by the European Central Bank in Frankfurt. These proposals are not currently going anywhere too quickly but, if such a scheme were to be introduced, it would assist in dealing with the strong country-weak country issue. Within the EU it is widely believed (probably correctly) that a number of southern Member States have very weak financial positions and would not be able to meet demands by depositors should a significant bank fail. However, it is not only in southern Europe that there are potential problems. In September 2007, the UK Chancellor of the Exchequer, Alistair Darling, effectively guaranteed all the deposits in the UK banking system. It is far from clear whether this was something the UK government could actually afford to do. Could the UK authorities actually meet their obligations at the current level of cover under the DGSD? There is no fund in place and the money would have to be borrowed from HM Treasury. The current patchwork of depositor protection schemes across Europe today resembles the position of the individual US states in the late nineteenth century: only when the might of the Federal Reserve Banks was put behind the FDIC scheme was

[66] At the time of writing it is far from clear exactly what will happen to these Co-operative Bank customers. There is the possibility that some of these customers, who could stand to lose as much as 40% of their savings, may claim to have been misled by the Co-operative Bank's staff about what exactly they were investing in. The term used in the United States and some other countries is 'haircut' which arguably provides a better description of what is actually happening.

[67] This has also been a problem in many other countries, including the US.

[68] This is a question that was raised in conversation between Professor Andrew Campbell and Professor George Kaufman of Loyola University, Chicago at the Second Research Conference of IADI in Basel, Switzerland in March 2013.

a sufficient level of confidence achieved. This makes the proposals for the pan-European scheme look eminently sensible.

CONCLUDING THOUGHTS

This article has sought to identify a number of questions about depositor protection which require clarification. First, on the basis of what has been discussed, is it reasonable, or indeed rational, to believe that bank deposits up to the insured limits are actually fully protected from all possible events? The move towards bank bail-in and OBR might suggest that the DGSD guarantee will be ineffective in a situation where a bank does not actually fail (as was the case in Cyprus): if the bank does not default, can the guarantee actually be called? What are the circumstances in which depositors will be protected? Should deposits in fact be protected against all eventualities or are there some situations where it might be deemed reasonable *not* to protect them?

This leads to the second question: is there a legal distinction between a deposit insurance scheme and a deposit guarantee scheme which may have an impact on outcomes for depositors? This may just be a question of semantics, with everyone believing that the terms have the same legal and commercial effect, but it is a question that does not appear to have been considered.

These questions need answers from policy makers so that depositors know where they stand. The "Cyprus problem" has not actually gone away. While the proposal to "tax" insured deposits did not go ahead, there has been no indication from the relevant authorities that this could not happen in the future. The proposed Cyprus tax was set at the relatively low level of 6.75% but there is nothing to suggest that a future "tax" could not be set at a significantly higher level. Many depositors in the UK and elsewhere in the EU have expressed concern about whether this could happen to them

A further question remains as to the funding of schemes. The European situation suggests that very few country schemes in the EU have sufficient funds to be able to deal with a sizeable bank failure. In fact, many country schemes are not funded ex-ante and that is perhaps another problem which needs to be addressed. Is it right for law makers to set cover at unrealistically high levels? The level of cover was raised significantly in the EU, the US and in other jurisdictions during the post crisis period seemingly without consideration being paid to whether or not the countries in question would ever be able to provide the promised level of compensation to depositors. It may be that the approach taken in New Zealand in determining the *de minimis* amount for the purposes of OBR has some merit if it means that the government is not guaranteeing unrealistically large sums.

The pan-European scheme may provide an answer to the question of affordability if it is subsidised by bank levy. Care would have to be taken to ensure that the knowledge that the system's ultimate backer was the ECB did not, of itself lead to moral hazard. This option is not likely to arise soon as it is unclear whether there is consensus across the Member States.

The OBR policy, which allows depositors' money above a *de minimis* threshold to be set against bank losses, lacks appeal as it smacks of co-insurance. Sir Mervyn King, the former Governor of the Bank of England, recently revealed that during discussions about deposit insurance after the collapse of Bank of Credit and Commerce International in 1991, he supported the idea of providing 100% protection up to a particular limit.[69] However, at that time the majority view was that there should be an element of co-insurance applied to all bank deposits to ensure that all depositors were aware that they would share the loss should their bank fail. The former Governor's view ultimately prevailed after the Northern Rock crisis and the overwhelmingly prevailing view now is that at least a certain level of deposit should have total protection.[70]

But in its practical application, OBR may lead to outcomes which are little different from the application of, for example, the DGSD. Quite how different will depend upon the level of the *de minimis* threshold and the extent of the losses incurred by the failing bank. It could be argued that there is a greater degree of honesty, or perhaps reality, attached to the OBR: it is upfront about the fact that, if the bank fails, you won't get all your money back and it tries to preserve government funds for the tax payer. But it lacks the certainty associated with the DGSD: the DGSD limit makes explicit the scope of the protection afforded to depositors. The OBR does not do this and it is this lack of certainty that could lead to a bank run and potential contagion. In the light of the OECD comments, however, it may be the case that, were a financial crisis to arise, the *de minimis* amount would be set very high to prevent such a bank run. If this were to happen, then it would be difficult to see that the OBR posed any serious disadvantages for New Zealand depositors.

Both the EU Member States and New Zealand government have sought to publicise the level of depositor protection available under the DGSD and the OBR respectively. Such awareness-raising is consistent with Core Principle 12 and serves to distinguish these regimes from the Cypriot bank levy. As has been previously discussed, the outcomes for depositors under the Cypriot bank levy could prove to be no worse than those under, say the OBR regime, but the difference is that the depositors were not given the choice about where to put their deposits in the light of the risk.

The use of formal, explicit deposit insurance schemes which provide full protection up to a particular amount has clearly been the most favoured approach in the wake of the financial crisis and this, despite the approach taken by New Zealand, seems likely to continue to be the case.

The authors conclude that there is an urgent need for both IADI and EFDI to consider these questions and to make policy recommendations. Further, individual Member States within the EU as well as the European Commission will need to determine their stance on these matters so that the EU's position can be agreed by the European Council and Parliament. It is crucial that the depositing public know what protections they are entitled to, both as part of the mechanism of maintaining financial stability and in order to ensure the successful operation of deposit guarantee systems within the EU in the future.

[69] *Financial Times* 15/16 June 2013.

[70] The FDIC in the US had never used co-insurance and provided 100% protection up to a particular amount. Initially the EU Directive on Deposit Guarantees permitted Member States to use co-insurance if they wished, but post Northern Rock this has been removed and all Member States must provide 100% protection up to 100,000 euros.

CREDIT WHERE CREDIT IS DUE: THE EFFECT OF DEVOLUTION ON INSOLVENCY LAW IN SCOTLAND

*DONNA MCKENZIE SKENE**

INTRODUCTION

The Scotland Act 1998 reserved some aspects of insolvency law to the United Kingdom parliament and devolved others to the Scottish parliament.[1] The period since the Scottish parliament's establishment has been characterised by rising debt, particularly consumer debt, and a severe financial crisis and recession resulting in increased financial difficulties for both consumers and businesses.[2] The total number of personal insolvencies, including sequestrations, protected trust deeds (PTDs) and, since their introduction in 2004, debt payment programmes (DPPs), has increased steadily;[3] the total number of corporate insolvencies, namely compulsory and creditors' voluntary liquidations, receiverships, administrations and company voluntary arrangements under Part 1 of the Insolvency Act 1986, has fluctuated but the general trend has also been upwards.[4]

It is not therefore surprising that the Scottish parliament has already paid considerable attention to, *inter alia*, the devolved aspects of insolvency law and is about to legislate further. This article examines the effect of devolution on insolvency law in Scotland. It begins with a discussion of the reserved/devolved split in relation to insolvency law, provides an overview and assessment of the legislation already passed by the Scottish parliament and that in prospect and concludes with an overall assessment.

RESERVED AND DEVOLVED ASPECTS OF INSOLVENCY LAW

The Scotland Act 1998 specifically reserved to the United Kingdom parliament most aspects of corporate insolvency law and some aspects of non-corporate insolvency (bankruptcy) law.[5] All non-reserved aspects are devolved. In broad terms, this means

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[1] See further below.

[2] See, e.g., *A Better Deal for Consumers* (2009) (Cm 7669), at paragraph 1.1.

[3] See statistics published by the Accountant in Bankruptcy, available at: http://www.aib.gov.uk (last accessed 5 July 2013). The relative numbers of each procedure have fluctuated over time, some of these fluctuations being attributable to changes brought about by various pieces of legislation enacted by the Scottish Parliament as discussed further below.

[4] See statistics published by the Insolvency Service, available at: http://www.insolvency.gov.uk/otherinformation/statistics/insolv.htm (last accessed 5 July 2013). Again, the relative numbers of each procedure have fluctuated over time, some of these fluctuations being attributable to the changes brought about by the Enterprise Act 2002. It should be noted that the information recorded in respect of compulsory liquidations has changed from financial year 2009–10: the figures for compulsory liquidations are not therefore directly comparable with previous years.

[5] Scotland Act 1998, Schedule 5, Part II, Section C2. Subject to specified exceptions, this encompasses the following: (1) in relation to business associations (a) the modes of, the grounds for and the general legal effect of winding up, and the persons who may initiate winding up, (b) liability to contribute to assets on winding up, (c) powers of courts in relation to proceedings for winding up, other than the power to sist proceedings, (d) arrangements with creditors, and (v) procedures giving protection from creditors; (2) preferred or preferential debts for the purposes of the Bankruptcy (Scotland) Act 1985, the Insolvency Act 1986, and any other enactment relating to the sequestration of the estate of any person or to the winding up of business associations, the preference of such debts against other such debts and the extent of their preference over other types of debt; (3) regulation of insolvency practitioners and (4) co-operation of insolvency courts. The specified exceptions are: (1) in relation to business associations (a) the process of winding up, including the person having responsibility for the conduct of a winding up or any part of it, and his conduct of it or of that part, (b)

the process of winding up and the effect of winding up on diligence and prior transactions generally; certain additional aspects of the winding up of registered social landlords; receivership (with the exception of preferential debts, regulation of insolvency practitioners and co-operation of courts); and bankruptcy law (also with the exception of preferred debts, regulation of insolvency practitioners and co-operation of courts). These areas reflect the areas of insolvency law which have traditionally been distinctively Scottish.

The reserved/devolved split has, however, given rise to difficulties, most notably with regard to the reform of corporate insolvency law. Since devolution, the United Kingdom parliament has legislated extensively on corporate insolvency. Most of that legislation has related to reserved matters and applied equally to Scotland, but the Enterprise Act 2002 (EA 2002), for example, included reforms to receivership which, as noted, is largely devolved. The Scottish parliament had the option of passing separate legislation implementing the relevant reforms in Scotland, consenting to the inclusion of provisions implementing the relevant reforms in Scotland in the EA 2002 or deciding that it did not want these reforms in Scotland and therefore refusing to do either of these things. Since the receivership reforms were part of an integrated package of corporate insolvency reforms, however, such a refusal could have caused a constitutional crisis - the United Kingdom parliament would have had to decide whether to ignore the constitutional convention of not legislating on devolved matters without the Scottish parliament's consent in order to implement the reforms in their entirety. Fortunately, this did not happen: the Scottish parliament was agreeable to the relevant reforms and passed an appropriate Sewel motion.[6] Similar issues may, however, arise in future. For example, the government recently proposed to introduce new statutory provisions regulating pre-pack sales in administration and liquidation.[7] Since administration is reserved, the relevant legislation relating to administration would have fallen to be made by the United Kingdom parliament for both England and Wales and Scotland. Since this aspect of liquidation is devolved, however, in

the effect of winding up on diligence, and (c) avoidance and adjustment of prior transactions on winding up; (2) in relation to business associations which are social landlords, the following additional exceptions, namely (a) the general legal effect of winding up, (b) procedures for the initiation of winding up, (c) powers of courts in relation to proceedings for winding up, and (d) procedures giving protection from creditors, but only in so far as they relate to a moratorium on the disposal of property held by a social landlord and the management and disposal of such property; and (3) floating charges and receivers, other than in relation to preferential debts, regulation of insolvency practitioners and co-operation of insolvency courts. For this purpose, "business association" has the same meaning as in the Scotland Act 1998, Schedule 5, Part II, Head C, Section C1, but does not include any person whose estate may be sequestrated under the Bankruptcy (Scotland) Act 1985 or any public body established by or under an enactment; "social landlord" means a body which is (a) a society registered under the Industrial and Provident Societies Act 1965 which has its registered office for the purposes of that Act in Scotland and satisfies the relevant conditions or (b) a company registered under the Companies Act 1985 which has its registered office for the purposes of that Act in Scotland and satisfies the relevant conditions, the "relevant conditions" being that the body does not trade for profit and is established for the purpose of, or has among its objects and powers, the provision, construction, improvement or management of (a) houses to be kept available for letting (b) houses for occupation by members of the body, where the rules of the body restrict membership to persons entitled or prospectively entitled (as tenants or otherwise) to occupy a house provided or managed by the body or (c) hostels, "house" and "hostel" having the meanings given in section 338(1) of the Housing (Scotland) Act 1987; and "winding up", in relation to business associations, includes winding up of solvent, as well as insolvent, business associations. Scotland Act 1998, Schedule 5, Part II, Head C, Section C1 provides that "business association" means any person (other than an individual) established for the purpose of carrying on any kind of business, whether or not for profit; and "business" includes the provision of benefits to the members of an association.

6 The use of Sewel motions raises another issue, however: the United Kingdom legislation to which consent is to be given does not always receive the same scrutiny by the Scottish parliament that its own legislation would receive, which is a general weakness in that procedure. This is discussed further below.

7 See Insolvency Service, *Consultation/Call for Evidence: Improving the Transparency of, and Confidence in, Pre-Packaged Sales in Administration* (March 2010); Insolvency Service, *Improving the Transparency of, and Confidence in, Pre-Packaged Sales in Administration: Summary of Consultation Responses* (March 2011); Ministerial Statement by Edward Davey (31 March 2011); Insolvency Service, *Letter to Consultees* (31 March 2011); and Ministerial Statement by Edward Davey (26 January 2012), available at: http://www.bis.gov.uk/insolvency/Consultations/PrePack?cat=closedwithresponse (last accessed 5 July 2013). The Insolvency Service had also published draft Insolvency (Amendment) Rules (No 2) 2011 for comment in June 2011.

relation to liquidation, separate legislation made by the Scottish parliament or its consent to the inclusion of the relevant provisions in the legislation made by the United Kingdom parliament would have been required. The government subsequently decided not to proceed with these proposals, but a review of pre-packs is now in prospect[8] and further legislation remains a possibility.

Less amenable to resolution have been issues resulting from the programme of general updating and modernisation of insolvency legislation implemented by the United Kingdom parliament since devolution. These were encapsulated in submissions made to the Commission on Scottish Devolution (Calman Commission) by the Institute of Chartered Accountants for Scotland (ICAS), which submitted that the law relating to corporate insolvency so far as devolved had not kept abreast of changes in England and Wales, thereby creating difficulties for insolvency practitioners.[9] This is possible because changes in reserved areas fall within the remit of the United Kingdom Insolvency Service (IS), with the relevant legislation made by the United Kingdom parliament, whereas changes in devolved areas fall within the remit of the Accountant in Bankruptcy (AIB), with the relevant legislation made by the Scottish parliament. While the Scottish parliament has legislated extensively on the devolved aspects of bankruptcy, however, it has legislated little on the devolved aspects of corporate insolvency.[10] Thus corporate insolvency law so far as devolved has fallen behind the changes to both the corresponding provisions in England and Wales and the reserved areas in both jurisdictions where reform has been implemented by the United Kingdom parliament.[11]

ICAS also submitted to the Calman Commission that the expertise necessary to ensure appropriate changes were made in devolved areas was lacking, and proposed that the whole of corporate insolvency law should be (re)reserved.[12] The Calman Commission sought further evidence[13] and, having received it, concluded that devolution had "produced an unsatisfactory state of affairs relating to corporate insolvency": there was an absence of clarity as to where responsibility lay for drawing up the relevant insolvency rules; there were unnecessary and confusing divergences between the rules applying in England and Scotland; and there had been unnecessary and damaging delays in introducing new rules in Scotland.[14] It considered, however, that matters could be resolved without altering the reserved/devolved boundary if the IS, with appropriate input from the relevant Scottish government department(s), was

[8] See Insolvency Service, News Release (12 March 2013) at: http://www.bis.gov.uk/insolvency/news/news-stories/2013/Mar/PrePackStatement (last accessed 5 July 2013).

[9] Commission on Scottish Devolution, *The Future of Scottish Devolution within the Union: A First Report* (December 2008), at paragraph 5.48.

[10] See further below.

[11] The main pieces of modernising legislation comprise: the Legislative Reform (Insolvency) (Advertising Requirements) Order 2009, SI 2009/864, which made changes to the advertising requirements in voluntary liquidations which apply in England and Wales only as the relevant provisions in Scotland are devolved; the Insolvency (Amendment) Rules 2009, SI 2009/642, which made changes to the rules on publication or advertisement of notices in all insolvency procedures in England and Wales only; the Legislative Reform (Insolvency) (Miscellaneous Provisions) Order 2010, SI 2010/18, which made a number of other changes to the provisions relating to voluntary liquidations which apply in England and Wales only as the relevant provisions in Scotland are devolved, as well as wider changes to all insolvency procedures which in Scotland apply to those corporate insolvency procedures which are reserved only; the Insolvency (Amendment) Rules 2010, SI 2010/686, as amended by Insolvency (Amendment) (No 2) Rules 2010, SI 2010/734, which create a completely new set of insolvency rules for England and Wales covering all corporate insolvency procedures; the Insolvency (Scotland) Amendment Rules 2010, SI 2010/688, which made relevant corresponding changes to the insolvency rules in Scotland for those corporate insolvency procedures which are reserved only. While most of these pieces of legislation post-date the submissions to the Calman Commission, they were in prospect at the time.

[12] Commission on Scottish Devolution, *The Future of Scottish Devolution within the Union: A First Report* (December 2008), at paragraph 5.48.

[13] *Ibid* at paragraphs 5.48, 5.49 and 5.52.

[14] Commission on Scottish Devolution, *The Future of Scottish Devolution within the Union: Final Report* (June 2009), at paragraph 5.275.

made responsible for laying down the relevant rules in both jurisdictions, and that this could be achieved by United Kingdom legislation to which the Scottish parliament could consent, and it recommended accordingly.[15]

The United Kingdom government accepted the need for change,[16] but there were concerns. For example, the then chairman of the Scottish Law Commission (SLC), Lord Drummond Young, commented that if it meant that all legislation bearing on (corporate) insolvency was to be reserved to Westminster under the control of the Department of Business Innovation and Skills (DBIS), of which the IS forms part, the result would be that the sensible reform of Scottish commercial law would become impossible.[17] His comment reflected his wider concerns over the perceived attitude of DBIS to reform of Scots law in reserved areas, but this may have been misplaced in this particular case: in practice, the IS has not been dilatory in matters of corporate insolvency reform in Scotland in reserved areas, at least where equivalent changes are also being made in England and Wales.

The bill which ultimately became the Scotland Act 2012 was introduced in the House of Commons on 30 November 2010 and contained provisions (re)reserving the devolved aspects of winding up and, so far as appropriate, updating and modernising them in line with the changes already made in winding up in England and Wales and in reserved areas in both jurisdictions.[18] Unsurprisingly, these were opposed in principle by the then minority SNP administration, which considered that the issues could be addressed by improved inter-governmental working.[19] The Scotland Bill committee established by the Scottish parliament in December 2010 to consider the bill was, however, content with them, subject to some concerns regarding the impact on registered social landlords.[20] It therefore recommended the Scottish parliament give legislative consent to the provisions, subject to amendments allowing devolved legislation on the winding-up of registered social landlords,[21] and the Scottish parliament subsequently passed a motion agreeing the bill be considered by the United Kingdom parliament, but inviting it and the United Kingdom government to consider the changes proposed in the Scotland Bill committee's report with a view to future debate in the Scottish parliament on a further legislative consent motion.[22]

Following the Scottish parliament elections in May 2011, however, the SNP minority administration became a majority administration. As a result, more extensive changes to the devolution settlement, and thus the Scotland Bill, were sought and a new Scotland Bill committee was established in June 2011. It took the view that it was not necessary to (re-)reserve the devolved aspects of corporate insolvency to the United Kingdom government and parliament in order to address the issues and improved inter-governmental working was preferable,[23] and it recommended that, as a matter of principle, no powers should be re-reserved and legislative consent should not be given to the provisions.[24] Discussions between the Scottish administration and the United

[15] *Ibid* at paragraph 5.277 and recommendation 5.23.

[16] See Scotland Office, *Scotland's Future in the United Kingdom: Building on Ten Years of Scottish Devolution* (Cm 7783), at paragraphs 5.33–5.35; HM Government, *Strengthening Scotland's Future* (Cm 7973), at 57–58.

[17] See Chairman's Foreword to Scottish Law Commission, *Annual Report 2009* (Scot Law Com No 221, 2009).

[18] Scotland Bill, clause 12 and Schedule 2.

[19] See Scotland Bill Committee, *Report on the Scotland Bill and Relative Legislative Consent Memoranda*, at paragraph 723.

[20] *Ibid* at paragraph 147.

[21] *Ibid* at paragraph 148. This recommendation was presented as a recommendation of the whole committee notwithstanding a minority dissent: see Scotland Bill Committee, above note 19, Annex A.

[22] Scottish Parliament, *Official Report*, column 34358 (10 March 2011).

[23] Scotland Bill Committee, *Report on the Scotland Bill, Volume 1*, at paragraph 74. Three members of the committee dissented from this view (footnote 74).

[24] *Ibid* recommendation 20. Three members of the committee dissented from this recommendation (footnote 12).

Kingdom government followed, as a result of which it was agreed, *inter alia*, that the provisions should be removed from the Scotland Bill.[25] They were duly removed at report stage in the House of Lords[26] and the Scottish parliament subsequently passed a motion agreeing the bill as amended be considered by the United Kingdom parliament.[27] The Scotland Bill as amended received Royal Assent on 1 May 2012. The original reserved/devolved split on corporate insolvency was therefore maintained.

The AIB has now established a working party to work on the updating and modernisation of the devolved aspects of corporate insolvency law and legislation including new corporate insolvency rules is planned for the autumn. The maintenance of the reserved/devolved split on corporate insolvency, however, means that this project remains far from unproblematic. For example, changes to the Insolvency Act 1986 to allow provisions in devolved areas which currently apply in England and Wales but not in Scotland to apply in Scotland will be required and will have to be made by the United Kingdom parliament, while the new rules will continue to have both reserved and devolved elements which means that they cannot be enacted in their entirety by the Scottish parliament.

Inevitably, lines must be drawn somewhere. It is critical, however, that the coherence and effectiveness of the law is maintained irrespective of the legislator. The issue therefore becomes how the interface between what is reserved and what is devolved can best be managed to achieve this, particularly where a single area of law such as insolvency law is partly reserved and partly devolved. This remains a crucial issue for the development of insolvency law, in particular corporate insolvency law, in Scotland.

THE SCOTTISH PARLIAMENT'S LEGISLATION ON INSOLVENCY

Introduction and Overview

As noted, the Scottish parliament has so far legislated extensively on the devolved aspects of bankruptcy, but little on the devolved aspects of corporate insolvency. The main focus of this section will therefore be its legislation on bankruptcy, in particular the Debt Arrangement and Attachment (Scotland) Act 2002 (DAA(S)A 2002), the Bankruptcy and Diligence etc. (Scotland) Act 2007 (BD(S)A 2007), the Home Owner and Debtor Protection (Scotland) Act 2010 (HODP(S)A 2010) and the most important related secondary legislation. Consideration will also be given to the further legislation now in prospect.

This legislation must be seen in its context as part of a wider body of legislation passed by the Scottish parliament relating to debt and enforcement generally which has brought about extensive and, for the most part, systematic reform of the wider law of diligence and aspects of debtor protection as well as reform of bankruptcy law as such. The first relevant piece of legislation was the Abolition of Poindings and Warrant Sales Act 2001 (APWSA 2001), which was introduced to the Scottish parliament less than three months after its establishment and ultimately brought about the abolition of what was seen as the outmoded diligence of poinding and warrant sale.[28] The DAA(S)A 2002 replaced that diligence with a modernised diligence in the form of attachment, and

[25] See the *Legislative Consent Memorandum* (21 March 2012), available at: www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/LCM_-_Scotland_Bill_-_Final.pdf (last accessed 5 July 2013) and Scotland Bill Committee, *Report on the Scottish Government's Legislative Consent Memorandum*, SP Paper 106, at paragraphs 1–5 and 11.

[26] See Hansard (HL), 28 March 2012, volume 736, column 1440.

[27] Scottish Parliament, *Official Report*, column 8137 (18 April 2012).

[28] The diligence used to attach moveable property of the debtor in the debtor's own possession.

also introduced the DAS. In the interim, the Mortgage Rights (Scotland) Act 2001 (MR(S)A 2001) had made provision for the suspension of enforcement of a standard security on application to the court and related provision for the protection of the debtor. The next and, for this purpose, most significant piece of legislation was the BD(S)A 2007, which made far-reaching changes to the law of diligence and floating charges as well as the law of bankruptcy. Finally, the HODP(S)A 2010 extended the protections given to debtors by the MR(S)A 2001 as well as making further changes to bankruptcy law. There has also been a considerable volume of related secondary legislation.

The Legislation on Bankruptcy

As noted, the DAA(S)A 2002 replaced the diligence of poinding and warrant sale with a modernised diligence in the form of attachment. The new provisions on attachment included an expanded list of items exempt from the diligence which reflected changes that had already been made to the list of items exempt from the old diligence of poinding by secondary legislation as an interim measure.[29] These exemptions also apply in sequestration.[30]

The DAA(S)A also introduced the DAS. Although not a new concept, previous proposals had remained unimplemented.[31] However, following the original lodging of the proposal for the Abolition of Poindings and Warrant Sales Bill (APWS Bill),[32] a reference was made to the SLC, which duly published a discussion paper followed by a report.[33] This recommended that consideration should be given to introducing debt arrangement schemes,[34] the form of which should be determined in consultation with debtor and creditor interests.[35] The report of a cross-party parliamentary working group established by the SE, Striking the balance - a new approach to debt management, also recommended the introduction of a statutory debt arrangement scheme.[36] Following consultation on the latter report, the SE announced it would implement the working group's approach and detailed proposals for a statutory debt arrangement scheme would be issued for consultation. These were subsequently set out as part of the SE's consultation paper on enforcement of civil obligations in Scotland.[37]

Before that consultation was completed, however, the Debt Arrangement and Attachment (Scotland) Bill (DAA(S) Bill) was introduced including provisions establishing the DAS. The reason given was the importance the SE attached to the DAS, which it wished to introduce as soon as possible.[38] The DAA(S) Bill therefore set out the framework and empowered the Scottish Ministers to make provision for the details

[29] See Debtors (Scotland) Act 1987 (Amendment) Regulations 2000, SSI 2000/189.

[30] See Bankruptcy (Scotland) Act 1985, section 33.

[31] A debt arrangements scheme was originally proposed by the Scottish Law Commission in its *Fourth Memorandum on Diligence: Debt Arrangement Schemes*, Scot Law Com Consultative Memorandum No 50 (1980) and recommended in its *Report on Diligence and Debtor Protection* (Scot Law Com 95, 1985).

[32] The original proposal was too narrow in scope to allow the introduction of the bill and the bill was introduced only after a second proposal was subsequently lodged: see Scottish Law Commission, *Report on Poinding and Warrant Sale* (Scot Law Com 177, 2000), at paragraph 1.2; *Stage 1 Report on the Abolition of Poindings and Warrant Sales Bill*, at paragraphs 1–2.

[33] Scottish Law Commission, *Poinding and Sale: Effective Enforcement and Debtor Protection* (Discussion Paper No 110, 1999); *Report on Poinding and Warrant Sale* (Scot Law Com 177, 2000).

[34] *Ibid* at paragraph 5.61.

[35] *Ibid.*

[36] See the Working Group Report, *A Replacement for Poinding and Warrant Sale, Striking the Balance: A New Approach to Debt Management* (July 2001), at paragraph 100.

[37] See Scottish Executive, *Enforcement of Civil Obligations in Scotland*, Part 4(D).

[38] SP Bill 52-PM, at paragraph 17.

by way of regulations to be prepared taking into account the consultation responses,[39] although this effectively rendered the consultation superfluous in relation to the framework and raised questions as to whether all the matters left to secondary legislation were properly so left.[40] The DAA(S)A 2002 provided for the DAS provisions to be brought into force on a date to be appointed, thus allowing time for the supporting regulations to be put in place. Following limited consultation on a draft, revised draft Debt Arrangement Scheme (Scotland) Regulations were laid before and approved by the Scottish Parliament, becoming the Debt Arrangement Scheme (Scotland) Regulations 2004.[41] The DAS came into force on 30 November 2004.[42] It has been subject to review and amendment on a number of occasions, most recently in July 2013.[43]

As noted, the BD(S)A 2007 made far-reaching changes to the law of bankruptcy. Consultation on these changes began in 2003 with a consultation paper Personal Bankruptcy Reform in Scotland: A Modern Approach,[44] which sought views on proposed reforms to bankruptcy in Scotland. It identified two "drivers for change":

1. the importance of having an integrated debt management framework within which the available debt management tools worked together to form a comprehensive package of solutions for debtors;[45] and
2. "developments", identified as the introduction of DAS and the need to consider its fit with sequestration;[46] the need to consider whether action was still required on certain issues raised in previous consultations;[47] and the changes to bankruptcy in England and Wales introduced by the EA 2002,[48] which included enabling debtors to obtain an automatic discharge after a maximum period of one year and the introduction of a bankruptcy restrictions regime.[49]

A further consultation paper and draft bill, Modernising bankruptcy and diligence in Scotland: Draft Bill and Consultation,[50] followed in 2004. A working group on debt relief was also established to consider further issues surrounding debtor access to sequestration and debtors with little or no assets or income. Its report was published in 2005 but not subject to formal consultation.[51]

[39] *Ibid.*

[40] See further below.

[41] SSI 2004/468. These were almost immediately amended by the Debt Arrangement Scheme (Scotland) Amendment Regulations 2004, SSI 2004/470.

[42] See the Debt Arrangement and Attachment (Scotland) Act 2002 (Commencement No. 2 and Revocation) Order 2004, SSI 2004/416, which revoked the earlier Debt Arrangement and Attachment (Scotland) Act 2002 (Commencement) Order 2004, SSI 2004/401, which contained an error.

[43] See further below.

[44] Scottish Executive, *Personal Bankruptcy Reform in Scotland: A Modern Approach* (November 2003), available at: http://www.scotland.gov.uk/Resource/Doc/1097/0030743.pdf (last accessed 5 July 2013).

[45] *Ibid* at paragraph 3.1.

[46] *Ibid* at paragraph 3.3.

[47] *Ibid* at paragraph 3.4.

[48] *Ibid* at paragraph 3.5.

[49] For the history of the changes to bankruptcy law in England and Wales, see Insolvency Service, *Bankruptcy - A Fresh Start* (2000); *Productivity and Enterprise: Insolvency - A Second Chance* (2001) (Cm 5234); *Summary of Responses to the White Paper "Productivity and Enterprise - Insolvency: A Second Chance"* (2001); *An Update on the Bankruptcy Proposals* (26 March 2002); *Individual Insolvency* (8 November 2002).

[50] Scottish Executive, *Modernising Bankruptcy and Diligence in Scotland: Draft Bill and Consultation* (July 2004), available at: http://www.scotland.gov.uk/Resource/Doc/203606/0054275.pdf (last accessed 5 July 2013).

[51] *Report of the Working Group on Debt Relief* (2005), available at: http://www.scotland.gov.uk/Resource/Doc/1097/0016112.pdf (last accessed 5 July 2013).

On its introduction, the bankruptcy provisions of the Bankruptcy and Diligence etc. (Scotland) Bill (BD(S) Bill) comprised provisions similar to those introduced in England and Wales by the EA 2002 (EA 2002-style reforms), limited provision on debtor access to sequestration, provisions for reversion of certain assets to the debtor in defined circumstances, provisions for streamlining sequestration procedure and provisions providing a platform for PTD reform.[52] The majority of the PTD reforms were to be contained in separate regulations, a draft of which was the subject of a separate consultation published early in 2006.[53] The SE also carried out a review of the DAS which was neither published nor subject to formal consultation. During the legislative process, a number of new provisions were added to the bankruptcy part of the bill, including provisions to reform the DAS and provisions for access to sequestration by low income, low asset debtors (LILAs). The detailed provisions relating to LILAs were also to be contained in regulations and a consultation was duly published.[54]

Some of the provisions relating to the DAS, including the power to make regulations introducing an element of debt relief, came into force on 8 March 2007;[55] a minor amendment to claims in sequestration came into force on 31 March 2007;[56] some of the provisions relating to PTDs came into force on 19 February 2008;[57] and the remainder of the provisions, with some exceptions, came into force on 1 April 2008.[58]

The Protected Trust Deed (Scotland) Regulations 2008[59] and the Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008[60] also came into force on 1 April 2008, together with new Bankruptcy (Scotland) Regulations 2008[61] and appropriate changes to the relevant court rules.[62] The Debt Arrangement Scheme (Scotland) Amendment Regulations 2007,[63] which made provision for the introduction of the element of debt relief into the DAS, and the Debt Arrangement Scheme (Scotland) Amendment (No. 2) Regulations 2007,[64] which made other important changes to the DAS, both came into force on 30 June 2007.

The HODP(S)A 2010 had its genesis in fears of a rise in repossessions resulting from the credit crunch and recession. Following the final report of the debt action forum

52 See further below.

53 See Scottish Executive, *Protected Trust Deeds: Consultation on Draft Regulations* (January 2006), available at: http://www.scotland.gov.uk/Resource/Doc/89955/0021680.pdf; Scottish Executive, *Protected Trust Deeds: Partial Regulatory Impact Assessment* (January 2006), available at: http://www.scotland.gov.uk/Resource/Doc/92494/0022197.pdf; Scottish Executive, *Protected Trust Deeds – Consultation on Draft Regulations and Partial Regulatory Impact Assessment: Analysis of Responses* (June 2006), available at: http://www.scotland.gov.uk/Resource/Doc/1097/0031324.pdf (all sites last accessed 5 July 2013).

54 See Accountant in Bankruptcy, *Low Income, Low Assets – A New Route into Bankruptcy: Consultation on Proposed Regulations* (April 2007), available at: http://www.scotland.gov.uk/Resource/Doc/174131/0048565.pdf; Accountant in Bankruptcy, *Low Income, Low Assets – A New Route into Bankruptcy: Report on Public Consultation* (February 2008), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000580.pdf (all sites last accessed 5 July 2013).

55 See the Bankruptcy and Diligence etc. (Scotland) Act 2007 (Commencement No. 1) Order 2007, SSI 2007/82, article 3.

56 *Ibid* article 4(a), (d).

57 See the Bankruptcy and Diligence etc. (Scotland) Act 2007 (Commencement No. 2 and Saving) Order 2008, SSI 2008/45, article 2.

58 See the Bankruptcy and Diligence etc. (Scotland) Act 2007 (Commencement No. 3, Savings and Transitionals) Order 2008, SSI 2008/115, article 3.

59 SSI 2008/143.

60 SSI 2008/81.

61 SSI 2008/82. These have already been amended: see the Bankruptcy (Scotland) Amendment Regulations 2008, SSI 2008/334.

62 See the Act of Sederunt (Sheriff Court Bankruptcy Rules) 2008, SSI 2008/119 and the Act of Sederunt (Rules of the Court of Session Amendment No. 3) (Bankruptcy and Diligence etc. (Scotland) Act 2007) 2008, SSI 2008/122.

63 SSI 2007/262.

64 SSI 2007/187.

(DAF) and its repossessions sub-group established to consider these issues,[65] the SE announced its intention to introduce legislation containing what it considered to be urgent and uncontroversial measures, including a number of reforms to sequestration and PTDs, to be followed by consultation on further changes to PTDs and the treatment of the family home in bankruptcy and further legislation.[66] The SE legislative programme for 2009–2010[67] duly included proposals for a Debtor Protection Bill in autumn 2009 and a Debt and Family Homes Bill to follow further consultation.[68]

The proposed Debtor Protection Bill duly became the Home Owner and Debtor Protection (Scotland) Bill (HODP(S) Bill). The reforms to sequestration and PTDs were contained in Part 2 and included provision for a new certificated route into sequestration; provision allowing the exclusion of certain property, specifically the family home, from a PTD; extension of the existing protections for the family home in sequestration to PTDs; and abolition of certain requirements for advertisement in the Edinburgh Gazette. In addition, provision was to be made in secondary legislation to increase the financial limit for a vehicle exempt from attachment (and consequently sequestration), and draft statutory instruments were produced for comment.[69] On the basis that the measures were urgent, and had received broad, if not in all cases unanimous, support in the DAF,[70] the bill did not go through the usual pre-introduction consultation, but was progressed to a truncated timetable[71] and passed on 11 February 2010. Some of the provisions of Part 2 came into force on 7 September 2010, while the remainder come in to force on 15 November 2010 once the supporting secondary legislation was in place.[72]

A review of the DAS in 2008[73] led to further proposed changes,[74] but there was no formal consultation, and the resultant Debt Arrangement Scheme (Scotland) Amendment Regulations 2009[75] were revoked before coming into force following reservations about the changes.[76] A formal consultation was then undertaken,[77] followed by a report.[78] This was followed by workshops with stakeholders and ultimately resulted in

65 Debt Action Forum, *Final Report* (June 2009), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000813.pdf (last accessed 5 July 2013).

66 See Debt Action Forum, *Report – The Scottish Government Response*, available at: http://www.aib.gov.uk/About/DAF/DAFofficialresponse; Scottish Executive News Release, "Law Change to Help Families" (17 June 2009), issued in response to the specific recommendations of the Repossessions Sub-group, available at: http://www.scotland.gov.uk/News/Releases/2009/06/17172506; Scottish Executive News Release, "Dealing with Debt" (23 June 2009), available at: http://www.scotland.gov.uk/News/Releases/2009/06/23115155 (all sites last accessed 5 July 2013).

67 See Scottish Executive, *Towards A More Successful Scotland: The Government's Programme For Scotland 2009–2010* (September 2009), available at: http://www.scotland.gov.uk/Publications/2009/09/02152902/0, at 34–35. See also the First Minister's speech to the Scottish Parliament setting out the legislative programme for 2009–2010 (3 September 2009), available at: http://www.scotland.gov.uk/News/Speeches/Speeches/First-Minister/programme-for-scotland (all sites last accessed 5 July 2013).

68 Summaries of the proposed bills as they stood at that time can be found at: http://www.scotland.gov.uk/About/programme-for-government/2009-10/summary-of-bills (last accessed 5 July 2013).

69 See Draft Bankruptcy (Certificate for Sequestration) (Scotland) Regulations, Bankruptcy (Scotland) Amendment Regulations and Protected Trust Deeds (Scotland) Amendment Regulations, available at: http://www.scottish.parliament.uk/s3/committees/lgc/inquiries/HomeOwnerDebtorProtection/index.htm(last accessed 5 July 2013).

70 See *Home Owner and Debtor Protection (Scotland) Bill Policy Memorandum*, SP Bill 32-PM, at paragraphs 68–70.

71 See *Local Government and Communities Committee, Stage 1 Report on the Home Owner and Debtor Protection (Scotland) Bill*, at paragraph 2.

72 Home Owner and Debtor Protection (Scotland) Act 2010 (Commencement) Order 2010, SSI 2010/314.

73 Accountant in Bankruptcy, *Debt Arrangement Scheme Review 2008* (31 March 2008), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000669.pdf (last accessed 5 July 2013).

74 See Accountant in Bankruptcy News Release, "Key Changes to Debt Arrangement Scheme" (13 March 2009), available at: http://www.aib.gov.uk/News/releases/2009/03/13114653 (last accessed 5 July 2013).

75 SSI 2009/234.

76 See the Debt Arrangement Scheme (Scotland) Revocation Regulations 2009, SSI 2009/258.

77 Scottish Executive, *The Debt Arrangement Scheme – Improving Access: A Consultation Document* (September 2009), available at: http://www.scotland.gov.uk/Publications/2009/09/22141137/0 (last accessed 5 July 2013).

78 Accountant in Bankruptcy, *The Debt Arrangement Scheme Improving Access: Report on Public Consultation*, available at:

the Debt Arrangement Scheme (Scotland) Regulations 2011[79] and Debt Arrangement Scheme (Interest, Fees, Penalties and Other Charges) (Scotland) Regulations 2011[80] which replaced the previous regulations with an updated scheme from 1 July 2011. Further changes have now been made by the Debt Arrangement Scheme (Scotland) Amendment Regulations 2013[81] as part of the ongoing reform discussed below. These changes came into force on 2 July 2013.

The proposed consultation on the treatment of the family home in bankruptcy was subsequently deferred,[82] and thus no Debt and Family Homes Bill has been introduced. There has, however, been consultation on other reforms to bankruptcy law as a result of which further reform is now ongoing.

A review of the LILA provisions took place after four months and again after one year[83] but did not lead to changes at that time. Following a review of PTDs in 2009,[84] a protected trust deed working group was established which issued its final report in June 2010[85] and the SE subsequently issued a consultation Protected trust deeds, improving the process in October 2011.[86] It then issued a further consultation, Consultation on Bankruptcy Law Reform in February 2012,[87] which proceeded on the basis that the earlier reforms to bankruptcy legislation had been focused on specific issues such as low income, low asset debtors and the consultation offered the opportunity to consider the principles and concept of bankruptcy and other debt management solutions "for the first time in a generation".[88] The proposals aimed to develop a new model of debt advice, debt management and debt relief fit for the 21st century, a "financial health service" providing "rehabilitation to individuals and organisations. . .while acknowledging their financial responsibilities". The proposals consulted on were wide-ranging, but did not include the family home, which is still intended to be the subject of separate consultation at a later stage.[89]

Following the consultation, some proposals were dropped and others set aside for further development in future, but the majority were confirmed as going ahead.[90] These include the introduction of mandatory debt advice in all procedures; the introduction of a pre-application moratorium in all procedures; changes to the level of qualifying debt in sequestration; revised provision for no income debtors; provision for executor

http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000980.pdf (last accessed 5 July 2013).

79 SSI 2011/141.

80 SSI 2011/238.

81 SSI 2013/225.

82 See further below.

83 See Accountant in Bankruptcy, *The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008: Four Month Review* (October 2008), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000658.pdf and Accountant in Bankruptcy, *The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008: One Year Review* (October 2009), available at: http://www.aib.gov.uk/sites/default/files/publications/LILA%20Review%202009%20R30589.doc (all sites last accessed 5 July 2013).

84 See Accountant in Bankruptcy, *Protected Trust Deed Review 2009* (June 2009), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0000821.pdf (last accessed 5 July 2013).

85 Protected Trust Deeds Working Group, *Final Report* (June 2010), available at: http://www.aib.gov.uk/sites/default/files/publications/Resource/Doc/4/0001023.doc (last accessed 5 July 2013).

86 Scottish Executive, *Protected Trust Deeds – Improving the Process* (October 2011), available at: http://www.scotland.gov.uk/Publications/2011/10/14103349/0 (last accessed 5 July 2013).

87 Scottish Executive, *Consultation on Bankruptcy Law Reform* (February 2012), available at: http://www.scotland.gov.uk/Resource/0038/00388465.pdf (last accessed 5 July 2013).

88 *Ibid* Ministerial Foreword.

89 *Ibid.*

90 See Accountant in Bankruptcy, *Consultation on Bankruptcy Law Reform: The Report of the Summary of Responses* (2012), available at: http://www.scotland.gov.uk/Publications/2012/08/2539; *The Scottish Government's Response to the Consultation on Bankruptcy Law Reform* (2012), available at: http://www.aib.gov.uk/publications/scottish-government%E2%80%99s-response-consultation-bankruptcy-law-reform; Accountant in Bankruptcy, *Bankruptcy Law Reform – Update* (February 2013), available at: http://www.aib.gov.uk/news/releases/2013/02/bankruptcy-law-reform-update (all sites last accessed 5 July 2013).

applications for sequestration to be made to AIB; the introduction of a common financial tool for calculating debtor contributions in all procedures; the introduction of payment holidays in all procedures; changes to discharge in sequestration; the introduction of financial education; the introduction of a business DAS; and further changes to DAS and PTDs.[91] Consequently, as noted above, the Debt Arrangement Scheme (Scotland) Amendment Regulations 2013[92] have already been passed and came into force on 2 July 2013 and a Bankruptcy and Debt Advice (Scotland) Bill ("BDA(S) Bill") was introduced in the Scottish Parliament on 11 June 2013. Further secondary legislation relating to PTDs and business DAS is expected to be introduced in the autumn of 2013. This is to be followed by a consolidation bill.

The Legislation On Corporate Insolvency

As noted, the Scottish parliament has so far legislated little on the devolved aspects of corporate insolvency, and such legislation as there has been has been secondary legislation which is essentially narrow in scope compared to the scope of the bankruptcy legislation.

The Non-Domestic Rating (Unoccupied Property) (Scotland) Amendment Regulations 2008[93] extended empty property relief to companies in administration and to limited liability partnerships in administration and liquidation.[94]

The Insolvency (Scotland) Rules 1986 Amendment Rules 2008[95] made some changes to the Scottish insolvency rules including amendments to the provisions on claims in liquidation, the introduction of a new rule relating to the provision of information by a liquidator or receiver about time spent on a case and an amendment requiring the final report in a creditors' voluntary liquidation to be sent to the Accountant in Bankruptcy rather than the Registrar of Companies.

The Limited Liability Partnerships (Scotland) Amendment Regulations 2009[96] made a number of amendments to the Limited Liability Partnerships (Scotland) Regulations 2001[97] consequential on changes made to the Insolvency Act 1986 by, *inter alia*, the Insolvency Act 2000 and the EA 2002.

The Insolvency Act 1986 Amendment (Appointment of Receivers) (Scotland) Regulations 2011[98] amended the provisions relating to the appointment of receivers. The genesis of these changes was a jurisdiction issue which had been identified following the introduction of the EC Regulation on Insolvency Proceedings,[99] and the changes were made following consultation.[100] It is thought, however, that some of the amendments are unnecessary and have unintended (and undesirable) consequences, with the result that corrective legislation may be required. As noted, further, more substantial, legislation on corporate insolvency is now in prospect.[101]

91 *Ibid.*

92 SSI 2013/225.

93 SSI 2008/83.

94 It should be noted, however, that the Scottish Parliament's ability to make these changes derived from its devolved powers in relation to rates rather than its devolved powers in relation to corporate insolvency, administration, of course, being reserved.

95 SSI 2008/393.

96 SSI 2009/310.

97 SI 2001/128.

98 SSI 2011/140.

99 Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings OJ L160/1 (30 June 2000).

100 Scottish Executive, *Insolvency Act 1986 Floating Charges, Foreign Investment and European Regulations: The Power to Appoint a Receiver* (July 2010), available at: http://www.scotland.gov.uk/Resource/Doc/254431/0101393.pdf (last accessed 5 July 2013).

101 See above.

Assessment

This section offers an assessment of the Scottish parliament's insolvency legislation to date and how the particular way in which the Scottish parliament functions has shaped it, focusing on the bankruptcy legislation as the major part of that legislation. This assessment is necessarily general given the volume of legislation involved, but it identifies a number of inter-connected issues underpinned by what can be seen as a unifying theme running through not only the bankruptcy legislation already enacted, but the wider legislation on diligence and debtor protection as a whole and, indeed, the legislation the Scottish parliament is about to consider, namely the creation of a modern system which is fit for purpose and strikes an appropriate balance. It also considers what lessons might be learnt and applied to the Scottish parliament's consideration of that prospective legislation.

The starting point is that, as in England and Wales, bankruptcy reform in Scotland was seen as important in building a modern and prosperous Scotland.[102] In both cases, the reforms were intended to foster entrepreneurship, but applied equally to consumer debtors (the vast majority). There is research suggesting more liberal bankruptcy regimes do have a positive effect on entrepreneurship,[103] but although referred to this in evidence, the Enterprise and Culture Committee (ECC) in its Stage 1 Report on the BD(S) Bill considered the impact of the reforms on entrepreneurial activity/business restarts would be negligible, and maintenance of a "level playing field" with England and Wales was a more likely reason for their introduction.[104] Interestingly, the evidence from England and Wales has been that, despite reform, there is still stigma attached to bankruptcy,[105] and there also appears to be continuing stigma in Scotland.[106] Entrepreneurship is also an element of the current reforms: they are seen as supporting the current economic strategy of making Scotland a more successful country through increasing sustainable growth, one priority of which is creating a supportive business environment,[107] and proposals such as the new business DAS are clearly aimed at fostering entrepreneurship.[108]

Maintaining a level playing field was acknowledged to be one reason for including EA 2002-style reforms in the BD(S)A 2007,[109] although it was said in the Stage 1 debate that the desire to align the two jurisdictions did not seem to be a terribly strong rationale for following these reforms.[110] The Scottish bankruptcy reforms were, however, wider than those in England and Wales, and even where following them, did

[102] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 1.6.

[103] See J. Armour and D. Cumming, "Bankruptcy Law and Entrepreneurship" (2005), available at: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/ArmourCummingEntrepreneurship.pdf (last accessed 5 July 2013) and J. Armour, "Bankruptcy Law and Entrepreneurship" (2008) 10(2) AELR 303–350.

[104] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraphs 37–38.

[105] See Insolvency Service, *Attitudes to Bankruptcy*, available at: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudestobankruptcy1.pdf; Insolvency Service, *Attitudes to Bankruptcy Revisited*, available at: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisited.pdf; Insolvency Service, *Enterprise Act 2002: Attitudes to Bankruptcy Revisited 2009 Update*, available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/policychange/AB2009/Enterprise%20Act%202002%20-%20Attitudes%20to%20bankruptcy%202009%20update.doc (all sites last accessed 5 July 2013).

[106] See AIB News Release (16 February 2009), available at: http://www.aib.gov.uk/News/releases/2009/02/16120010 (last accessed 5 July 2013).

[107] Scottish Government, *Consultation on Bankruptcy Law Reform*, Part 3.

[108] *Ibid* at paragraph 11.4.

[109] See Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraphs 29 and 38.

[110] Scottish Parliament, *Official Report*, column 25930 (24 May 2006). This was contrasted with floating charge reform, for which there was seen to be a much stronger case.

not copy them exactly. For example, they do not allow automatic discharge in less than a year, a provision which has now been repealed in England and Wales,[111] and LILAs were dealt with differently, through increased access to sequestration, whereas in England and Wales, a separate debt relief order procedure was introduced.[112] One reason for introducing the HODP(S)A 2010 provision allowing exemption of a debtor's main residence from a PTD was that it would give a debtor entering a PTD in Scotland the same opportunity to exclude his home from the procedure as a debtor entering an individual voluntary arrangement (IVA) in England and Wales.[113] Arguably, however, this failed to recognise that, although functionally similar, PTDs and IVAs are legally quite different.

The maintenance of a level playing field has not, however, been wholly one-sided. England and Wales has followed some Scottish innovations such as the removal of debtor petitions for bankruptcy from the courts,[114] which was done in Scotland by the BD(S)A 2007. Interestingly, both jurisdictions have rejected the removal of (non-contentious) creditor applications for bankruptcy from the courts following overlapping consultations,[115] although the current reforms in Scotland do include the removal of executor petitions for bankruptcy from the courts.[116]

The importance of a comprehensive and coherent approach to bankruptcy reform was recognised in the consultations prior to the introduction of the BD(S) Bill. In its Stage 1 Report on the bill, however, the ECC said it wanted to see a more joined-up approach by the SE in terms of the different options ranging from debt write-off to

[111] Enterprise and Regulatory Reform Act 2013, section 73 and Schedule 21, Part 3, paragraph 5. These provisions are expected to be brought into force on 1 October 2013: see Department for Business Innovation and Skills, *Enterprise and Regulatory Reform Act 2013: a guide* and indicative timetables for commencement of those provisions not already in force available at: https://www.gov.uk/government/publications/enterprise-and-regulatory-reform-act-2013-a-guide. For the preceding consultation, see Insolvency Service, *Reforming Debtor Petition Bankruptcy and Early Discharge from Bankruptcy* (November 2009), at 32–33, available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Debtor%20Petition%20Reform%20Final%20Nov%2009.pdf; Insolvency Service, *Response to Consultation on Reforming Debtor Petition Bankruptcy and Early Discharge* (October 2010) and Ministerial Statement, available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/DPRefResponses/DPrefIndex.htm (all sites last accessed 5 July 2013).

[112] See Part 5 of the Tribunals, Courts and Enforcement Act 2007.

[113] See Home Owner and Debtor Protection (Scotland) Bill Policy Memorandum SP Bill 32-PM, at paragraph 44; see also Scottish Parliament, *Official Report*, columns 22399–22400 (17 November 2009) (Stage 1 debate).

[114] Enterprise and Regulatory Reform Act 2013, section 71 and Schedules 18 and 19. These provisions are expected to be brought into force in 2015–16: see Department for Business Innovation and Skills, *Enterprise and Regulatory Reform Act 2013: a guide* and indicative timetables for commencement of those provisions not already in force, available at: https://www.gov.uk/government/publications/enterprise-and-regulatory-reform-act-2013-a-guide. For the preceding consultation, see Insolvency Service, *Reforming Debtor Petition Bankruptcy and Early Discharge from Bankruptcy* (November 2009), at 32–33, available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Debtor%20Petition%20Reform%20Final%20Nov%2009.pdf; Insolvency Service, *Response to Consultation on Reforming Debtor Petition Bankruptcy and Early Discharge* (October 2010) and Ministerial Statement, available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/DPRefResponses/DPrefIndex.htm; Insolvency Service, *Consultation on Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up* (November 2011); Insolvency Service, *Consultation on Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up Summary of Responses* (September 2012) and Ministerial Response (9 October 2012), all available at: http://www.bis.gov.uk/insolvency/Consultations/petition%20reform?cat=closedwithresponse (all sites last accessed 5 July 2013).

[115] For England and Wales, see Insolvency Service, *Consultation on Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up* (November 2011), Insolvency Service, *Consultation on Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up Summary of Responses* (September 2012) and Ministerial Response (9 October 2012), all available at: http://www.bis.gov.uk/insolvency/Consultations/petition%20reform?cat=closedwithresponse (last accessed 5 July 2013). For Scotland, see Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Part 12; Accountant in Bankruptcy, *Consultation on Bankruptcy Law Reform: The Report of the Summary of Responses* (August 2012); Scottish Government, *Response to the Consultation on Bankruptcy Law Reform* (October 2012); Accountant in Bankruptcy, *Bankruptcy Law Reform Update* (February 2013).

[116] Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Part 12; Accountant in Bankruptcy, *Consultation on Bankruptcy Law Reform: The Report of the Summary of Responses* (August 2012); Scottish Government, *Response to the Consultation on Bankruptcy Law Reform* (October 2012); Bankruptcy and Debt Advice (Scotland) Bill.

sequestration.[117] This was said in the context of access to sequestration, where the ECC suggested the SE should consider a certification route into sequestration.[118] The SE considered, however, that the bill would deliver a new and better-integrated system of debt management and debt relief.[119] The coherence of bankruptcy reform was, however, jeopardised by Part 2 of the HODP(S)A 2010: although it was presented as an emergency measure "…to protect home owners and debtors during a period of recession and, in particular to reduce risk of homelessness as result of insolvency",[120] the SE was accused of introducing it simply to be seen to be doing something in the light of the financial crisis.[121] It is certainly arguable that the Part 2 measures were less urgent. Furthermore, it was clearly envisaged that the measures being introduced "would continue to be appropriate in the event of an early recovery",[122] and were therefore intended to be longer-term measures. In addition, as was acknowledged in the Stage 1 debate, Part 2 was never intended to be "the be-all and end-all" of further bankruptcy legislation.[123]

Taking all these things together, it is arguable that the Part 2 measures should never have been included in the HODP(S) Bill and should have been pursued later as part of the more comprehensive reform which is now being undertaken. This might also have avoided issues it created around the various provisions relating to the debtor's home in bankruptcy: for example, the existence of two separate provisions using two different definitions of the debtor's home in the context of PTDs, one relating to the debtor's main residence and one relating to the debtor's family home as defined by section 40 of the Bankruptcy (Scotland) Act 1985 (B(S)A 1985). The current reforms, with their vision of a new model of debt advice, debt management and debt relief in the form of a "financial health service", also seek to deliver comprehensive and coherent reform, although it is arguable that this cannot really be achieved absent consideration of the family home, since any changes to way in which the family home is dealt with might be regarded as fundamental to bankruptcy reform.[124]

It is clear that one of the main aims in legislating has been to strike the right balance between the interests of debtors, creditors and third parties, and in general terms, this was seen as requiring a shift in the balance in the debtor's favour. The ECC in its Stage 1 Report on the BD(S) Bill noted that the SE considered the (then) laws, made 20 years previously, were in need of reform because they were no longer fit for purpose and did not strike the right balance between the interests of debtors, creditors and public.[125] The issue of balance also arose in the debates on the HODP(S) Bill, where it was said the rights of creditors must be balanced with humane debt solutions proportionate to the impact of debt on families and the wider community.[126] The difficulty, of course, is that views on where the correct balance lies differ. This is encapsulated in the SE's

[117] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 96.

[118] *Ibid*, at paragraph 95. This suggestion was not taken up at the time in the light of the LILA reforms, but as noted above, was subsequently implemented by the HODP(S)A 2010.

[119] See Scottish Parliament, *Official Report*, column 29984 (30 November 2006) (Stage 1 debate).

[120] *Home Owner and Debtor Protection (Scotland) Bill Policy Memorandum*, SP Bill 32 – PM, at paragraph 2.

[121] Scottish Parliament, *Official Report*, column 23738 (11 February 2010).

[122] *Ibid*.

[123] Scottish Parliament, *Official Report*, columns 22373–4 (17 December 2009). See also Scottish Parliament, *Official Report*, column 22379 (17 December 2009).

[124] The wide-ranging impact of any change to how the family home is dealt with in bankruptcy or diligence was acknowledged in the consultation: see Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Executive Summary.

[125] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 30.

[126] Scottish Parliament, *Official Report*, column 23752 (11 February 2010).

acknowledgement in the Stage 3 debate on the BD(S) Bill that ". . .[s]ome people will think that we should do more and some people will think that we should do less."[127]

This is aptly illustrated by two contrasting views of the Scottish parliament's wider work on debt as a whole. The first was offered in the Stage 3 debate on the BD(S) Bill:[128]

> The Parliament has a strong record on reforming the way in which debt is dealt with. From the Abolition of Poindings and Warrant Sales Act 2001 to the Debt Arrangement and Attachment (Scotland) Act 2002, we have recognised the reality that people who are in financial difficulties face and the fact that they need support and advice to help them to repay, rather than threats.

The second was offered in the Stage 3 debate on the HODP(S) Bill;[129] "The Scottish Parliament in the field of debt has been a one-way street of reforms that make it easier for people to avoid paying their bills. Before we go any further beyond this bill, we should pause to think about the stage we have reached."

There is no doubt that Part 2 of the HODP(S)A 2010 effected a further shift in the balance towards the debtor. The current reforms also specifically refer to the need for balance,[130] but can be seen as shifting the balance back towards the creditors in some respects, for example through those changes designed to improve returns to creditors. In terms of fitness for purpose generally, the ECC in its Stage 1 Report on the BD(S) Bill considered that it was a "once-in-a-generation" opportunity to reform bankruptcy and diligence law in Scotland and a chance to provide a legislative framework fit-for-purpose for decades to come.[131] Perhaps inevitably, this did not prove not to be the case, as the HODP(S)A 2010 and the current reforms prove, and while the current reforms also aim to develop a new model of debt advice, debt management and debt relief "fit for the 21st century", it may be questioned whether this kind of "future-proofing" can ever really be achieved.

The tenor of the legislation to be considered and ultimately passed by the Scottish parliament can, of course, be affected by a change of administration.[132] For example, more radical changes to the treatment of the family home in bankruptcy and diligence may now be more likely since the previous minority administration which espouses them is now a majority administration.[133] Irrespective of "regime change", however, it is clear that in legislating on bankruptcy in particular, and diligence and debtor protection more widely, the Scottish parliament's policy has been shaped largely by what might be characterised as "social" issues, particularly the impact of debt and enforcement on individuals. In contrast, economic issues, particularly the potential (adverse) effects of (more debtor-oriented) reform, appear to have received less credence or weight.

One particular aspect of this can be seen in the desire to prevent homelessness which was reflected, for example, in those provisions in Part 2 of the HODP(S)A 2010 allowing exclusion of the debtor's main residence from a PTD and extending the

[127] Scottish Parliament, *Official Report*, column 29972 (30 November 2006).

[128] *Ibid*.

[129] Scottish Parliament, *Official Report*, column 23738 (11 February 2010).

[130] See, in particular, Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Part 5.

[131] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 236. This sentiment was echoed in both the Stage 1 debate (see Scottish Parliament, *Official Report*, column 25928 (24 May 2006)) and the Stage 3 debate (see Scottish Parliament, *Official Report*, column 29965 (30 November 2006)).

[132] It must be remembered, however, that not all bills originate with the administration, and indeed the APWSA 2001 and the MR(S)A 2001 were both member's bills, although the latter, unlike the former, had Scottish Executive support.

[133] See, for example, Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Executive Summary.

protection for the family home in sequestration to PTDs. The ECC in its Stage 1 Report on the BD(S) Bill said that there were occasions where the sale of the home was merited in bankruptcy and occasions where it was not; that it would make no sense for bankruptcy to cause homelessness; and that the SE should ensure its policies on these issues were consistent.[134] The current administration has maintained its position on homelessness,[135] but policy in this area requires to be very carefully considered, since preventing homelessness by exempting the debtor's home from bankruptcy or diligence either wholly or partly not only opens the door to potential abuse but effectively shifts the cost of housing debtors from the state to creditors with potentially wider implications for access to credit generally. The need to consider the issues carefully has been acknowledged as the reason for deferral of consideration of the treatment of the family home.[136]

There can also be disagreements between the parliament and the administration, as epitomised by the parliament taking a different view from the (then) minority administration on the corporate insolvency (re)reservation provisions of the Scotland Bill. More generally, committees examining legislation often raise issues or make recommendations for change, although these are often responded to positively. For example, a number of amendments were made to the BD(S) Bill at Stage 2 in response to issues raised in the Stage 1 Report.[137] In the Stage 1 debate on the HODP(S) Bill, it was said that the Local Government and Communities Committee (LGCC) might have rejected Part 2 of the bill altogether and ministers had "a big job" to do to ensure it could be safely passed.[138] The SE issued a formal response to the Stage 1 Report, indicating in several cases that amendments would be lodged at Stage 2, including amendments to the provisions relating to delegated powers which had caused particular concern,[139] and the willingness of ministers to respond to the LGCC's concerns was noted in the Stage 3 debate.[140] Such issues may, of course, be less likely to arise in relation to the current reforms given that they are being put forward by a majority administration.

The use of secondary legislation, and in particular the correct balance between primary and secondary legislation and the type of procedure used to ensure the parliament has an appropriate role in scrutinising secondary legislation, is an issue which has regularly concerned the parliament, and the Subordinate Legislation Committee (the SLCtte) has had an important role to play in this respect. The Social Justice Committee (SJC) noted in its Stage 1 Report on the DAA(S)A 2002 that much of the detail of the DAS would be left to secondary legislation and there was real concern about the lack of detail on face of bill.[141] It therefore said it expected the SE to consult on the secondary legislation,[142] even though this would delay implementation.[143] The SE's position in the Stage 1 debate was that it would have put the detail

[134] See Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraphs 61–62.

[135] See Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Executive Summary.

[136] *Ibid.*

[137] See SPICe Briefing, *Bankruptcy and Diligence etc. (Scotland) Bill: Parliamentary Consideration Prior To Stage 3*, 06/100 (21 November 2006), for a full account of the amendments at Stage 2.

[138] Scottish Parliament, *Official Report*, column 22383 (17 December 2009).

[139] See *Home Owner and Debtor Protection (Scotland) Bill, Local Government and Communities Committee Stage 1 Report, Scottish Government Response* (January 2010). The issue of delegated powers is discussed further below.

[140] Scottish Parliament, *Official Report*, column 22736 (11 February 2010).

[141] Scottish Parliament, *Official Report, Social Justice Committee, Stage 1 Report on the Debt Arrangement and Attachment (Scotland) Bill*, at paragraph 21.

[142] *Ibid* at paragraphs 24, 27.

[143] *Ibid* at paragraph 25.

in the primary legislation if time had permitted, but it would consult.[144] There was also an amendment at Stage 3 to ensure that the first set of DAS regulations was subject to affirmative procedure.[145]

In its Stage 1 Report on the BD(S) Bill, the ECC noted in relation to the provisions on PTDs that it was being asked to agree the general principles of the bill without knowing the detail of the proposed statutory instruments which would give effect to the relevant provisions, a practice it described as "less than desirable", and that a balance needed to be struck between provisions written into primary legislation and those left to secondary legislation.[146] There was an amendment at Stage 3 to ensure that the first set of PTD regulations was subject to affirmative procedure. There was also an amendment at Stage 3 to ensure that any regulations changing the debt thresholds for sequestration were subject to affirmative procedure.[147]

The issue of amendments raises another important issue, that of drafting. Issues have arisen about the quality of drafting of some bills. For example, in its Stage 1 Report on the BD(S) Bill, the ECC noted it had received a substantial number of suggestions for mainly technical amendments which were non-controversial, which it recommended be taken forward at Stage 2.[148] It also commented on the role of consultation in ensuring there was less likelihood of amendments at Stages 2 and 3 and more consensus on the detail of a bill.[149] Notwithstanding the size and scope of the BD(S) Bill, the number of amendments at Stage 2 alone was considerable, and many were technical amendments which arguably should have been unnecessary.[150] The bankruptcy provisions of the BD(S) Bill also raised a different drafting issue. These provisions consisted primarily of amendments to the B(S)A 1985. The extent of the amendments begged the question of whether a consolidating measure would have been more appropriate. This was not accepted at the time, but the SLC was subsequently asked to undertake work to consolidate the bankruptcy legislation.[151] Initially expected to be completed by the end of 2009, this work was delayed in order to take account of the (then) HODP(S) Bill.[152]

A consultation including a draft bill was eventually issued in 2011[153] and has now been followed by a report including a draft Bankruptcy (Scotland) Bill 2013, a draft section 104 order and draft tables of derivations and destinations.[154] This has, however, effectively been superseded by the introduction of the BDA(S) Bill, which makes further amendments to the B(S)A 1985, although as noted above it is still intended to proceed with a consolidation after these have been enacted. Furthermore, the HODP(S) Bill was criticised in the debates as being "badly constructed" and linking together "two disparate sets of issues" thereby creating "controversy, confusion and disagreement",[155] and it was said that the SE should not come to a committee with legislation

[144] Scottish Parliament, *Official Report*, column 13886 (19 September 2002).

[145] Scottish Parliament, *Official Report*, columns 15180–3 and 15281 (13 November 2002).

[146] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 21.

[147] Scottish Parliament, *Official Report*, columns 29834, 29837 (30 November 2006).

[148] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraphs 104–105.

[149] *Ibid* at paragraph 20. Consultation is dealt with further below.

[150] See SPICe Briefing, above note 137, for a full account of the amendments at Stage 2.

[151] See Scottish Law Commission, *Annual Report 2008* (Scot Law Com No 214, 2008).

[152] See Scottish Law Commission, *Annual Report 2009* (Scot Law Com No 221, 2009), at 26.

[153] Scottish Law Commission, *Consultation Paper on the Consolidation of Bankruptcy Legislation in Scotland* (August 2011).

[154] Scottish Law Commission, *Report on the Consolidation of the Bankruptcy Legislation in Scotland* (Scot Law Com No 232).

[155] Scottish Parliament, *Official Report*, column 22382 (17 December 2009).

so unclear as a result of a last-minute rush to address issues that might have been better dealt with in future legislation.[156] And while it was also said that it is "...the Government's responsibility to produce draft legislation and it is the Parliament's job to improve and amend it as appropriate",[157] this cannot mean that legislation should not be as well-drafted as possible at the outset. It is to be hoped that similar issues do not arise with the current reforms.

Turning to consultation, this can be seen as important at two levels: a policy level and a technical level. This is undoubtedly why consultation is built into the parliamentary procedures themselves, even where there has been previous consultation, and it was noted in the Stage 1 Report on the BD(S) Bill that part of the committee's role at Stage 1 is to consider whether the SE has consulted appropriately at the pre-legislative stage.[158] In that case, the ECC was generally satisfied with the consultation, but urged the SE to make more use of working groups and other participative forms of engagement that try to resolve problems and road test ideas before legislation is published.[159] As already referred to, the ECC in its Stage 1 Report on the BD(S) Bill was unhappy that some consultation was still ongoing, for example in relation to PTDs, and in the Stage 1 debate, it was said that the continuing uncertainty about the SE's proposals on PTDs and the failure to have full proposals available was "deeply regrettable", the bill being presented as package, but with some of its contents missing.[160] Consultation, or rather the lack of it, became a major issue in relation to the HODP(S) Bill. As noted, a truncated timetable was adopted on the basis that the measures in the bill were urgent and had received broad, if not in all cases unanimous, support in the DAF, and the usual pre-introduction consultation was not undertaken. However, the LGCC in its Stage 1 Report noted that the proposals in Part 2 had not been specifically recommended by DAF and it was not clear if or to what extent they had been discussed in subsequent meetings with stakeholders,[161] although it accepted it was a question of balance between the need for consultation and the need to take action quickly.[162] It ultimately concluded that the consultation on Part 2 had been "unsatisfactory".[163] The Finance Committee ("FC") went further in calling the failure to undertake the normal consultation process in respect of Part 2 "unacceptable".[164]

It was observed in the Stage 3 debate that the parliament is a unicameral parliament, so it is vital to observe all current protocols when passing legislation and not excusable to ignore consultation and proper evidence taking.[165] Lack of consultation was also the downfall of the Debt Arrangement Scheme (Scotland) Amendment Regulations 2009[166] which, as noted above, were revoked before coming into force following reservations

[156] Scottish Parliament, *Official Report*, column 23746 (11 February 2010). The issue of whether the provisions in Part 2 should have been left to future legislation is discussed above.

[157] Scottish Parliament, *Official Report*, column 22385 (17 December 2009).

[158] Scottish Parliament, *Official Report, Enterprise and Culture Committee, Stage 1 Report on the Bankruptcy and Diligence etc. (Scotland) Bill*, at paragraph 16.

[159] *Ibid* at paragraph 20.

[160] Scottish Parliament, *Official Report*, columns 22911–25912 (24 May 2006). See also Scottish Parliament, *Official Report*, column 29833 (30 November 2006).

[161] Scottish Parliament, *Official Report, Local Government and Communities Committee, Stage 1 Report on the Home Owner and Debtor Protection (Scotland) Bill*, at paragraph 9.

[162] *Ibid* at paragraph 36.

[163] *Ibid* at paragraph 43.

[164] *Ibid* at paragraph 55.

[165] Scottish Parliament, *Official Report*, column 23748 (11 February 2010).

[166] SSI 2009/234.

about the changes they contained which had not been formally consulted on.[167] There has been extensive pre-legislative consultation on the current reforms, including meetings with stakeholders, but consultation on the principles is different from consultation on the detail, and there is to be no formal consultation on the BDA(S) Bill itself. It remains to be seen whether this leads to difficulties since there are some aspects of the bill which have not been previously consulted on in detail or at all.

The truncated timetable for the HODP(S)A 2010 and the resultant criticism of lack of proper consultation on Part 2 highlights another important issue, parliamentary time. One of the main arguments for the Scottish parliament is the opportunity to legislate on matters for which time would not be found at Westminster. The length of time it takes to get legislation on the statue book, however, is also important, and it can be argued that the procedure can take too long. As was recognised in the debates surrounding the HODP(S)A 2010, however, there is a balance to be struck.

In considering the way in which legislation is shaped by the parliament, it is clear the committee structure is pivotal and it has been favourably contrasted with the procedure at Westminster, for example, in the debates on the BD(S) Bill.[168] One of the main strengths of the committee system lies in the ability to take evidence and consider views from all stakeholders. It is important that a wide range of stakeholders can give evidence directly to the committees scrutinising a bill even if there has been pre-legislative consultation,[169] but particularly where there has not, as in the case of Part 2 of the HODP(S)A 2010. It is, therefore, perhaps somewhat ironic that it was acknowledged in the Stage 3 debate on that bill that not just members but key stakeholders had been influential throughout the passage of the bill, and although stakeholders did not always get their own way, the process of consultation was valuable in securing a better balance between protection for lenders and debtors and ensuring workable legislation.[170]

Issues have arisen, however, about the selection of the committees chosen to scrutinise a bill. In the debates on the BD(S) Bill, initial surprise was expressed at the designation of the ECC as the lead committee given that the overwhelming number of bankrupts were not entrepreneurs but consumer debtors,[171] and it was said that questions remained over the decision to allocate the bill to that committee.[172] It must also be recognised that committees may lack expertise, particularly in highly technical areas such as bankruptcy, although this may be compensated for to some extent by the appointment of advisers, as happened in the case of the BD(S) Bill and is proposed for the BDA(S) Bill. The committee structure was, however, generally approved of by the Calman Commission, who recommended that it should be maintained, although the turnover of membership during the parliamentary session should be minimised in order to allow committee members to build expertise, and a committee should have the facility to establish sub-committees to address temporary problems of legislative overload without prior approval of parliament as a whole.[173]

The Calman Commission also considered, however, that the Scottish parliament could be more effective in its scrutiny of bills towards the end of the legislative

167 See the Debt Arrangement Scheme (Scotland) Revocation Regulations 2009, SSI 2009/258.

168 Scottish Parliament, *Official Report*, column 25902 (24 May 2006).

169 Consultation is discussed in detail above.

170 Scottish Parliament, *Official Report*, columns 23733–23734 (11 February 2010).

171 Scottish Parliament, *Official Report*, column 25919 (24 May 2006).

172 Scottish Parliament, *Official Report*, column 22975 (30 November 2006).

173 Commission on Scottish Devolution, *The Future of Scottish Devolution within the Union: Final Report* (June 2009), recommendation 6.1.

process.[174] In particular, it recommended the current three-stage bill process should be changed to a four-stage process, with Stage 3 becoming limited to a second main amending stage, taken in the chamber, while the final debate on whether to pass the bill would become Stage 4.[175] It also recommended that the parliament should amend its rules so that any MSP would have the right to propose at the conclusion of the Stage 3 amendment proceedings that parts of a bill be referred back to committee for further Stage 2 procedure,[176] and that the presiding officer should be able to identify in advance of Stage 3 amendments which in his view raised substantial issues not considered at earlier stages and, where any such amendments are agreed to, the relevant provisions of the bill should be referred back to committee for further Stage 2 consideration unless the parliament decides otherwise on a motion by the member in charge of the bill.[177] Such a procedure would clearly have affected some of the legislation discussed in this chapter in view of the nature of amendments made at Stage 3, in particular in the case of the BD(S)A 2007.

CONCLUSION

The period since the establishment of the Scottish parliament has been characterised by rising debt, particularly consumer debt, and has encompassed a financial crisis and severe recession resulting in increased financial difficulties for consumers and businesses alike. Against that background, it is not surprising that the Scottish parliament has legislated extensively on, *inter alia*, insolvency law, particularly bankruptcy law.

The reserved/devolved split in relation to insolvency law has, however, given rise to difficulties, particularly in the context of corporate insolvency law reform. These difficulties are partly a function of the nature of the split itself and partly a function of the Scottish parliament's focus on the reform of bankruptcy law and the wider law relating to debt and enforcement generally at the expense of the devolved aspects of corporate insolvency law. Particularly in the current economic climate, however, a Scottish corporate insolvency law in which every available procedure is modernised and fit for purpose is equally as important as a Scottish bankruptcy law which fulfils these criteria. It is therefore to be hoped that now that the issue of re-reservation has finally been resolved, rapid progress will be made in relation to the devolved aspects of corporate insolvency law as well as bankruptcy law notwithstanding the difficulties which remain as a result of the maintenance of the original reserved/devolved split.

As to an assessment of the Scottish parliament's legislation on insolvency to date, effectively its legislation on bankruptcy, like its wider legislation on debt and enforcement generally, this has been underpinned by a general theme of the creation of a modern system which is fit for purpose and strikes an appropriate balance, a theme which in broad terms also underpins the current reforms. The cumulative effect of the legislation to date, which has sought to bring about comprehensive and integrated reform, has been to bring about a major shift in the balance in favour of debtors. The current reforms, however, can be seen as seeking to shift the balance back towards creditors in at least some respects. Inevitably, there are different views on where the correct balance lies and whether the current reforms will strike a better balance or not. In this respect, it must be noted that the effects of the legislation

[174] *Ibid* Executive Summary, at paragraph 53.

[175] *Ibid* recommendation 6.2.

[176] *Ibid* recommendation 6.3.

[177] *Ibid* recommendation 6.4.

enacted by the Scottish parliament, at least up to and including the BD(S)A 2007, can be seen as consistent with European initiatives with their emphasis on reduction of the stigma of bankruptcy and a fresh start for (non-culpable) debtors[178] and as generally benchmarking well against international standards on consumer bankruptcy.[179] The current reforms also explicitly seek to take account of European and international developments.[180] It is suggested, however, that the comment made in the course of the Stage 1 debate on the BD(S) Bill that care must be taken that the pendulum does not swing too far in *either* direction is instructive.[181] Care must also be taken to ensure that the ongoing reform is coherent and takes proper account of the likely consequences.

As to the way in which the Scottish parliament functions has shaped the legislation to date, it is notable that some measures have had cross-party support while others have been more controversial. The legislation provides an interesting study in how the parliament treats SE policy, ranging from initial rejection in the case of the corporate insolvency (re)reservation provisions of the Scotland Bill[182] to the more common seeking of clarification or changes, particularly in relation to matters such as delegated powers, where the SE response is often, if not always, positive. It has also raised issues relating to drafting, with serious questions arising regarding the quality of the drafting in particular of the BD(S) Bill and the HODP(S) Bill and associated delegated legislation, and to consultation, with serious questions arising regarding the consultation on Part 2 of the HODP(S)A 2010 and its truncated timetable generally. Nonetheless, it is clear that the committee system, which is pivotal to the parliament's procedures, has generally served it well in relation to the legislation in this area, notwithstanding lack of expertise in what is admittedly a highly technical area. This is partly due to the ability to appoint an adviser in an appropriate case, as was done in the case of the BD(S) Bill, and partly due to the fact that the system of evidence-taking allows both policy and technical issues to be aired and debated. In this respect, the Calman Commission's general endorsement of the committee system seems well justified notwithstanding its suggestions for further improvement.

In conclusion, therefore, it might be said that the effect of devolution on insolvency law in Scotland so far has been mixed. The Scottish parliament has brought about extensive reform of bankruptcy law and the wider law of diligence and debtor protection in Scotland which has taken account of developments in England and Wales but continued to reflect a distinctively Scottish approach to these areas and it looks set to continue on this path with the current reforms. It has, however, sadly neglected the

178 In particular the work being carried out by the European Commission: see *Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy* (2002), available at: http://ec.europa.eu/enterprise/entrepreneurship/sme2chance/doc/stigma_study.pdf; *Best Project on Restructuring, Bankruptcy and A Fresh Start: Final Report of the Expert Group* (2003), available at: http://ec.europa.eu/enterprise/entrepreneurship/sme2chance/doc/failure_final_en.pdf; Communication from the Commission to the Council, the European Parliament, The European Economic and Social Committee and the Committee of the Regions, *Overcoming the Stigma of Business Failure – For a Second Chance Policy Implementing the Lisbon Partnership for Growth and Jobs* (5 October 2007) (COM (2007) 584), available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:DKEY=456594:EN:NOT; *Business Dynamics: Start-ups, Business Transfers and Bankruptcy* (January 2011), available at: http://ec.europa.eu/enterprise/policies/sme/business-environment/files/business_dynamics_final_report_en.pdf; *A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start, Final Report of the Expert Group* (January 2011), available at: http://ec.europa.eu/enterprise/policies/sme/business-environment/files/second_chance_final_report_en.pdf. See also Communication from the Commission to the Council, the European Parliament and The European Economic and Social Committee, A New European Approach to Business Failure and Insolvency (12 December 2012) (COM (2012) 742), available at: http://ec.europa.eu/justice/civil/files/insolvency-comm_en.pdf (all sites last accessed 5 July 2013).

179 See D. McKenzie Skene and A. Walters, "Consuming Passions: Benchmarking Consumer Insolvency Law Systems" in P. Omar (ed), *Insolvency Law: Issues, Themes and Perspectives* (2008, Ashgate, Aldershot).

180 Scottish Government, *Consultation on Bankruptcy Law Reform* (February 2012), Part 4.

181 Scottish Parliament, *Official Report*, column 25919 (24 May 2006).

182 Although the parliament's stance may, of course, now change following the conversion of the then minority administration into a majority administration.

devolved aspects of corporate insolvency law, a situation which it is hoped will soon be remedied, and there are clearly some important lessons to be learned from the experiences of the previous legislation. Provided these issues are addressed, however, it is thought that cautious optimism for the forthcoming legislation may not be unjustified.

CASE NOTES AND COMMENTARY

The address for submission of case notes is given at the beginning of this issue.

A CONFLICT BETWEEN THE INSOLVENCY ACT AND THE PENSION ACT

Re Nortel GmbH and Lehman Brothers International (Europe)[1] [2013] UKSC 52 (Lord Neuberger, President, Lord Mance, Lord Clarke, Lord Sumption and Lord Toulson)

INTRODUCTION

In 2013, the Supreme Court overturned the controversial decision of the Court of Appeal which held that financial contribution to an underfunded pension scheme should rank higher than debts to other creditors. The decision finally lay to rest how financial contributions to underfunded pension schemes should be ranked when a company is insolvent. The *Re Nortel/ Re Lehman* case is illustrative of conflicts that may arise during insolvency proceedings. In this case, there was a clear conflict between the protection of the vulnerable (pension schemes) and the preservation of the overall collective interest in insolvency proceedings. This conflict was further underlined by two bodies of law; the provisions of the Insolvency Act 1986 and the Pensions Act 2004 and this is the focal point of this paper**.** The paper will therefore examine the tension between the provisions of the Insolvency Act 1986 and the Pensions Act 2004 as it relates to the classification of claims made in relation to under-funded pension schemes during a company's insolvency.

THE FACTS

In 2009, a regulatory action was commenced by the Pensions Regulator against *Re Nortel/ Re Lehman Brothers* respectively; both companies had become insolvent and gone into administration. The pension schemes of both companies were considerably underfunded[2] and under the provisions of the Pension Act 2004, the Pension Regular could issue a Financial Support Direction (FSD)[3] order requiring a defaulting company to make a financial contribution to underfunded pension schemes.[4] In Nortel and Lehman Brothers such an order was issued in a bid to protect the benefits of the

[1] [2013] UKSC 52. Herein after referred to as *Re Nortel/Re Lehman.*

[2] When the companies went into administration Nortel's scheme was approximately £2.1 billion in deficit, while Lehman's' was approximately £148 million in deficit.

[3] A financial support direction requires that a company which is the subject of the FSD makes a proposal for financial support for a pension scheme.

[4] See Pension Act 2004, s.38.

pension scheme members and limit demands on the Pension Protection Fund to pay compensation for lost pension benefits.

FSDs require the recipient to put forward a financial support proposal to remedy the deficiency and where the recipient of the FSD fails to offer a proposal, the Pensions Regulator may issue a Contribution Notice (CN) which requires the recipient/target company (Nortel and Lehman Brothers in this case) to pay a specific sum determined by the Regulator, to the pension scheme. Administrators for some of the subsidiary companies in Lehman and Nortel companies respectively, sought the direction of the court on three main questions regarding the FSD/CN. Firstly, they wished to know the effectiveness of liabilities ensuring from a FSD issued in the wake of insolvency; secondly, if such liabilities would rank as provable debt and thirdly if the FSD liabilities would rank as an administration expense. The case which commenced in the High Court[5] and went on appeal to the Court of Appeal[6] saw both courts being of the view that where a CN was issued in relation to an FSD which itself was issued before a company entered into insolvent administration, the CN would rank as a provable debt, whereas, if the CN related to an FSD issued after such event, it would rank as an administration expense; the High Court therefore held that an FSD should be considered as an administration expense and this decision was upheld by the Court of Appeal. On appeal to the Supreme Court, the decision of the Court of Appeal was overturned.

MATTERS ARISING

Where a company is insolvent and has relied on any of the mechanisms available under the Insolvency Act to come to an arrangement with its creditors on how its liability to them will be realised, the insolvency legislations (the Insolvency Act 1986[7] and the Insolvency Rules 1986)[8] as interpreted and extended by the courts have laid down the order of priority for payment out of the debtor company's assets to its creditors and it is as follows;

- Secured creditors;
- Expenses of the insolvency proceedings;
- Preferential creditors;
- Floating charge creditors;
- Unsecured provable debts;
- Statutory interest;
- Non-provable liabilities; and
- Shareholders.

The decision by the lower courts to rank the FSD claim above claims of other creditors, including floating charge holders; a group largely made up of banks, raised concerns that it enabled the Pensions Regulator to boost the ranking of its claims by deliberately waiting until a company entered administration before making a claim.[9] Such an approach would have been a logical one for the Pensions Regulator, as making a claim against the company prior to administration would place such a claim

5 [2011] Bus LR 766.

6 [2011] EWCA Civ 1124.

7 See Insolvency Act 1986, s. 107, s. 115, s. 143, s. 175, s.176ZA, s. 189, paras 65 and 99, Schedule B1.

8 See Insolvency Rules 1986, r.2.67, R.2.88, r.4.181 and r.4.218.

9 See http://www.out-law.com/en/articles/2013/july/supreme-court-to-rule-on-pension-scheme-insolvency-ranking-next-week/.

with the class of unsecured creditors upon the company entering administration and, as a result, the claim would rank behind secured creditors, the administration expenses, floating charge holders and preferential creditors. The priority meant that such claims could be considered as administration expenses and paid ahead of the administrators' remuneration, preferential debts (unpaid wages and holiday pay), claims of floating charge holders, and unsecured claims. The decision of the lower courts could have resulted in some adverse consequences for corporate rescue in the UK[10]and administration in particular. This could have impacted on businesses' ability to borrow funds and administrators' willingness to rescue businesses from insolvency.

On appeal by the administrators of the insolvent subsidiaries, the Supreme Court was asked to interpret a series of rules in the insolvency legislation, as well as to consider if it was Parliament's intention that the Pensions Regulator's claim should benefit from expense status. Whilst the Pensions Act 1995 clearly stated that pension deficits (debts) are not preferential debts, the Pensions Act was silent as to how claims of the Pensions Regulator in these circumstances (where a FSD has been issued) should rank. The Supreme Court in its judgment, reversed the decision of the Court of Appeal and held that liabilities arising from an FSD issued after a company has gone into administration should be treated as a provable debt, ranking as an unsecured claim, as opposed to an expense in administration or liquidation. The Supreme Court Justices led by Lord Neuberger who gave the leading judgment, unanimously agreed that it had not the intention of Parliament to create such an unfair and arbitrary result.

The decision by the Supreme Court had been long awaited after the original ruling three years ago by the lower courts which gave priority to the FSD claim. The decision by the Supreme Court will definitely be seen as a step in the right direction as it eliminates the potential risk of administration expenses weakening or extinguishing altogether the possibilities of a restructuring by discouraging insolvency practitioners from participating in an administration and running the risk of not being paid.[11] Whilst the decision means that the pension scheme deficit will no longer be classed as an administration expense and rank ahead of every other claim apart from the secured claims, it does not do away with the pension liabilities owed the scheme by both companies, rather the Supreme Court placed the FSD claim on a par with other unsecured claims. It has been stated that the decision of the Supreme Court is likely to have an impact on the approach of pension trustees and the Pensions Regulator to restructurings. Despite the fact that the pension schemes were no longer entitled to an enhanced position as beneficiaries of an administration expense claim, they will be considered alongside other creditors and are not left out of the equation completely. Where pension liabilities are substantial, such creditors will still have a voice in the running of the insolvency process.[12]

THE JUDGMENT

Having established that the FSD claim was a provable debt within the meaning of the Insolvency Rules 1985 and the Pensions Act 2004, the Supreme Court had to determine where the claim ranked in the hierarchy of creditors. The Pensions Act had already provided that the claim by the Regulator could not be classed as a preferential debt,

[10] The decisions of the lower courts may have an impact on the cost of lending since any statutory liabilities ranking as an expense would have been taken out of the floating charge.

[11] http://www.cliffordchance.com/publicationviews/publications/2013/07/supreme_court_nosuperpriorityforpensio.html.

[12] http://www.cliffordchance.com/publicationviews/publications/2013/07/supreme_court_nosuperpriorityforpensio.html.

the only two options left were either for it to be classed as an administration expense (the interpretation of the lower courts) or an unsecured claim. Under the English Insolvency law any debt which is not secured by a charge is payable in order of ranking to the affected creditors who put in a claim.[13] The only exceptions to this rule would be insolvency expenses, administrator/liquidator's remuneration and preferential claims. Conversely, the Insolvency rules defines insolvency expenses as "all fees, costs, charges and other expenses incurred in the course of winding up or bankruptcy proceedings"[14] and these enjoy priority payments after secured claims.[15] The category which the FSD claim (by its definition) would be most likely to fall under and as the Supreme Court held was that of the unsecured creditors. The FSD claim, which arose out of an obligation incurred prior to the company becoming insolvent and was issued during the course of the administration process, does not appear to constitute an insolvency expense. The Insolvency Rules define expenses as *all fees, costs, charges and other expenses incurred in the course of an insolvency*, and, when read in conjunction with rules 4.218 seems to suggest that the expense must be as a result of the insolvency and not an incorporation of a pre-existing obligation which was brought to the fore by the insolvency event.

COMMENTARY

The *Nortel/Lehman Brothers* case brought to the fore conflicts that can exist when two bodies of law addresses the same issue, but from different angles. In this case, the Pensions Act on the one hand and the Insolvency Act 1986 on the other. Essentially, the Pensions Act deals with all aspects of employees' benefits as they relates to payments and contributions to pension schemes. The Act also established the Pensions Regulator with the main objective of protecting employees from the adverse consequences of an under – funded occupational pension and personal pension scheme. It also ensures that employers comply with provisions of the Pensions Act as it relates to them. Consequently, the Pensions Act 2004 empowers the Pensions Regulator with wide-ranging authority to ask for financial contributions or support from persons (including insolvency practitioners) connected to or associated with the pension scheme employer, in order to make up pension scheme shortfalls.

Under the Pensions Act 2004, the Pensions Regulator can issue a Financial Support direction (FSDs)[16] and Contribution Notices[17] for this purpose. These powers ensure that the main purpose of the Pension Protection Fund (PPF), which was established by the Pensions Act 2004 to provide compensation to members of eligible defined benefit pension schemes, when an employer is insolvent, and lacks adequate assets in the pension scheme to cover the Pension Protection Fund level of compensation, is not abused by companies. These regimes were introduced as a result of European Directives[18], which called for member states to take measures which ensure the protection of the interests of employees or ex-employees in relation to pension rights in the event of their employer's insolvency.

[13] Insolvency Act 1986, s.107; Insolvency Rules 1986, r.4.181 (1), r.2.69 (for a limited use of the rule during administration).

[14] See Insolvency Rules 1986, r. 12.2.

[15] *Ibid.,* r. 4.218.

[16] Pensions Act 2004, s.43.

[17] *Ibid.*, s.38.

[18] See Directive 2003/41/EC of the European Parliament and of the Council of June 2003 on the activities and supervision of institutions for occupational retirement provision.

The Pensions Act 1995 was also a determining factor in how the decision in Nortel/Lehman Brothers was reached by the courts. The relevant provision which had some bearing on the case was section 75. The section deals with how shortfalls in the assets of an occupational pension scheme should be treated. It states that, where an insolvency event occurs in relation to an employer, an amount equivalent to any deficit in the assets of an occupational pension scheme when compared to its liabilities which existed prior to the occurrence of insolvency shall be treated as a debt due from the employer to the trustees of the scheme.[19] Initially the 1995 Act only made reference to liquidation as the insolvency event which would warrant the application of Section 75(1);[20] however the Pensions Act 2004 expanded the definition of an insolvency event to include company voluntary arrangements, administrative receiverships, voluntary windings-up and administrations.[21] In addition, sub-section 75(4a) states that for the purposes of an employer's insolvency, such a debt (i.e. the deficit) will be deemed to *arise immediately before the occurrence of the insolvency event*. Naturally at the point of insolvency this would have meant that such a debt accruing from employees' entitlements would be classed as a preferential debt. However the provisions of the 1995 Act exclude the classification of debt arising from the operation of Section 75 from being regarded as a preferential debt for the purposes of the Insolvency Act 1986.[22]

The Insolvency Act 1986 on the other hand, deals with issues of insolvency relating to individuals and corporate entities. The main objective of the Act is to provide a framework for the protection and balancing of competing creditors' interests and the rescue of the business where possible. Thus, the 2002 Enterprise Act introduced some reforms to the UK corporate insolvency laws which led to the improvement of the company administration process. Though not a rescue process in itself[23], administration acts as a conduit[24] through which other rescue mechanism such as company voluntary arrangement[25] or a scheme of arrangement[26]can be achieved, where feasible and liquidation where it is normally impracticable to achieve a rescue. Typically, only debts or liabilities which arise out of an obligation that was incurred prior to the commencement of the administration[27] can actually be provable in that administration procedure.[28] As a consequence of this restriction, any liabilities incurred after the administration order has been put in place will ordinarily not be included in the computation of claims, the only exception being, if the debt/liability is part of expenses incurred as a result of the administration order. Administration expenses usually consist of claims that are deemed essential to the conduct of the administration and as a result, are under statute allowed priority as an administration expense.[29]

The FSD claim which was at the heart of this suit was made by the Pensions Regulator after Nortel/Lehman Brothers had gone into administration. Under the

[19] See Pensions Act 1995, s.75(1) & (2).

[20] See Pensions Act 1995, s.75(4).

[21] See Pensions Act 2004, s.121(3).

[22] See Pensions Act 1995, s.75(8).

[23] The Administration process is not a stand-alone procedure, it is designed as a mechanism through which a rescue can be achieved either via a Company voluntary arrangement or a business sale and where this is not achievable, liquidation.

[24] R Goode, *Principles of Corporate Insolvency Law* (3rd edn Sweet and Maxwell, London, 2010), chap 10.

[25] Insolvency Act, 1986.Part1, S. 1–6.

[26] Company Act 1985, s.425.

[27] This the cut off point for creditors who may wish to bring claims against a debtor company.

[28] Insolvency Rules 1986, r. 40.2.

[29] See Insolvency Act 1986 para 99, Sch B1 and Insolvency Rules 1986, r.2.67.

Pensions Act 2004,[30] it is well within the powers of the Pensions Regulator to make such a demand on an employer, or insolvency practitioner in this case, where there is a deficit in contributions to occupational pension scheme. The Act also makes it clear that such a debt would be treated as if it arose prior to the insolvency event which gave rise to the need to put in such a claim. Therefore making such a claim if brought after a company goes into administration, a provable debt under the administration. This point is further buttressed by the provisions of rule 13.12(1)(b) of the Insolvency Rules 1986 which defines debt in winding up to include "any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date" of the winding up order (in this case the FSD) and rule 12.3 which provides that "in both winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained. . ."

Under the Insolvency Act, employees enjoy preferential status[31] and the preferential rights of employees are divided into two broad categories. The first is made up of any sum owed by the insolvent employer in respect of unpaid employer's and employees' contributions to an occupational pension scheme within the definition of Schedule 4, Pension Scheme Act 1993.[32] The second category of employees' preferential rights consists of unpaid remuneration, holiday remuneration and related employment rights.[33] Generally under the insolvency act, preferential debts enjoy priority over floating charge holders and unsecured claims[34] but this priority can only be triggered and established on the occurrence on four distinct events, which are[35];

- The taking of possession of security by or on behalf of the charge
- The appointment of a receiver
- The winding up of the debtor company
- The making of a distribution by an administrator when the company is in administration.

While it may be assumed from the provisions of the Insolvency Act that the claim brought by the Pensions Regulator could at best be classed as a preferential debt, the Pensions Act prevents this by providing that in the event that a pension deficit debt claim is made, it shall not be treated as a preferential debt. Accordingly, it seems that while the Pensions Act provides a remedy for contribution not made to a pension scheme prior to a company's insolvency by classifying such deficits as debt which arose before the insolvency event, it seems to trump this benefit by denying it the status of a preferential debt. On the other hand, it can be argued that allowing pension deficits or schemes to be classed as a preferential debt may produce undue hardship for unsecured creditors who may come away from the whole process with little or nothing as in most cases these deficits could amount to huge sums of money.

Much of the judgment by their Lordships was centred on an analysis of these two statutory provisions, with the ensuing judgement attempting to achieve a balance of fairness in considering that the rights of the pension scheme trustees should not receive any greater or lesser priority than any other unsecured creditors.

[30] See *fn* 12 and 13.

[31] See Insolvency Act 1986, sch 6.

[32] See Insolvency act, 1986, sch.6, para. 4.

[33] See Insolvency Act 1986, sch.6, para. 5.

[34] See Insolvency act 1986, s.175.

[35] See Insolvency act s. 387; R Goode, *Principles of Corporate Insolvency Law* (3rd edn Sweet and Maxwell, London, 2010),para 9–64.

CONCLUSION

The Nortel/Lehman case, while making clear how claims brought as a result of pension scheme deficits should be treated and ranked during insolvency, also showcases how conflicts between two bodies of laws dealing with a particular issue can be resolved. Despite the decision of the Supreme Court appearing to be a painful pill for the pension scheme beneficiaries to swallow, it does lend certainty to how such claims may be treated in future. In addition, it also means that any adverse effect on lending which would have arisen if the Supreme Court had upheld the decisions of the lower courts may have been averted. Floating charge lenders who would have had their security undermined by such claims are assured of their place and can lend to companies with defined benefit schemes with confidence. It also ensures that the threat to the use of administration for successful rescues and restructuring has been eliminated as administrators do not have to face the threat of large pensions deficit claims eroding the sums available before their remuneration is paid.

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HOME OFFICE RULES ON SPOUSAL VISAS FAIL TO CONSIDER IMPACT ON FAMILY LIFE

MM & Others v Secretary of State for the Home Department [2013] EWHC 1900 (Admin) (Justice Blake)

INTRODUCTION

New immigration rules regarding the requirements for entry and leave to remain in the UK as a spouse came into force on 9 July 2012 in Appendix FM.[1] The rules introduced new financial requirements including the requirement that the applicant's spouse earn at least £18,600 and excludes any funding that may be available to the couple via a third party.

This case considered three couples whose applications would fail under the new rules. Blake J carefully scrutinizes the Home Secretary's legitimate aim of strict immigration control with the rights of British citizens and refugees to private and family life.

THE FACTS

MM was granted asylum in the UK with leave as a refugee until 28 January 2014. He had siblings in the UK and a particularly close relationship with his nephew. At the time of the hearing MM was a post-graduate student and was working 37 hours a week earning around £15,600. He had recently married an English speaking Lebanese woman by proxy in Lebanon where she worked as a pharmacist.

The second applicant was a British Citizen of Pakistani origin married to a Pakistani woman living in Kashmir. The couple had five children, four of which lived in the UK. Mr Majid had experienced long-term unemployment but at the time of the hearing was earning £17,361.

The third applicant, Ms Javed, was also a British Citizen of Pakistani origin. She had married a Pakistani man living in Pakistan. She had no formal qualifications and a sporadic employment history. The applicant stated that she was unaware of any of her female peers earning above the income threshold and believed that her local Job Centre only advertised jobs with salaries below it.

THE ISSUES ARISING

MM maintained that, by excluding his wife's future earning capacity as well as any third party support he may receive, there was an unjustified infringement of his right to respect for private and family life under Article 8 ECHR. He further contended that the new rules for partners did not consider the best interests of any children involved, in this case MM's nephew. He believed this to be contrary to s55 Border, Citizenship and Immigration Act 2009, which requires the Home Secretary to consider the best interests of the child in immigration matters.

Mr Majid contended that his earning capacity would increase if his wife were able to join him in the UK and take responsibility for the childcare. He also argued that the third party support available to the couple should be considered with their

[1] UKBA Immigration Rules, App. FM.

application. Further to MM's arguments, Ms Javed complained that the rules discriminated against British Asian women who, statistically, earned significantly lower than men.

In assessing whether the interference with the applicants' rights pursued a legitimate aim as required by Article 8 (2), the Home Secretary contended that Appendix FM offered transparency and simplicity for the decision-maker. Further, evidence showed that low-income families found it harder to integrate into British Society, integration being a key policy consideration for the UK government. As Article 8 is a qualified right, the Home Secretary contended that it did not afford a couple a right to choose their country of matrimonial residence. The Home Secretary also defended the new rules by pointing to the wealth of support they had received from Parliament as well as stating that the new rules did not discriminate on grounds of race or any other protected characteristic.

THE JUDGMENT

Blake J recognised that the right of British citizens to reside in the UK was a 'fundamental right of constitutional significance'. This right was enshrined in statute under s1 Immigration Act 1971 which allows British citizens to reside in the UK 'without let or hindrance'. It was noted that this right should be on an equal footing, if not higher, than the right of EEA citizens to reside in another member state whilst exercising their EEA rights. Blake J observed that there was a 'serious interference with the right of residence' where a British citizen would have to choose either to live in the UK without their spouse or leave their country of citizenship to enjoy family life.

It was also observed that refugees (such as the first applicant) are in a similar position to British citizens because, unlike economic migrants, refugees have no choice but to flee their country of persecution and seek sanctuary in the UK. Further, it is typically the only country in which they have the right to reside.

Blake J agreed with the observations made by the court in *R(Quila and another)* v *SSHD [2011] UKSC 45* that, when dealing with British citizen and refugee sponsors, their right to reside 'without let or hindrance' must be considered along with their right to marry, found a family and, as a result of that, their Article 8(1) ECHR rights. It was for the state to demonstrate that any infringement of the right was proportionate and pursuant to a legitimate aim.

Whilst acknowledging that the protection of the welfare of the UK was a legitimate aim of Appendix FM, Blake J went on to consider whether the measures were proportionate to that aim. There were five features that, when combined, acted so onerously in effect as to constitute an 'unjustified and disproportionate interference with a genuine spousal relationship':

1. **The income requirement**

   Where previously a couple satisfied the requirements by proving that the spouse's entry would not cause further recourse to public funds, a sponsor must now prove they earn at least £18,600. This threshold is far higher than the average salaries for many occupations and considerably higher than that of someone on minimum wage (£13,124). He observed that:

   > "many young people however energetic and well-qualified are discovering that finding paid employment of any kind or sufficiently well-paid employment for the purposes of the Immigration Rules is a real challenge"

The income requirement was set to reflect the national average for rented accommodation or mortgage repayment, however, rent and house prices vary significantly across regions. Furthermore, whilst the rules recognised that some couples may find free or highly subsidized accommodation through family members, they did not enable a discount of the income requirement to reflect that arrangement.

The new threshold reflected the Migration Advisory Committee's advice on the income needed to assure that no recourse to public funds would be required. However, as Blake J noted, this had been calculated using the 'dismal science' of economics and had not purported to consider a person's right to family life. MAC's advice was not capable of justifying 'the terms in which the policy is set'.

As an alternative Blake J suggested that the income threshold should be equal to the amount of money the government purports a UK family can live on i.e. the minimum wage. He declined to go further than a recommendation, leaving it to the Home Secretary to change the requirement in light of his ruling.

2. The savings threshold

Appendix FM provides that any shortfall in the income requirement could be met by savings over £16,000. Blake J regarded this as 'a rather cruel piece of mockery: how is a person earning the minimum wage likely to accumulate savings of £16,000?' He suggested that any savings over £1000 should be taken into account where a sponsor fell below the income threshold.

3. 30-month income projection

Blake J described the use of an income projection for the thirty-month period proceeding entry as 'both irrational and manifestly disproportionate in its impact on the ability for the spouses to live together'. Whilst this requirement had already been in practice prior to the new rules, the new income threshold, as well as the exclusion of third party support, had made the requirement too onerous. A more proportionate requirement might entail a twelve-month projection with review.

4. Third party support

The new rules exclude any form of third party financial support. Blake J considered the impact of this rule exacerbated the negative effects of the aforementioned changes. It was recommended that, where undertakings by third party supporters had been satisfactorily supported by evidence, there was no clear reason why this should not be taken into account. Indeed such a requirement could not be viewed as necessary to achieve the legitimate aim of protecting the state's purse.

5. Potential earning capacity of the spouse

Appendix FM excluded any consideration of the spouse's potential earning capacity on entry to the UK for the whole 2 Ꟶu=year period of the first leave to remain. There did not seem to be a particular rationale for potential income to be excluded from this assessment. Again it does not appear necessary in the pursuit of the legitimate aim.

The Home Secretary's argument of promoting transparency in spousal applications could not successfully justify disproportionately interfering with the sponsors' right to family life. Furthermore, Blake J considered that, with the application fee being £851, the applicant's interests should be the priority rather than the ease of administration.

Blake J considered Article 8 and Article 14 together and rejected the argument that Appendix FM was unlawfully discriminatory towards women and/or ethnic minorities. This was because the aim of the Rules was to exclude those on too low an income to establish economic independence; it was thus inevitable that some sectors of society would be 'disproportionately affected'.

It will be recalled that the complainants further contended that the Rules relating to partners failed to make the best interests of the child central to the application in contravention of s55 UK Borders, Citizenship and Immigration Act 2009. The argument was rejected by Blake J, who said that this did not automatically make the Rules unlawful. It was also thought that requiring extra maintenance for couple's who had children was both reasonable and proportionate.

COMMENT

Theresa May's response to the judgment has been to pause all applications where the financial requirements are unsatisfied pending an appeal to the Court of Appeal scheduled which commenced in March 2014. The decision brings hope to many who would have been denied entry clearance on the basis of the stringent financial requirements. However, further interference with family life has undoubtedly resulted from this pause. As a matter of legal importance the case is likely to be further appealed to the Supreme Court resulting in further uncertainty for hundreds of British and refugee spouses.

The new rules can be criticized for both practical and legal inconsistency. When financial requirements are met, couples are still required to prove their relationship is 'genuine and subsisting' under the rules. It is difficult to see how a sponsor is able to take time off work and spend money visiting their partners when they are expected meet the earnings threshold.

If the Home Secretary's aim was to promote a couple's integration into society via self-sufficiency then it should not matter whether the finance comes from the sponsor, a third party or the prospective income of the partner. All three have the potential of securing financial stability and independence from state funds. The aim of Appendix FM appears to be more about procedural simplicity and expedition and in this sense it is anything but legitimate. The Migration Advisory Committee estimated that the income threshold would have meant that 45% of spouse visas granted in 2009 would have been rejected under the new Rules. Here again the inconsistency can be seen, migrant integration is unlikely to be promoted where families are divided.

Indeed the new rules appear to be part of a general policy direction where the executive are attempting to dictate the decision-making process when human rights considerations are engaged. So far the courts have resisted these moves and asserted that the tribunal must be prepared to make its own assessments of proportionality. The recent case of *MF (Nigeria)* v *SSHD [2013] EWCA Civ 1192* confirms that it is the Strasbourg standards and principles that continue to govern the decisions relating to Article 8 ECHR. Whilst this marks an important constitutional safeguard, it has undoubtedly added momentum to current plans to repeal the Human Rights Act and to reduce rights of appeal on immigration cases.

The current Immigration Bill is partly drafted to reflect concerns over judicial interference. Clause 14 attempts to control how the courts and tribunals apply Article 8 ECHR in immigration matters, although it seems likely that the courts will continue to assert their independence as the final arbiters of human rights considerations.

Having the Rules put on a statutory footing will not save them from being disproportionate and unjustified although it will certainly make the challenge more difficult for the disadvantaged applicant.

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COLLECTIVE AGREEMENTS AND THE CONTRACT OF EMPLOYMENT: DETERMINING THE INTENTION OF THE PARTIES OR DENYING LEGITIMATE EMPLOYEE EXPECTATIONS?

George v. Ministry of Justice [2013] EWCA 324
(Lord Justice Maurice Kay, Lord Justice Rimer, Lord Justice Jackson)

INTRODUCTION

A distinguishing feature of industrial relations in the United Kingdom is that, *prima facie*, collective agreements between trade unions and employers are not legally binding as it is presumed the parties do not intend the agreement to be legally enforceable. This principle was confirmed by the Court of Appeal in *Ford Motor Co Ltd v AEUW*[1] and later put into statutory form by s.179(1) Trade Union and Labour Relations (Consolidation) Act 1992. Although collective agreements are not ordinarily of any legal significance between employer and union, if they are translated into a contractual relationship between employer and employee, then they can have legal force at the individual level as a term of the contract of employment. To assume contractual validity the relevant clauses of the agreement must be incorporated into the contract of employment expressly or impliedly and must be of an individual nature; capable of being legally binding between the employer and the employee as an individual term. *George v Ministry of Justice (George)* is the latest case where the Court of Appeal has examined the factors that should be taken into account in determining when the terms of a collective agreement are incorporated into a contract of employment and when such a term is "apt" for incorporation.

THE FACTS

The crux of this case was a dispute between the trade union (the Prison Officers Association) and the employer (now the Ministry of Justice, previously the HM Prison Service) over the incorporation of a term of a collective agreement in prison officers' contracts relating to overtime provisions. With a view to amending a number of working practices lengthy negotiations had taken place between HM Prison Service and the Prison Officers' Association over a number of years in the 1980's resulting in a detailed agreement (known as Bulletin 8) between the parties in 1987. The particular provision in dispute, paragraph 23 of Annex A to Bulletin 8, replaced paid overtime with "Time Off In Lieu" (TOIL) - prison officers who worked over their normal 39 hour week would be entitled to TOIL for the excess hours worked. The relevant part of paragraph 23 in dispute stated: "Group managers should ensure that individual members of staff do not work high levels of additional hours without being compensated by TOIL. The aim should be for no more than five additional hours to be accumulated in any one week. *Accumulated TOIL will be granted as soon as operationally possible and within a maximum period of five weeks.*"

The claimant appealed against the dismissal of his claim for breach of contract when, after working the additional overtime, the employer had failed to offer him TOIL within the 5 weeks' time period outlined in paragraph 23. Judge Wood QC in the county court had held that the failure of the employer to comply with this requirement

[1] [1969] 2 QB 303.

was not legally significant as there was insufficient documentation adduced in evidence to conclude that paragraph 23 had been expressly incorporated into the claimant's contract of employment. Wood J, nevertheless, did determine that a general obligation to grant TOIL was arguably incorporated by implication as a custom and practice; as payment for overtime was a recognised practice for a number of years and so clearly understood by both parties to be contractually binding. However, as there was no continuous provision of TOIL within 5 weeks as required by paragraph 23, this specific time frame was not legally inferred.

THE DECISION IN THE COURT OF APPEAL

The Court of Appeal dismissed the appeal. Rimer LJ (who gave the only reasoned judgment) found that paragraph 23 had not been incorporated by express reference as the claimant was unable to produce his original letter of appointment or written particulars of employment or any other documentation addressed to him that expressly introduced Bulletin 8 (and therefore paragraph 23) into his terms and conditions. A later standard form letter had been sent to employees that made express reference to Bulletin 8 and additionally referred to TOIL provisions in the staff handbook. Rimer LJ, however, rejected the letter's significance as the provisions in the staff handbook did not form part of the contract of employment and the failure to provide evidence that George had actually received the letter was fatal to the claim that Bulletin 8 had been expressly incorporated into his contract.

As there was no direct evidence of express incorporation paragraph 23 could only be incorporated by inference; the basis for which was an intention by both parties to be bound by that provision. Counsel for George submitted that the extensive negotiations on the particular wording of this paragraph prior to agreement was part of the factual background that should be considered when determining the intention of the parties – justifying the conclusion that the parties implicitly intended paragraph 23 to be legally binding at the individual level and therefore enforceable as a term of the contract. Rimer LJ, however, rejected Counsel's submissions. The negotiations prior to the subsequent collective agreement were only one source of the evidence of the intention of the two parties and ultimately insufficient to justify implied incorporation.

Rimer LJ also explicitly overruled the decision of the county court that TOIL had been impliedly incorporated by custom and practice. Rimer LJ applied the test from the judgment of Hobhouse J in *Alexander v Standard Telephones*[2] - that intent can be implied from both parties knowledge of the relevant clause of the agreement and subsequent compliance with that provision, particularly where it has a day to day impact. Rimer LJ noted that TOIL, as compensation for additional hours, had been operating for a number of years since Bulletin 8 had been agreed in 1987, but as it was not always the case that TOIL was granted within five weeks this was an inadequate level of compliance to satisfy the test for TOIL *per se* to be an enforceable custom of employment.

Of greater significance was Rimer LJ's view that even if paragraph 23 was intended by the parties to be enforceable it was not "apt" for incorporation – it was not the type of clause that was capable of incorporation as an individual term. The proviso that leave should be available within a 5 week period was a mere 'aspiration or target'; non-binding guidance on the issue of when TOIL would, in normal operational

[2] [1991] IRLR 286 at para 27.

circumstances, be granted. Rimer LJ came to this conclusion by taking account of the generalised language of paragraph 23 and its associated provisions and by the fact that paragraph 23 was contained in a staff handbook ostensibly dedicated to "policies and procedures". Furthermore, Rimer LJ noted that paragraph 23 required TOIL to be provided without taking account of the efficient functioning of the Prison service. Counsel for the employer's observation that if paragraph 23 was applied literally, as an unqualified contractual obligation, it would have "catastrophic" operational consequences, informed his conclusions that such a clause was not legally binding as it was in practice unworkable and thus "... inconsistent with the parties likely intention". [3]

COMMENTARY

The Court of Appeal in *George* has followed a form of interpretation of the principles of incorporation that has implications for the drafting of collective agreements and their impact at the workplace.

In determining that the standard form letters referring to the TOIL provisions were not significant, the court had arguably failed to construe the documents in context - by reference to the detailed negotiations prior to the agreement on paragraph 23 which provides evidence of an intention by both parties to be bound by its content. Furthermore, in determining the issue of whether the clause had been incorporated by inference, although Rimer LJ had quoted extensively and approvingly from the judgment of Hobhouse J in Alexander v Standard Telephones[4] he had arguably failed to fully apply the principles from this judgment to the facts in *George.* TOIL was an issue of day-to-day relevance (relating to wages and time off) and over a number of years the Bulletin 8 TOIL provisions (stemming from the bargaining process) had been substantially followed. To determine that an aspect of detail of the TOIL provisions contained in Bulletin 8 was not incorporated by inference because it had not been followed in absolute terms seems an overly restrictive approach to the principles of implied incorporation by custom and practice.

Of greater concern is Rimer LJ's decision that paragraph 23 was not "apt" for incorporation. Some aspects of Bulletin 8 were clearly aspirational and not appropriate for incorporation; including the first two sentences of paragraph 23. However, the final sentence of paragraph 23 was clear and specific in its language and not a vague policy orientated clause but one on pay that affected employees on a daily basis. As the wording of the clause was clear and transparent and was not on an issue that was solely of collective interest and relevant only to the union/employer relationship it ought to have been considered as "apt" for incorporation.

The Court of Appeal's decision in *George* continues the modern trend of the Court of Appeal to emphasise the relevance of the impact of incorporation when assessing whether the clause is capable of incorporation. An earlier example of this approach is demonstrated in *Malone v British Airways plcs*[5] where the disputed clause in the relevant collective agreement prescribed in detail the minimum number of cabin crew to be allocated to specific aircraft. Although the Court of Appeal accepted that the clause in dispute was a clear undertaking, it was held that the employer's unilateral reduction of crew members for individual aircraft below the number outlined in the collective agreement did not amount to a breach of the individual contract of

[3] *George v Ministry of Justice* [2013] EWCA 324 at para 60.

[4] [1991] IRLR 286.

[5] *Malone v British Airways plc* [2011] IRLR 32.

employment - it was merely an undertaking to the union as a collective body and so not "apt" for incorporation. The Court of Appeal declared that the parties could not have intended for the clause to be individually enforceable – taking into account that it could result in grounded flights and ". . . the disastrous consequences for British Airways which would ensue".[6]

This method - of determining the aptness of a clause based on its practical effect - may be a technique to avoid unfortunate consequences for an employer but it is difficult to see how it can be supported by the application of principle. Case law undoubtedly holds that recognition or facility agreements[7] are unsuited to incorporation as they are areas of concern to the union collectively, as are documents of a general policy nature; for example, on long term redundancy or training issues[8] or clauses in an agreement that are too vague.[9] In all these circumstances the parties would not intend or expect to be bound at the individual level. However, if the clause is sufficiently individual in scope; on a substantive issue, such as pay, hours of work or other such term expected in a contract of employment, it is prima facie suitable for incorporation[10] unless there is plain evidence that the parties did not intend the clauses to have legal effect.

In *George* (as in *Malone*), the provision in dispute was an issue of an individual nature; unrelated to any collective issue. The evidence of intention of both parties to treat paragraph 23 as enforceable (the clear and specific language, the enforcement of related clauses and the evidence of the negotiation surrounding the agreements) was given little emphasis by the Court of Appeal. What was given emphasis and taken into account when construing the intention of the parties was not the prior negotiations and the surrounding documentation but the organisational and operational implications of the provision. This arguably more subjective analysis in determining whether the parties intended legal consequences to flow from the provision does not, on the face of it, comply with the principles of contractual construction.[11]

One conclusion that can be derived from the decision in *George* (and the earlier *Malone* case) is that clauses that are detrimental to employers' interests are less "apt" for incorporation than clauses that are not. These cases suggest that the courts are entitled to look behind the express obligations in a collective agreement and that terms stemming from collective agreements are worthy of greater scrutiny than other contractual documents. Decisions like *George* thus arguably undermine the process of collective bargaining as an effective means of regulating workplace issues and determining terms and conditions of employment. In the future those involved in union-employer negotiations need to ensure that the results of negotiations are very clearly expressed as definite undertakings so that they can withstand the sort of rigorous contractual analysis demonstrated by *George* and *Malone*.

CHARLES BARROW*

[6] *Malone v British Airways plc* [2011] IRLR 32 at para 62.

[7] *Gallagher v Post Office* [1970] 3 All ER 712.

[8] *British Leyland v McQuilken* [1978] IRLR 245.

[9] *Lee v GEC Plessey Telecommunications* [1993] IRLR 383.

[10] *National Coal Board v National Union of Mineworkers* [1986] IRLR 439; *Kaur v MG Rover Group* [2005] IRLR 40.

[11] The principles of construction relating to collective agreements were succinctly outlined by Sir Thomas Bingham MR in *Adams v British Airways plc* [1996] IRLR 574 at para 22 – "..a collective agreement must be construed like any other agreement . . . construed in its factual setting as known by the parties at the time".

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BOOK REVIEWS

Book reviews and books for reviewing should be sent to the address given at the beginning of this issue

Law as Engineering: Thinking About What Lawyers Do
by DAVID HOWARTH, Cheltenham, Edward Elgar, 2013, ix + 237 pp, Hardback, £69.95, ISBN 978 0 85793 377 5

Law as Engineering is a provocative and stimulating book that asserts that lawyers are designers, and further that the type of designers that they are most closely aligned with are engineers.

The book starts with a lively account of earlier explorations of law and lawyers as social and legal engineers. The tradition most prominent in this account is the legal realist tradition, and the most prominent writer is Karl Llewellyn. Lon Fuller is also given respectful attention. One demarcation made in the introduction that is important for the book is the distinction between policy and law. The engineering of interest to Howarth is centred in legal drafting, of statutes and contracts, not in legal policy and grand schemes of social engineering. The autonomy of the law, both as a practice and as an academic subject, is tied up with this distinction between policy which is political and legal craft which is legal proper. The other task of the introduction is to suggest that our paradigm of the lawyer is wrong. Most lawyers are not concerned with litigation: the paradigm should not be lawyers as dispute specialists but lawyers as creators of legal devices such as statutes, companies, contracts and property interests. With this more realistic paradigm in place it is then possible to see more clearly the similarities with engineers who make devices.

Howarth locates his work alongside or as part of the self-proclaimed "new legal realists" movement.[1] However, it seems congruent with many other contemporary approaches to ethical theory, legal theory, law, legal practice, and legal education. Consider the following attacks on the *primacy* of theory over practice:

Howarth on the relationship between science and engineering:[2]

> "Engineers are not even 'applied' scientists, in the sense of those who merely take advances in theoretical knowledge and apply them to practical problems . . . it is mistake to believe that the intellectual movement is always from science to engineering. The contrary movement is also important . . . many engineers claim that engineering is not merely applied science because it generates its own forms of knowledge . . . that engineering knowledge is not just 'know-how', a set of unspoken practices, but knowledge that can be stated clearly, tested and transmitted."

[1] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at p. 167 citing Howard Erlanger, Bryant Garth, Jane Larson, Elizabeth Mertz, Victoria Nourse and David Wilkins, *Is it Time for a New Legal Realism?* [2005] Wisconsin Law Review 335. The revival of legal realism, which was inspired at least in part by American pragmatism, finds a parallel in philosophy with Cheryl Misak (ed), *New Pragmatists* (2007) Clarendon Press, Oxford.

[2] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at pp. 54–55.

Howarth on his vision for legal research:[3]

> "Academic engineers study how practicing engineers create new useful objects. Their objective is to take engineers' implicit, unspoken 'know-how' and to turn it into explicit knowledge . . .They systemise what engineers do and make it explicit, but they also study the existing processes' successes and failures . . . so they can suggest improvements . . . There is a template here for legal research."

Carnegie report on the primacy of practice:[4]

> "Formal knowledge is not the source of expert practice. The reverse is true: expert practice is the source of formal knowledge about practice. Once enacted, skilled performance can be turned into a set of rules and procedures for pedagogical use, as in the cognitive apprenticeship. But the opposite is not possible: the progression from competence to expertise cannot be described as a simple step-by-step build-up of the lower functions. In the world of practice, holism is real and prior to analysis. Theory can – and must – learn from practice."

MacKinnon on the split between high status theory and low status clinical practice in legal education.[5]

> "The theory/practice split inherited from male dominance has not served women conceptually or practically. I doubt it serves legal education either."

Toulmin on the proper role and use of ethical theory as subordinate to moral practice, rejecting the ideas that theory is foundational for practice or the source of principles that are then somehow simply 'applied' in specific cases:[6]

> "This brings into focus the relation of Ethical Theory to Moral Practice, which comes onto center stage at this point: the central issue is not the timeless question, 'What general principles can be relied on to decide this case, in terms that are binding on everyone who considers it?', but rather the more timely question, 'Whose interests can be accepted as morally overriding in the situation that faces us here and now?'"

> "Theory (so to speak) is not a foundation on which we can safely construct Practice; rather it is a way of bringing our external commitments into line with our experience as practitioners."

[3] *Ibid.* at p. 158.

[4] William M. Sullivan, Anne Colby, Judith Welch, Lloyd Bond and Lee S. Shulman, *Educating Lawyers: preparation for the Profession of Law* (2007) Jossey-Bass: San Francisco, CA at 118.

[5] Catharine **A.** MacKinnon, *Mainstreaming Feminism in Legal Education* (2003) 53 J. Legal Educ. 199 at p. 211 citing: Phyllis Goldfarb, *A Theory-Practice Spiral: The Ethics of Feminism and Clinical Education* (1991) 75 Minn. L. Rev. 1599.

[6] Stephen Toulmin, *Return to Reason* (2003) Harvard University Press, Cambridge MA at loc 1629–32 and loc 1762–63.

Ferris and Johnson on the purposes of legal education:[7]

> "There has been an implicit assumption that legal education should be about exposition and evaluation, and should reward facility in exposition and theoretical awareness. This theoretically based assumption generates a theory-induced blindness . . . The role of lawyer as rule entrepreneur is lost sight of. One alternative assumption about legal education would be that law is a game like activity; and legal education should be directed towards promoting those qualities that would enhance performance in this game . . . We argue for a clearer awareness of the role of rule entrepreneurship in clinical programmes and in legal education generally."

Finally, pre-dating these twenty-first century attempts to subordinate theory to practice is Bernard Williams on theory (bad) critical reflection (good) and life (the point of it all):[8]

> "Theory looks characteristically for considerations that are very general and have as little distinctive content as possible, because it is trying to systemize and because it wants to represent as many reasons as possible as applications of other reasons. But critical reflection should seek for as much shared understanding as it can find on any issue, and use any ethical material that, in the context of the reflective discussion, makes some sense and commands some loyalty. Of course that will take things for granted, but as serious reflection it must know it will do that. The only serious enterprise is living, and we have to live after the reflection; moreover (though the distinction of theory and practice encourages us to forget it), we have to live during it as well."

These various currents are not obviously the result of conscious borrowing and active discourse. The cross-references between them are surprisingly few. The Carnegie report is not referred to in Howarth; and neither the Carnegie report nor Howarth refer to the work of Toulmin or Williams; and MacKinnon is not referred to in Carnegie or Howarth. It seems that the twenty-first century academic *zeitgeist* rejects the traditional primacy of theory over practice and *Law as Engineering* can be best understood in this broader intellectual context.

Chapter Two devoted to the question "What do lawyers do?" is excellent. It reviews a lot of research on legal services and is persuasive on the need to give a higher profile to transactional lawyers in accounts of legal professional practice. The material on legislative draftsmen is interesting and informative and this reader certainly profited from the attention given to the work of these specialists. The material on the work of City lawyers is also well assembled and structured. The transactional lawyer and the legislative draftsman are both seen as producing documents which are the form of the devices that lawyers design. This means that social interactions are rather downplayed: negotiation, team building and management, and oral communication fall into the background as necessary antecedents of the final documents. The textual bias may be due to a desire to downplay the oral aspects of the role, because the oral and

[7] Graham Ferris and Nick Johnson, *Practical Nous as the Aim of Legal Education?* (2013) 19 International Journal of Clinical Legal Education at 271. Howarth in *Law as Engineering* notices rule entrepreneurship but does not emphasise its importance at p. 196. However, the role of the legislative draftsman is given great emphasis in the book. It seems Howarth retains a technocratic view of legal practice: see pp. 151–158 and p. 167. However, he is clearly very concerned with the ethics of legal practice and pp. 168–169 suggests he thinks ethical lawyering can temper, minimise, or even avoid unethical practices. The section of the Nottingham Law Journal devoted to "Practical Applied Legal Theory" is an attempt to encourage thinking about the relationship between practice, real life, and theory.

[8] Bernard Williams, *Ethics and the Limits of Philosophy* (2006) Routledge, Abingdon at pp. 116–117, first published (1985).

situational has traditionally been emphasised in the lawyer as advocate paradigm that Howarth is trying to supplant.

The chapter does have a rather partial focus on commercial private practice and legislative drafting. Howarth shows awareness of the relative neglect of lawyers who do not serve powerful institutions, whether public or private. However, he seems to assume transactional lawyers working for private clients do the same sort of thing as City lawyers at a less exulted level. He develops one example from private client work, specifically will drafting, to highlight key aspects the transactional lawyer's role. The whole chapter is a very useful corrective for unreflective characterisations of legal services as being concerned with disputes and courts.

The following chapter "Law as engineering" is also excellent. It gives a fascinating account of academic engineering. It is hard to disagree with Howarth's judgment that the engineers have a far better articulated and differentiated account of the practice of engineering than academic lawyers have managed to produce of the work of transactional lawyers. The chapter goes on to compare the roles of the drafting lawyer to the engineer and the comparison is interesting and generates novel insights. Finally, the chapter allows for the possibility of allowing litigators into the engineering fold. Together these two chapters constitute sufficient reason to read this book. The similarities between law and engineering are powerfully delineated. The material assembled is instructive and excites intellectual curiosity and engagement.

The fourth chapter "Implications (1) – Professional ethics" works less well. The central contention: that the ethics of transactional lawyers, those involved in non-contentious work, need far greater attention is surely correct. The criticism of assertions in non-contentious fields of ethical positions justified by systemic features of adversarial advocacy is well made. Identification of a problem with the effects of legal advice and services on third parties to the lawyer client relationship is sound. Thus, the chapter is valuable. However, the examples chosen to illustrate these problems do not work very well.[9] The examples are chosen to link legal ethics to the banking crisis, and this renders the argument rather artificial. The systemic causes of the banking crisis were not driven by legal practices.[10] It would have been better to use situations that have already been discussed in the literature on professional ethics.[11] This is because better examples are available in the literature, and the repeated examination of the same problem scenarios from different perspectives can produce a more generative and elaborated discourse: one might refer to the related literature developed around runaway trolleys in ethical discourse. Thus, novelty of presentation here was at the expense of the potential value of the discussion. However, as noted the questions raised are pertinent and important and the discussion of analogous engineering ethics is valuable.

The fifth chapter "Implications (2) – Legal research and teaching" is a useful contribution to ongoing debates about the Law School. The assumption that lawyers

9 Linklaters' advice letter on Repo 105s in the context of Lehman Brothers business, and the assembling of derivatives for Goldman Sachs that the bank shorted.

10 See: Charles P. Kindleberger and Robert Z. ALiber, *Manias, Panics and Crashes: A History of Financial Crises* (2011) Palgrave Macmillan, Houndmills.

11 For example: William H. Simon, The *Practice of Justice: A Theory of Lawyers' Ethics* (2000) Harvard University Press, Cambridge MA develops some pertinent cases that could have been discussed. The cause lawyer literature also offers illuminating discussion of the relationships between the personal ethics of the person who is a lawyer, the ethics of the lawyer as professional, and the ethics of the practice of the client. The treatment of the extensive and varied literature is disappointing. Finally, the problem of ethical action in the face of pressure is clearly identified as an important issue in the context of the Challenger disaster, but no attention is given to the literature on moral courage and efficacy e.g. Mary C. Gentile, *Giving Voice to Values: How to Speak Your Mind When You Know What's Right* (2012) Yale University Press, New Haven.

do and should serve the powerful is evident once more, and there is no counter-balancing example from private client practice.[12] Also, from a UK Law School perspective there is a neglect of those students who study law but do not go into practice.

The differentiation between policy and law is also active. The distinction tends to introduce a division between purpose and technical implementation. It is an instrumentalist view of law that Howarth advances. He then superimposes a duty to have regard to the uses made of legal devices taken from ethical discourse in engineering. In effect he places role morality and public benefit in an uneasy and unresolved relationship of tension.[13] He has identified problems with extending the role morality of the advocate to the transactional lawyer but has not given enough attention to the role morality of the transactional lawyer.

The suggestion that rules are legal materials the way that engineering has materials and that research into rules is usefully analogous to research into metals and plastics is unpersuasive.[14] Rules are words, or social practices, or logical relations, or authority bestowing conventions, or plans of action amongst other things. If there is to be a science of materials then the subject matter would have to be: the speech act or written equivalent (the operative words of a deed); the interpretative community; community norms of action (where community is defined by relationship or practice e.g. those people and organisations who work in the construction industry). The focus on the text that was present earlier returns and it is not just the advocate it displaces: it is the social situation that is obscured. If this is correct then Howarth's attempt to demarcate the social sciences and academic law also breaks down. The argument that doctrinal law serves by providing construction materials seems to be a return to a rather abstract naïve view of law. Practice is about what works, and sometimes rules work in practice. The movement from this to: all that is important for practice is clear rules; seems illegitimate. Construction of contracts and dispositions is uncertain in practice because the text, the rules or words, are not autonomous of communities of practice as Howarth recognises elsewhere.[15]

The fifth chapter is thus provocative and intriguing but not wholly successful in its own terms. Perhaps the sheer bravado of attempting a reformist account of the entire activity of the academic legal community in a single chapter is intended to imply that the treatment is tentative and exploratory, and an invitation to debate, rather than the final word on the subject from the author. It certainly kept this reader engaged, although ultimately it was unpersuasive.

Finally, Howarth's conclusion deals with "objections" to the idea of law as engineering and highlights the promised benefits of the approach. It keeps up the clear style but it suffers from the vice of setting up weaker positions to overcome than could be established. The benefits it identifies are also a little speculative.

In conclusion this book is entertaining, informative, engaging, and provocative. It is well written and referenced, the index is good and useful, the physical book feels and looks good. If seen as an attempt to reformulate how law and lawyers are seen by themselves and others, and how law is taught and researched, then I very much doubt it will succeed. However, if viewed as one work in a current that reflects a *zeitgeist* that rejects genuflection to systemic theorising in the legal academy then it is a useful and helpful contribution to the discourse. The book places legal practice in the field of

[12] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at pp. 151–158.

[13] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at 168 and pp. 178 – 181.

[14] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at 159 – 160.

[15] David Howarth, *Law as Engineering* (2013) Edwin Elgar Cheltenham at p. 90.

making, and depicts legal practice as *primarily* about making useful devices. It introduces to a legal audience an academic and practical discipline that does have real similarities with law. It thus allows fruitful generalisation and creative appropriation of concepts from engineering. It is certainly worth reading and reflecting upon.

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INTERNATIONAL LAW, EUROPEAN CITIZENSHIP AND THE ROMA

Foreigners, Refugees or Minorities? Rethinking People in the Context of Border Controls and Visas, by DIDIER BIGO, SERGIO CARRERA AND ELSPETH GUILD (eds.), United Kingdom, Ashgate, 2013, 258 pp, Hardback, £60.00, ISBN 978-1-4094-5253-94

INTRODUCTION

There has been a great deal of analysis of late on the tensions at the heart of the European asylum policy and the direction that European citizenship appears to be heading. This multi-disciplinary collection of essays is a timely and important contribution to this debate and, through its central analysis of Roma migration it addresses questions which have been much neglected by the scholarship to date.[1]

The Roma present a unique case-study where the tensions inherent in conceptions of both national and European citizenship can be explored and scrutinised. Collective expulsions of Roma migrants from France and Italy and the hostile reception that Roma migrants have attracted in parts of the UK, challenge the very notion of common European citizenship. EU Justice Minister, Vivienne Reding received wide-spread criticism when she drew analogies with the Vichy Government's expulsions in WW2. She appeared a lone voice as the European Commission failed to condemn the expulsions or commence enforcement action, despite the absence of clear legal authority justifying the expulsion measures.

The degree of entrenched structural discrimination faced by Roma in the 'new' Europe is not recent news. The degree of poverty and social exclusion facing Roma populations in many European states (both old and new) is difficult to over-state. Thus one might be forgiven for thinking that difficult questions should have been raised regarding compatibility with human rights during the accession process. The Copenhagen criteria demanded respect for the rule of law and protection of minorities within the human rights branch of the political criteria. Slovak and Czech Roma had been attempting to claim asylum in other European states following the dissolution of Czechoslovakia in 1993. The enactment of the Czech Citizenship law excluded many Czech Roma residents from citizenship, making them de facto stateless. Extremist violence towards Roma was regularly reported by human rights bodies in both countries and in one particularly well-documented case a wall was constructed in Usti Nad Labem to segregate Roma residents from other Czechs. The education system in several countries was, and remains, inherently discriminatory with many Roma pupils assigned to special remedial schools for students who are mentally disadvantaged.

As Judit Tóth recognises in her contribution on Czech and Hungarian Roma, the candidate states were good pupils at passing legal rules, presenting a façade of human rights protection (p54). Both countries were considered to have met the criteria and formally joined the European Union in 2004. With the carrot of Union membership consumed, any significant incentive to encourage improvements in the protection of human rights was considerably reduced.

The effect of the Aznar Protocol combined with the Dublin Regulation, is to prevent European Union citizens from making a successful asylum application in another EU state. All Member States are presumed generally free from persecution for all inhabitants.

[1] One exception to this is O'Nions, H "Roma Expulsions and Discrimination: The elephant in Brussels" 2011 EJML 13, 4, 361

CONTENT

In their introductory chapter, Guild and Carrera identify some of the difficulties present when purporting to understand and address the challenges facing Roma communities. They reveal alarming disparities in official statistics on Roma populations in every country surveyed. Further, the romanticised image of the Gypsy as nomad has a profound influence on the direction of national policies, enabling policy-makers to strip sedentary Roma of their ethnicity. Contrary to popular opinion, most Roma in Europe are sedentary and have been for several generations. By contrasting them with the image of the travelling Romany, it becomes possible for a position of inequality and disadvantage to be portrayed as a life-style preference. Paradoxically, the universality of Union citizenship is denied to European Roma migrants on the basis of their ethnicity. Criminality appears in much of the exclusionary language deployed by French and Italian politicians as an inherent component of a 'primitive', non-European identity.

Analysis of the Canadian visa affair enables the reader to consider the inherent contradictions in a European citizenship predicated on the rule of law, democracy and human rights which then appears to selectively apply those same rights. The international principle of reciprocity is certainly undermined by the imposition of visas on Czech citizens. Neither state has covered the themselves in glory here. The imposition of visa requirements as a direct result of increasing asylum applications is nothing new. Indeed the UK government applied a visa requirement for Zimbabwean nationals in 2003 and Slovak nationals in 1998 for precisely that reason. However, it certainly undermines the right to seek sanctuary from persecution under the Refugee Convention.

Didier Bigo's chapter, 'When Montesquieu Goes Transnational: The Roma As An Excuse, Visas As Preventative Logic And Judges As Sites Of Resistance' explores the increasing role of transnational judges in addressing the human rights gaps left by political institutions. A conflict very familiar to British Constitutional lawyers is played out transnationally as governments in Europe and Canada respond to the security concerns of conservative electorates and the media. The author attributes some of the blame to experts in geopolitics and preventative criminology who are accused of disseminating a discourse which criminalises Roma by reference to transnational crime networks often centred on the exploitation of minors. One only needs to reflect on the media storm following the allegation that a Greek Roma couple had abducted a child in 2013.[2] The case led to the removal of a child from a Roma couple in Ireland who was later found to have been living with her biological parents. As this example demonstrates, the self-serving nature of the security problematic is axiomatic as European citizen's experience increased anxiety and then clamour for greater restrictions.

Bigo further observes how the Roma are typically seen as the architects of their fate rather than as the victims of wider societal changes. In the Czech Republic and elsewhere in the region, the situation of the Roma became markedly worse after the collapse of Communism. Most had left Slovakia to work during Communist industrial drives and lived in cheap, temporary housing. As the nature of the economy changed the need for lower-skilled workers diminished whilst discriminatory attitudes, largely kept in check under Communism, were more openly expressed. Indeed, the Roma are

[2] BBC "Roma case in Greece raises Child Concerns" 23rd Oct 2013 http://www.bbc.co.uk/news/world-europe-24635560.

the dialectical others. As a heterogeneous, non-territorial minority that lacks cohesive political representation, the Roma are 'useful enemies'

Until recently, European courts have viewed Roma rights complaints as isolated examples rather than through the prism of entrenched discrimination but transnational judges are now increasingly required to assert and defend the rights of minorities, foreigners and outsiders against government populism and public anxieties.

In Chapter Three, Judit Tóth presents an excellent overview of the migration of Czech and Hungarian Roma to Canada in the late 1990's. Following the collapse of Communism, Roma in the Czech Republic and Hungary experienced a dramatic rise in racist attacks, in a climate of police complicity and growing extremism. Following a TV Nova documentary presenting Canada as a favourable destination for Czech Roma in 1997 a pattern of migration began to emerge. There are well-documented accounts of Roma being given their air fare by local councillors who were happy to see their departure. An estimated 800 Czech Roma were able to demonstrate a well-founded fear of persecution and thus received refugee status in Canada. However, anxious to avoid responsibility for further arrivals and mindful of the political row that had ensued, the Canadian government introduced visa controls to dramatically reduce the number of arrivals.

From 1995 onwards a steady number of Hungarian Roma were taking a similar decision. In 1998 71% of Hungarian Roma asylum claims were accepted by the Canadian Refugee Board yet as Tóth observes, the number had dropped to 9% the following year. It is difficult to identify the precise cause of the decrease but lawyers and advocates point to a deliberate policy decision to shut the door on these arrivals.

Despite the more restrictive policy and the use of visa controls by the Canadian authorities, Roma migration has continued to Canada and many more Roma have used the free movement rights commensurate with European Citizenship, to migrate much closer to home.

Claude Cahn's chapter 'Roma and Racial Discrimination. The jurisprudence of the European Court of Human Rights', critically examines ECtHR jurisprudence concerning Roma applicants. As recognised by Bigo, there was initial reluctance to accept these applications as anything other than isolated cases and the Court has been particularly slow to develop a substantive application of Article 14, the non-discrimination principle. This leads Cahn to consider the ECtHR as complicit in the marginalisation of Roma issues.

Cahn observes how the decision in *Buckley v UK*, concerning the applicant's right to station a caravan on her own land, was principally regarded as an Article 8 claim. In the balancing act inherent in Article 8, the Court refused to engage with the applicant's rights from a perspective of her ethnicity, referring instead to the need to respect the Gypsy 'lifestyle' when making planning decisions. On the facts, the Court found that the applicant's right to a home and family life could be outweighed by the state's interest in applying and maintaining planning rules. The cautious development of Article 14 is further illustrated by reference to the Bulgarian police abuse cases. In three separate applications concerning police brutality, the court declined to examine the discriminatory application of Bulgarian law.[3] The Court were again forced to examine these issues in the case of *Nachova and Others v Bulgaria* [2005], which concerned the murder of two Romani men by the Bulgarian police and military and the subsequent failure to investigate the cases. The Grand Chamber found a violation of Article 2 (right to life) coupled with Article 14, to the extent that there had been no

[3] *Assenov v Bulgaria* [1997], *Velikova v Bulgaria* [2000] and *Anguelova v Bulgaria* [2002]

investigations or prosecution resulting from the incident. Numerous rights violations, including Article 14, were subsequently found in the Court's judgement relating to a pogrom against Romani villagers in Hădăreni, Romania.[4] Although twelve people were initially convicted for their part in the murder and arson in 2008, two cases were quashed on appeal and the others were pardoned by presidential decree two year later.

The most significant case concerning the development of Article 14 is the decision concerning segregated education for Roma pupils in *DH v Czech Republic* [2007]. For the first time, the ECthR were prepared to accept statistical evidence to support the applicant's claim of entrenched discrimination in the Czech education system, which revealed that Roma pupils were significantly more likely to attend such schools.

Whilst Cahn is able to recognise some significant progress in the Court's non-discrimination jurisprudence he remains concerned over the Committee of Ministers' success in supervising judgements and in the ability of the Council of Europe to translate it's judgements concerning Roma into tangible benefits for Roma in the Member States. It is difficult not to concur that the barriers facing Roma applicants in bringing a case to the attention of the Court are immense and 'progress seems a very distant prospect'.

Maria Koblanck provides an attempt to reconceptualise international law and a discourse dictated by historical assumptions. She draws heavily on the work of Dipesh Chakrabarty who asks us to question Europe's monopolisation of historical narratives. For Chakrabarty and Koblanck, Europe's experience of modernity is only one experience. The notion of Europe as the cradle of liberty is challenged by a heterogeneous interpretation which rejects a totalizing logic of historical development and social justice. This pre-modern discourse can be applied to much of the contemporary political discourse concerning the Roma. A fluid, different, 'primitive' lifestyle is often seen as the justification for exclusionary attitudes. This is illustrated by the remarks made by President Sarkozy concerning Roma expulsions from France. She contends that our "idealized notion of difference and culturally incommensurable types of life sit badly in a world of constant and never ending negotiation between certain given structures and processes due to modernisation and all of the different manners in which we negotiate those structures and processes" (p88)

Section 2 consists of three chapters relating to the 'The EU-Canada Visa and Roma 2009 Affair'. In Chapter 6, Alejandro Eggenschwiler identifies the principal factors said to justify the reintroduction of the temporary residence visa for Czech nationals. Whilst Canadian politicians referred to a rise in the number of claims for refugee status, increases in the inadmissibility of such claims and in the number of interceptions of Czech visitors en route to Canada, there was an assumption that the overwhelming majority of such arrivals were merely economic migrants. This assumption is in stark contrast to the decisions of the Immigration and Refugee Board which recognised 43% of Czech asylum applications as genuine in 2008. The author contends that the European Council's solidarity with the Czech Government over the principle of reciprocity may not be shared by individual Member States who fear introducing reciprocal visa requirements as they will negatively impact on their own nationals. The focus on reciprocity, the author concludes, has overlooked the fundamental rights dimension which is crucial to understanding the issues at the route of the visa affair.

Mark Salter and Can Multu examine the history of the global visa regime and its application on the Schengen system and in Canada. The influence of some of the more contentious aspects of the Common European Asylum System can be seen when

[4] *Moldovan and Others v Romania* [2005]

assessing the development of Canadian policy (including the use of manifestly unfounded and safe country of origin designations). From a fundamental rights perspective it is certainly worrying to see these concepts, which are based on generalised presumptions of safety, being exported beyond the European Union.

In Chapter Eight, Marina Caparini considers the ability of the Czech government and civil society to respond to the challenges facing the Roma community. She identifies some positive benefits in the field of policing but sees little impact in other crucial areas, concluding that the Roma still experience severe marginalisation. She also identifies two conflicting paradigms in European border control: the human rights paradigm and the exclusionary paradigm (with its emphasis on state sovereignty and border control). As the doors to migrants are refugees continue to close the challenge for liberal democratic states is how best to ensure that the former receives sufficient attention.

Section 3 is entitled 'The Visa and Surveillance Logics: Policing at a Distance'. It consists of five chapters with a range of themes centring on remote control migration strategies.

Annalisa Meloni examines the EU's Integrated Border Management which emphasises security and the intensification of control through initiatives such as pre-screening and extensive data collection. Raül Hernández i Sagrera considers the conditions of EU external visa relations with neighbouring countries, seeking to discover whether the conditions leading to the liberalization of visas from the Western Balkans could not also be applied to relations with the eastern partnership countries (particularly Moldova, Ukraine and the Russian Federation).

The question of extraterritoriality and its compatibility with fundamental rights is explored by Leonhard den Hertog. The author presents an informed analysis of Frontex Joint operations which leads him to conclude that there is an irreconcilable conflict with the fundamental principle of non-refoulement. As a result, he recognises a double-standard in EU negotiations with third countries which leads to a trade-off where fundamental rights and the rule of law may be "sacrificed on the altar of fighting irregular migration" (p226).

Katherine Rozmus explores the reasons why several EU states have not been deemed exempt from US visa restrictions. In the case of Bulgaria, Poland and Romania their visa refusal rates exceed 3% and consequently the US continues to regard their nationals with a degree of suspicion. The solution for the respective governments requires greater investment in security checks and biometric systems. In the meantime there is an evident detrimental effect on family members living in the US despite no evidence of significant security risks emerging from these countries and negligible rates of overstaying.

In her concluding chapter, Federica Infantino examines individual experiences of the allocation of Schengen visas by the Italian embassy and consulate in Morocco. The testimonies reveal a number of filtering and blocking devices which stem from the consular officials beliefs that the applicants are likely to be irregular migrants. The effect of *bordering at the window* is to encourage migrants to look for less organised, avoidance mechanisms. This undoubtedly perpetuates the difficulties inherent in managing irregular migration.[5]

[5] This has been well-documented in the US by Andreas, P 'The Transformation of Migrant Smuggling across the US-Mexican Border' in Kyle, D and Koslowoski, R (eds) *Global Human Smuggling: Comparative Perspectives* (Johns Hopkins UP 2001) 108.

CONCLUSION

The unique contribution of this collection stems from its focus on the Roma, in particular the Czech-Canada visa affair of 2009. My main criticism is that it omits to explore the contradictions inherent in free movement within the EU as it is applied to the Roma in any significant depth. The Roma expulsions from France and Italy are alluded to but are not fully analysed in terms of their compatibility with European and International law or when considering their impact on political discourse concerning Roma exclusion. This is rather unfortunate as the issue remains a live issue of enormous importance for all those concerned with fundamental rights in the EU. Roma arrivals in the UK have been met with similar hostility from the local community which is often stirred up by the mainstream media and politicians who appear to be pandering to perceived populist rhetoric which has seen a renewed interest in right-wing, anti-immigration political discourse. Bigo makes the legitimate observation that this discussion has been neglected in academia but unfortunately this text does little to redress that degree of neglect.

Whilst the analysis in the third section will undoubtedly be of value to readers with an interest in migration studies, I am not altogether convinced that they complement the overall theme of the collection. For greater cohesion it would, in my view, have been preferable to examine further the exclusion of Roma migrants from EU citizenship; something that it promised at the outset but which is never really given sufficient attention.

Nevertheless, the collection has much to commend it. The theme of Roma exclusion has been side-lined in much of the discussion over European enlargement and citizenship. This text seeks to situate the Roma at the centre of the academic debate over migration management in Europe and it reveals some of the inherent contradictions at the centre of both a common European Asylum System and the meaning of European citizenship.

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FINANCING TECHNOLOGICAL INNOVATION

Intellectual Property Rights and the Financing of Technological Innovation: Public Policy and the Efficiency of Capital Markets by CARL BENEDIKT FREY, Edward Elgar Publishing, 2013, 1st Edition, 304 pp, Softcover, £70, ISBN: 978–1782545897

In investing, what is comfortable is rarely profitable.

Robert D. Arnott,
Visiting Professor of Finance, UCLA,
Quantitative investing expert

INTRODUCTION

Innovation is central to our contemporary knowledge economy. *Intellectual Property Rights and the Financing of Technological Innovation* approaches the question of how best to facilitate innovation by enhancing access to equity financing. The author, Dr Frey[1] of Oxford University, adopts a multidisciplinary approach to his examination of the impact of future technology and analyses the roles that internal business managers, equity investors and public policy makers play commercialising new inventions. The book is written from a UK and European perspective of capital markets and he uses the pharmaceutical industry as a backdrop and focus for his research. Dr Frey's research explores reducing patent information asymmetry through enhanced corporate disclosure in the realm of listed companies and capital markets. His work is important because equity markets consistently undervalue intangible assets.[2] This is largely because patent information is multi-faceted and cannot be easily assessed without specific knowledge of the patent law framework. Dr Frey's stated aim is to "suggest ways of bridging the information deficit in capital markets that stems from the increasingly intangible economy".[3] His major finding is that public policy is the key to promoting the narrative corporate disclosure of intellectual property rights (IPR) information, especially with a view to shaping information efficiencies within the capital markets. Frey asserts:

> *That patent information explains the market value of firm better than information being published in firms' annual financial statements is also evident from studies conducted by Hirschey and Richardson (2004) in relation to US firms, but it also found to be true for Japanese firms (Hirshey and Richardson, 2001) and as well as a German one (Trautwein 2007). Accordingly, it has been suggested that patents can be used to signal future economic benefits to capital markets (see for example, Blind et al, 2006) a view that has received empirical support.*[4]

Specifically, Dr Frey studies the extent to which companies' IPR management is reflected in their share price performance. His conclusions are drawn from the interpretation of the results of empirical studies involving the patent valuation of a substantial dataset of companies in the pharmaceutical industry, as well as an exploratory study regarding how pharmaceutical firms conduct their IPR management

[1] Dr Carl Benedikt Frey is a Research Fellow, Oxford Martin Programme on the Impacts of Future Technology, the University of Oxford

[2] Eberhardt et al (2004).

[3] *Ibid* p.1.

[4] Frey, C.B (2013) Intellectual Property Rights and the Financing of Technological Innovation, *Edward Elgar Publishing Limited* at p19.

and the association with financial performance. This is conducted by way of a statistical analysis of a survey and a series of semi-structured interviews with the IPR managers. However, his work does not deal with the actual content of narrative disclosure concerning patent information in the companies' legally mandated corporate reports or how companies' should draft their narrative patent information and strategy corporate disclosures. Rather, his empirical study highlights categories of patent information companies disclose: IPR product reporting, IPR pipeline reporting, out-licensing, in-licensing, exclusivity, freedom to operate among others. Dr Frey's findings show that investors discount for lack of relevant information concerning IPR. He also finds that reporting exclusivity significantly reduces volatility. Further, the empirical research shows that investors perceive that information about IPR management measures are value relevant, if the expected financial benefits are to be realised in the not too distant future. Dr Frey concludes that reporting intellectual property information in legally mandated corporate reports assists companies to overcome stock market uncertainties due to asymmetric information. This has the knock on effect of reducing the costs of acquiring capital thus stimulating innovation and growth within technology centred firms. However, it is also clear that IPR information reporting is still at its infancy.[5]

CONTENT

The Table of Contents organises the book into five chapters. Chapter One is an Introduction to the author's theories and helps to contextualize the material in the chapters to follow. Chapter Two introduces the reader to features and characteristics of the modern Intangible Economy. Chapter Three is entitled 'Patent information and Corporate Credit Ratings: An Empirical Study of Patent Valuation by Credit Rating Agencies' and discusses the flow of information in the capital markets. Chapter Four focusses on the internal management of IPR within a company and the link between this and the level of corporate disclosure the pharmaceutical companies make about their patents assets and subsequently how these are subsequently valued in capital markets. The results of his empirical studies are presented with commentary.

The final Chapter reviews the phenomenon of the intangible economy and its implication and summarises the main findings of the research focussing on the future development of corporate reporting of IPR information. The author observes that IPR management is a continuous task associated with long term financial returns, accordingly sustainability is an issue. In other words, this final chapter considers the 'big picture' in relation to equity finance and how best to successfully and efficiently finance the commercialisation technological innovation in the future. Dr Frey submits that it is vitally important that IPR management information is presented in a systematic, accurate and comprehensive manner and he observes that capital markets generally need more forward looking information to enable investors to assess the assets in place and growth opportunities for technology driven companies. His key recommendation is that this could be done using a narrative 'Growth Statement' which would enable companies to voluntarily provide qualitative information linked to a specific commercial growth opportunity. At this point, the discussion shifts to American securities regulation however, there does not appear to be a link to the equivalent European or British legal framework which is a limitation of the book.

[5] See Lev, B. (2001) Intangibles: Management, Measurement and Reporting and Blair, M.M. and Walmman, S.M.H. (2001) Unseen Wealth, *Brookings Institutions Press*, Washington, DC.

CONCLUSION

In terms of readability, the author uses a traditional academic style of writing and presentation. The work is likely the publication of the author's PhD thesis which has not been specificially tailored for a wider mass-market audience. He carefully develops his ideas and concepts supported by detailed reference to the relevant literature. The research is extensively referenced in the Harvard style throughout which, while thorough, can distract the reader at times. The presentation of the research is supplemented by detailed graphs and diagrams to visually illustrate the results of the empirical and exploratory studies undertaken. Each chapter makes well-considered conclusions.

Intellectual Property Rights and the Financing of Technological Innovation is not specifically aimed at lawyers. It will be of interest to quite a wide readership including the innovation community, technology financiers, banks, IPR academics and professionals, corporate lawyers, policy makers, equity and credit rating analysts, accountants specialising in intangibles as well as executives in the pharmaceutical industry. However, the academic writing style will limit the books' wider appeal. Non-academic readers may find it somewhat dense and heavy going. The book is a very reasonable 304 pages but relatively expensive at £70. It is also available as an e-book.

To conclude, there are few other monographs in the field of innovation finance so this is indeed a pioneering book that contributes to much needed multi-disciplinary scholarship. The publication is timely in light of the fact that in August 2013, the UK Parliament approved *The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013*. The purpose of the new strategic report is to inform shareholders and help them to assess how the directors have performed their duty to promote the success of the company. It is separate to the Directors' Report and must be separately approved by the board of directors. Directors have a legal obligation to ensure that they report on the stewardship of the companies' assets and this includes reporting on intangible IPR assets. This new format will support the inclusion of enhanced narrative IPR information disclosure.

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INTRODUCTION

In this thought-provoking book the authors explore the press reporting of crime news in Britain by taking a different perspective in examining the role of sensationalist news and its effects on the public's understanding of the criminal justice system. Readers are taken on a detailed journey from the 1800s to the present day as the authors investigate crime journalism through an historical lens. They highlight the ebb and flow of the relationship between crime journalism and the criminal justice system and detail the effect on public perception of crime while questioning what 'justice' means. The book also examines the impact of libel and contempt laws as well as the implications of the Human Rights Act on investigative journalism within a framework of crime news stories.

In Chapter One 'The Beginnings of Crime Intelligence: 1800–1860', the authors point out that the original aim of crime reporting was to inform the public accurately and to educate as well as to entertain. The central argument of the book is that over time an informed legal content in crime news has been lost. In the Victorian era, crime reporting in the press was far more specialised than it is now. Indeed much news coverage was undertaken by lawyers with specific attention paid to the law and the workings of the criminal justice system. This ensured that there was accurate legal content to crime news as well as control over the dissemination of material to minimise dangers to trials.

In Chapter Two, 'A 'Golden Era'? 1860–1885' the authors explain how this arrangement bestowed an air of respectability on the field of journalism as a career choice for young middle class men. The third chapter 'Challenging the 'Golden Goose'? 1885 – 1900' demonstrates the decline in the use of lawyer journalists for crime reporting and shows how this was due to challenges to the anonymity of reporters and other financial changes.

Chapter Four, 'New Journalism Triumphant: 1900 – 1914' considers the changes that followed and explains how there was a shift in focus to events outside of the courtroom. It was during this period that the enduring relationship between the press and the police was born. Crime was depicted as a puzzle which was largely solved by specialists outside the court and trials were seen as largely confirming what had been decided elsewhere.

In the Fifth Chapter, 'New Perspectives and New Informants: 1914 – 1939' the authors suggest that crime reporters began to overstep the boundaries of the law as the focus on pre-trial investigation sometimes meant that when the police were not forthcoming with information, journalists would take it upon themselves to investigate with little regard for the law. By this stage therefore, the relationship between crime journalists and members of the criminal justice system was already distanced.

In Chapter Six, 'Enhancing Sensationalism: 1939 – 1960', the authors observe that the representation of crime news became more sensationalised often focusing on organised crime and graphic details of sexual offences. During this period many investigators did not attend court but simply turned up for the initial charge or committal hearings held at magistrates courts.

Chapter Seven 'Positively Criminal? Press, Police and Politicians: 1960 – 2010' brings us closer to a landscape more familiar with lawyers today. An absence of legal knowledge and focus on sensationalism appears compounded by the politicisation of news on law and order during this period. The legal aspects of cases and criminal proceedings was largely confined to specialist law pages, whereas actual crime news was often devoid of such content. Indeed, outside of the specialist law pages where the law is discussed, it is often in the form of social commentary - much of which is bereft of legal knowledge and ill-informed.

In the concluding chapter, the authors argue that this politicised but legally sanitised version of crime news has meant that such reporting has been exacerbated by the advent of the digital age of crime news beginning around 2010. There are several issues which potentially increase the risk of detrimental effects on public views about crime and the criminal justice system. As new technologies emerged and newspapers fought for survival by attempting to adapt to on-line reporting, the temptation to focus on more sensationalist and emotive aspects of crime stories intensified. At the same time, these new forms of digital dissemination changed the form of 'news' and arguably who could report on it. Through internet blogging, Twitter, Facebook and the use of mobile phones 'citizens' themselves have become crime reporters.

The constant expectation of up-to-the-minute updates on crime news and the speed with which such updates can be made, increases the risk of inaccuracy and has led to the careless dissemination of material and superficiality in reporting through the need to condense crime news into bite-sized chunks. Therefore, in the age of digitised media, 24 hour news coverage, mobile phones and Twitter feeds, crime reporting is often factually inaccurate and misleading due to its law free format absent legal knowledge. This inevitably means that the law and criminal proceedings are frequently misunderstood. This, as the authors suggest, fosters an emotional sense of justice rather than one informed by the law which is frequently exemplified by claims that real criminals are not brought to trial or not properly sentenced and that consequently both the public and victims are let down. Journalistic mistakes and apologies are rarely publicised prominently where the general public get to see them, particularly on electronic media forums, whilst positive news about the system is rarely publicised anywhere. Consequently much of the criticism is left unchecked. These misunderstandings of crime and justice which continue to fuel hostility towards the criminal justice system are speedily disseminated through digital means. Within this technological climate, the erosion of respect for the criminal law and confidence in the criminal justice system is especially troubling and the absence of legal specialists more keenly felt.

Such problems have not been alleviated by the Levenson Inquiry. Ironically it was public outrage about the hacking practices of investigative journalists and the potential to jeopardise a criminal investigation and subsequent trial that led to the Inquiry. This public outrage emerged following revelations about a journalist hacking the mobile phone of a murder victim. Yet this concern about possible implications for criminal prosecutions was quickly overtaken by a focus on press intrusions into privacy. Post the Levenson inquiry little concern remains about investigative crime news and criminal proceedings and even the privacy aspect of the inquiry appears to have been quickly forgotten by some journalists.[1]

There are two criticisms that I would make of the book. Firstly, whilst this was not a book on the sensationalised aspects of reporting it might still have been interesting

[1] See Joan Smith 'Lurid coverage of L'Wren Scott's death shows British Tabloids at their worst' The Guardian Online 18th March 2014

to see more detailed consideration of the content analysis of some of the examples and their presence or absence of legal context which may have added more interest to the historical examples used. It might also have been useful to detail some of the politicized professional changes to the legal profession over this period in order to consider the implications of these on news reportage and public perceptions. With this point in mind, the current political climate of cuts to legal aid[2] alongside reductions in the CPS and police budgets mean that the arguments made by the authors of this book are particularly persuasive. These austerity measures serve to further alienate the public from legal professionals and legal knowledge at time when public expectations of justice may well be higher as a result of the introduction of Police and Crime Commissioners in an attempt to provide the public with a say in policing. Moreover, the distance between the public and the courts is unlikely to be rectified by the possible televising of trials which may simply serve to trivialise and play up the emotive content of crimes rather than educating the public on the law and the legal process.[3]

Following the Levenson Inquiry, the authors suggest that what is needed is a more responsible reporting of crime news which necessitates a renewed but transparent relationship between journalists and criminal justice professionals, in particular, lawyers.

To conclude, this important and timely book illustrates how a study of crime news in the past can help to explain the present and inform suggestions for the future. It will therefore provide an illuminating read for all those interested in news media and crime including historians, legal scholars, criminologists, sociologists and their students.

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[2] Barristers supposed high earnings have recently been misrepresented in order to fuel support for legal aid cuts. See Watchdog criticises Ministry of Justice over barrister earnings claims: UK Statistics Authority accuses MOJ of overestimating barristers' earnings in figures aimed at justifying legal aid cuts. Owen Bowcott, 'High Court Rejects Challenge To Legal Aid' The Guardian Online, 18 March 2014

[3] See Oscar Pistorius trial. http://www.telegraph.co.uk/news/worldnews/oscar-pistorius/10687571/Oscar-Pistorius-sobs-and-vomits-as-court-hears-graphic-evidence-of-injuries-to-Reeva-Steenkamp.html.

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