CASE AND COMMENT

PRIVACY, CONFIDENTIALITY AND HORIZONTALLITY: THE CASE OF THE CELEBRITY WEDDING PHOTOGRAPHS

Michael Douglas and Catherine Zeta-Jones, the first and second claimants, sold the exclusive rights to publish their wedding photographs to OK! magazine, the third claimant; however, in spite of elaborate security arrangements, Hello! magazine obtained unofficial photographs, publication of which the claimants sought to restrain in the present proceedings. Although an injunction was granted at first instance, it was discharged by the Court of Appeal which held that, on the facts, damages would constitute an adequate remedy should the claimants succeed at trial. Given the interlocutory nature of the proceedings, Douglas v. Hello! Ltd. [2001] 2 W.L.R. 992 does not provide determinative answers to the substantive questions raised by the facts. Nevertheless, it supplies useful guidance as to the role of privacy in English law and tentatively addresses the “horizontal effect” of the Human Rights Act 1998 by considering whether that legislation may found claims against private parties as well as public authorities.

All three judges felt that the claimants had a strong prima facie case against Hello! on the basis of breach of confidence. However, as Brooke and Sedley L.JJ. noted, if the photographer was an intruder with whom no relationship of trust and confidence had been established, a claim based on breach of confidence would be likely to fail. It therefore became necessary to consider whether the claimants’ privacy could be protected independently of the doctrine of breach of confidence.

English law’s traditional reluctance to protect privacy per se. In the instant case, however, Sedley L.J. was satisfied that domestic law had evolved to the extent that it now “recognises and will appropriately protect a right of personal privacy” even in situations where no relationship of trust and confidence exists. This conclusion, which acknowledges that the established principle of confidentiality reflects the common law’s recognition of a deeper concept of privacy, is to be welcomed. It casts privacy as a legal principle in its own right which springs from the fundamental value of personal autonomy, and it permits judicial protection of that value openly, rather than by recourse to an artificially constructed relationship of confidentiality. In turn, the law comes to serve a broader function in this area: as Sedley L.J. observed, it protects “not only those people whose trust has been abused but those who simply find themselves subjected to an unwarranted intrusion into their personal lives”.

Although Sedley L.J. apparently felt that a concept of privacy could be inferred from domestic jurisprudence, he stated that it is the Human Rights Act which “gives the final impetus to the recognition of a right of privacy in English law”. Indeed, all three judges relied, to some extent, upon that Act. In itself, this is noteworthy, given that the present case involved horizontal litigation between private parties, rather than an attempt to make a privacy-based claim vertically against a public authority. The judges’ willingness to countenance the application of Article 8 of the Convention thus suggests, albeit tentatively, that the impact of the Human Rights Act will not be limited to vertical cases.

Brooke L.J. noted that, although the Convention rights appear to presuppose enforceability only against the State, the Strasbourg Court has held in a number of cases that national law-making bodies are required, by Article 1, to take positive steps to permit individuals to enjoy their Convention rights in horizontal, as well as vertical, situations. On this basis, it was arguable that Article 1 permitted (and required) English courts to develop a concept of privacy, and to allow its enforcement against private parties as well as public authorities. His Lordship felt that this reasoning was potentially undermined by the fact that the 1998 Act excludes Article 1 from the Convention rights which are given effect in national law; however, while Article 1 may be incapable of triggering horizontality in national law, section 6 may have precisely that effect in the domestic context, given that it requires all public authorities—including courts—to act compatibly with the Convention rights.
This was the approach favoured by Sedley and Keene L.JJ. The latter felt that section 6 may require the courts to interpret and develop the common law in light of the Convention even in purely horizontal situations, but he considered it more doubtful whether it permitted new causes of action (e.g., breach of privacy) to be developed. He therefore preferred to develop the law on breach of confidence in light of Article 8 by widening the circumstances in which a duty of confidentiality may be found. While his Lordship did not think it mattered whether the resulting liability was described in terms of breach of confidence or breach of privacy, this approach is arguably unsatisfactory in two respects: at a specific level, it obscures the normative weight being attached to privacy; and, more generally, it disguises what amounts to the conferment of substantive horizontality on a Convention right.

Sedley L.J., however, noted that, because the claimants were seeking to prevent publication of the photographs, section 12 applied, thus requiring the court to have particular regard to the free speech implications of any relief. Article 10 was therefore in play and, by extension, so were Article 8 privacy considerations (given that Article 10(2) makes it lawful to qualify free speech in order to protect confidential information or the reputation or rights of others). However, since section 12 applies only when the court is considering the grant of relief, it cannot itself found a privacy-based claim. Consequently, while section 12 clearly establishes that Convention rights will be relevant in some purely horizontal situations, judicial development of breach of privacy as a cause of action, if its justification is to depend on the 1998 Act, must be based on section 6. Indeed, Sedley L.J. accepted that, if a privacy-based claim was not straightforwardly possible at common law, then the common law should be revised in the light of section 6, because “this is precisely the kind of incremental change for which the Act is designed: one which without undermining the measure of certainty which is necessary to all law gives substance and effect to section 6”.

Although the conclusions which can be drawn from the present case are limited by the nature of the proceedings, it nevertheless points towards two very welcome developments. It corrects the long-standing and notable failure of English law to embrace the concept of privacy; and it discloses judicial unwillingness to insulate the development of the common law from the influence of the Convention rights, thus conferring upon them a measured degree of horizontal effect.

Mark Elliott
"THEY MADE A DESERT AND CALLED IT PEACE": BANISHMENT AND THE ROYAL PREROGATIVE

IN R. (Bancourt) v. Secretary of State for Foreign and Commonwealth Affairs [2001] 2 W.L.R. 1219 a former resident of the British Indian Ocean Territory ("BIOT") successfully challenged the lawfulness of banishment from his own country.

BIOT was established as a separate colony by the British Indian Ocean Territory Order 1965, an Order in Council made under the powers of the Royal Prerogative. The Chagos Archipelago and a few other islands were divided from the British colony of Mauritius in order to create a separate colony. The purpose of this exercise was to facilitate the establishment of an American military base upon Diego Garcia, the chief island of the Chagos Archipelago. The defence and security requirements of the base required the island to be unpopulated. In the 1960's, however, there was a significant number of indigenous people, called the Ilois, as well as other citizens, living in BIOT. All of the Ilois living on the island either were employed as contract workers on the coconut plantations or were members of their families, and none enjoyed property rights in any land. By 1967, the Crown held title to all the land on the islands. Internal memoranda revealed that the UK Government, relying on the status of the inhabitants as contract workers, intended to treat them as temporary rather than permanent residents in order to facilitate their removal and to avoid any obligations under international law. In 1971, the whole of the civilian population, including the Ilois, were compulsorily removed to Mauritius and prevented from re-entering the islands. The banishment was authorised by the Commissioner for BIOT pursuant to the BIOT Ordinance No. 1 of 1971, made under the 1965 BIOT Order. The substantive issue raised by the case was whether there was lawful power to remove the Ilois from BIOT. The Divisional Court held that there was not.

Laws L.J. gave the leading judgment. He initially addressed the question of whether the court had any jurisdiction to entertain the case. The respondent had argued that as there was a municipal court of competent jurisdiction, the High Court in England either had no jurisdiction, or should decline it. His Lordship concluded that there was "ample jurisdiction" to issue certiorari extra-territorially, "if it be right to make it". The second limb of the argument was that the Government of BIOT had a "separate and distinct sovereignty of its own" and therefore jurisdiction should be declined. Given the history and true purpose of the Ordinance and the fact that the Commissioner was effectively acting as an agent of
the Crown, this jurisdictional argument was tinged with unreality and quickly dismissed. In fact, his Lordship described it as representing “abject surrender of substance to form”.

His Lordship then turned to the substantive, and overlapping, grounds of the challenge to the legality of the BIOT Order. The first submission, described as “florid”, was that section 4 of the 1971 Ordinance (no person shall enter the BIOT territory or remain in the territory without a permit) violated the rights and liberties enshrined in Cap. 29 of Magna Carta, which specifically states that “No freeman shall be … exiled … but by the law of the land”. Unfortunately, this argument of “beguiling simplicity” provided no assistance in answering the question at the heart of this review: whether section 4 of the Ordinance was made in accordance with “the law of the land”. It is a basic principle of our constitutional system that even a statute as significant as Magna Carta cannot limit the sovereignty of the lawmaker. Nevertheless, the enduring importance of Magna Carta, according to Laws L.J., lies in its proclamation of the rule of law which is the central feature of this review.

The applicant’s second argument was that section 4 of the Ordinance abrogated the applicant’s fundamental right “to reside in or return to that part of the Queen’s dominions of which he is a citizen—where he is a ‘belonger’”. Such an abrogation could not then be lawfully authorised by the general words of section 11 of the BIOT Order, which provides that: “The Commission may make laws for the peace, order and good government of the Territory”. This submission, based on the so-called “Witham principle”, relies on a principle of the common law, independent of any rights now guaranteed by the Human Rights Act 1998. In R. v. Lord Chancellor, ex p. Witham [1998] Q.B. 575 the Divisional Court struck down part of a subordinate measure on the basis that a fundamental or constitutional right can only be abrogated by the executive where the abrogation has been specifically authorised by Parliament.

Yet the Witham principle also failed to assist the applicant: it was held not to be applicable to colonial laws. The Privy Council in Liyanage v. The Queen [1967] 1 A.C. 259 had established that, following the introduction of sections 2 and 3 of the Colonial Laws Validity Act 1865, colonial laws were void to the extent that they were repugnant to an Act of the United Kingdom Parliament applicable to that colony, “but not otherwise”. Respecting the decision of the Privy Council led to the rather uncomfortable conclusion that “there is a difference of approach between the developed law of England and the law applicable in the colonies.
Belongers here take the benefit of the constraints which the common law imposes upon the construction of legislation which interferes with such rights; belongers there do not.” In most cases this Imperial legacy will not affect the rights of citizens, since many territories, such as Gibraltar, protect fundamental rights in a written constitution. BIOT, however, does not do so.

The crucial and deciding question turned on whether the formula “peace, order, and good government” empowers section 4 of the Ordinance. Laws L.J. acknowledged that the precedents suggest that whilst these words confer very wide law-making powers on colonial authorities, nevertheless there are restraints: it “may be a very large tapestry, but every tapestry has a border”. Gibbs J. expressed a similar sentiment: such a formula is not “unfettered”. Laws L.J. applied the Wednesbury test and effectively asked whether a reasonable legislator could regard the exile of the Ilois from BIOT as conducive to the aims of “peace, order and good government”. A dissonance between our modern domestic law and colonial law was again evident. The heightened Wednesbury review, appropriate in our law where fundamental rights are at stake, was not available in reviewing the exercise of the Commissioner’s discretion. Nevertheless, a common sense interpretation of the language prevailed. In the words of Laws L.J.: “But the ‘peace, order, and good government’ of any territory means nothing surely, save by reference to the territory’s population. They are to be governed: not removed.” It would only be in an exceptional case, such as land becoming toxic or uninhabitable, that exile could arguably be for “peace, order and good government”.

Laws L.J. concluded that there was no principled basis upon which to justify the exile, and section 4 of the Ordinance was quashed. Moreover he doubted “whether the prerogative power extends so far as to permit the Queen in Council to exile her subjects from the territory where they belong”. The Ilois are keen to return to their “paradise” home and the UK Government is conducting a feasibility study for resettling the exiles. Diego Garcia will remain a US base (the lease runs until 2016) and closed for the immediate future. This decision may be a triumph for the rule of law but these events remain a sorry chapter in colonial history.

Stephanie Palmer
THE MADDENING EFFECT OF CONSECUTIVE TORTS

A couple of thugs entered the Burger King near King’s Cross and beat up the manager. They not only beat and kicked him, but also struck him in the eye with a gold knuckle-duster. The eye needed to be operated on, but the operation went wrong, and he can no longer see out of it. In consequence of these experiences he is now a total psychological wreck, unable to work for the foreseeable future. His employer, the first defendant, was held liable for failing to protect him from attack, and the hospital, the second defendant, admitted liability for the negligent operation: Rahman v. Arearose Ltd. [2000] 3 W.L.R. 1184 (C.A.). Quid iuris?

The solution in received tort law is as follows. (I) The hospital cannot be held liable for anything that preceded the negligent operation, since causation operates only forwards, not backwards, and the surgeon did not assault the claimant. By contrast, while the employer did not himself operate on the claimant’s eye, he can and should be held liable for its loss and the consequent psychological sequelae: only if the negligence of the surgeon was a novus actus interveniens is the employer off the hook. As Hart and Honoré state, it is a “generally accepted principle of common law that only an extraordinary medical mistake negatives causal connection” (Causation in the Law, 2nd ed., p. 357).

(II) The harm consequent on the operation was greater than might have been expected, since the claimant was already vulnerable by reason of the prior assault. This does not, however, diminish the hospital’s liability, for the “thin-skull” doctrine provides that in relation to subsequent harm a tortfeasor (including a second tortfeasor) takes the claimant as he finds him. Accordingly, while the employer alone is liable for the immediate consequences of the assault prior to the surgical intervention, both employer and hospital are liable for everything thereafter.

(III) The victim is entitled to judgment against each tortfeasor for the damage for which that tortfeasor is liable. Thereafter, the liability of the tortfeasors between themselves for such damage as both are liable for (the “same damage”) is determined by the application of the Civil Liability (Contribution) Act 1978, the apportionment being what is “just and equitable” in view of their respective responsibility.

What actually happened in the Court of Appeal was quite different. First, Laws L.J. asked whether the Contribution Act applied, and held that it did not. This is surprising. How can one consider the Contribution Act before deciding for what damage each defendant is liable? Contribution or apportionment between
defendants should take place only after the victim has obtained judgment against each of them. But why was the Act held inapplicable? True, it applies only where the tortfeasors are liable for “the same damage” and here there was some damage for which the first and not the second defendant was liable. But the fact that there was some damage which was not the same does not mean that there was no damage which was the same, and for the great bulk of the damage in this case both were surely liable, as stated above.

That left the (logically anterior) question of what damage each was liable for. Here the Court accepted an absurd report confected jointly by the experts for the three parties, who tentatively divided up the victim’s present condition in terms of the two causes. They should not have been asked to do this, and their answer should have been ignored, for there is no scientific basis for any such attribution of causality: the claimant is not half-mad because of what the first defendant did and half-mad because of what the second defendant did, he is as mad as he is because of what both of them did. His mania is aetio logically indiscernible, as when grief and shock combine to wreck the life of a parent who witnesses the death of her children. Suppose that the claimant was so maddened that he committed suicide: would his death have been divided up between those responsible for the triggering injuries?

In the event, the claimant got judgment against each defendant for part of his loss only. For his pain and suffering/loss of amenity he obtained judgment for £7.5K against the employer and £55K against the hospital, and for his economic loss of about £500K, one quarter against the employer and three-quarters against the hospital, the trial judge’s split of one-third/two-thirds being varied on the ground that the greater blame of the employer was irrelevant except under the (supposedly inapplicable) Contribution Act.

Such apportionment of the loss against the claimant rather than between the tortfeasors is quite wrong. Nor is this just a matter of aesthetics. Consequences ensue. If, in the present case, either defendant had been insolvent, the claimant would not have been fully indemnified. Indeed, he was not fully indemnified in this case, for after the trial his employer, which had denied liability altogether, got the claimant to settle for 60% of its eventual liability. Had the correct decision been made, the claimant would have obtained his full post-operative loss from the hospital, less anything actually received towards that loss from his employer, and the employer, whose greater fault would then have been taken into
account, could not have raised the settlement when sued for contribution by the hospital.

At the heart of this regrettable decision lies something very ominous. A few months previously, Stuart-Smith L.J. (the very judge who gave leave to appeal on the causation issue in our case) had said (in *Holtby v. Brigham & Cowan (Hull) Ltd.* [2000] 3 All E.R. 421, 428) that the claimant “is entitled to succeed if he can prove that the defendant’s tortious conduct made a material contribution to his disability”. So far so good: this is the precise message of *Wardlaw*, the leading case on causation ([1956] 1 A.C. 613). However, Stuart-Smith L.J. went on to say “But strictly speaking the defendant is liable only to the extent of that contribution.” This is an extremely heterodox view which even led him to cast doubt on *Wardlaw*. Now in *Wardlaw* the harm was lung disease which, like deafness or pollution, is an indivisible harm incrementally caused, and in such case this novel doctrine may possibly be entertained, on the view that a defendant should not be liable for *already existing* harm to which he did not contribute. It is, however, utterly unacceptable to extend it to a case like *Rahman*, where the harm was not incremental, but the indivisible result of a synergistic or catalytic concatenation of events.

The last thing we need in tort law, where questions of duty are presently at sixes and sevens, is to have the law of causation unravel under our very eyes. Anyone tempted to adopt the mantra of “liability in proportion to contribution to harm” should consider the chaos resulting in the United States from tampering with the doctrine of joint and several liability (see D. Dobbs, *The Law of Torts* (St. Paul 2000), pp. 1077ff.), a doctrine which is beneficial in protecting victims when one of the tortfeasors is insolvent, and otherwise does no harm to the paying tortfeasor, given that the Contribution Act allows the courts to make a just apportionment, which is more than was done by the courts in *Rahman*.

**Tony Weir**

**Remedies for Misrepresentation: Up in the Air Again**

The Misrepresentation Act 1967, with its three brief sections, illustrates perfectly that, where statutory drafting is concerned, short is not necessarily sweet. Section 2 is particularly troublesome, containing both the puzzling “fiction of fraud” in subsection (1) whereby misrepresentations are to be treated as if they were fraudulent (unless the misrepresentor can show he had reasonable
grounds to believe their truth), as well as the discretion in subsection (2) to award damages “in lieu of rescission” for non-fraudulent misrepresentations. Much judicial ink has been spilled construing these provisions, and in Government of Zanzibar v. British Aerospace (Lancaster House) Ltd. [2000] 1 W.L.R. 2333 section 2 (2) was again under scrutiny.

In 1992 the Government of Zanzibar ("Zanzibar") contracted with an aircraft manufacturer, British Aerospace ("BAe"), to purchase an executive jet. Jets being expensive things, Zanzibar needed help to fund the purchase, so it made a financing arrangement with a finance company, CIBC. This involved CIBC being substituted for Zanzibar as purchaser under the purchase contract (achieved by all parties entering into a novation agreement), paying the purchase price to BAe and immediately leasing the jet back to Zanzibar. However, faults developed in the aircraft, so Zanzibar ceased to pay its rent instalments to CIBC. Unsurprisingly, CIBC exercised its contractual right to terminate the lease and repossessed the aircraft, which was sold. This left Zanzibar out of pocket, with no aircraft and no contractual claims against BAe, since Zanzibar was no longer a party to the purchase agreement (the CIBC lease preserved Zanzibar's right to sue BAe for breach of warranty, but only for so long as the lease was subsisting). Moreover Zanzibar had no claim against CIBC for breach of contract either, since CIBC (being a hard-nosed finance company) had given no warranties as to the condition of the aircraft. After much delay, Zanzibar sued BAe and CIBC seeking (inter alia) rescission of the purchase and novation agreements, or damages under sections 2(1) and 2(2) of the Misrepresentation Act. (No misrepresentations were alleged against CIBC, which was joined as a defendant merely because rescission was claimed against contracts to which it was a party.) BAe applied for summary judgment under the Civil Procedure Rules, alleging that the claims had no real prospect of success as a matter of law.

Deputy Judge Raymond Jack Q.C. agreed first that the rescission claims had no real prospect of success, being barred because of delay and the impossibility of making restitutio in integrum. Indeed it is difficult to think of a clearer example of the latter bar, given that Zanzibar had long since been replaced by CIBC as party to the purchase agreement, and the aircraft had been leased and subsequently sold. But what effect did this have on damages in lieu of rescission under section 2(2): is such discretion conditional on the continuing availability of rescission, or can damages be awarded even when rescission is barred? This question has long divided judges and academics, but Zanzibar relied in
particular on *Thomas Witter Ltd. v. T.B.P. Industries Ltd.* [1996] 2 All E.R. 573, in which Jacob J. held that “the power to award damages under section 2(2) does not depend upon an extant right to rescission—it only depends upon a right having existed in the past”. Deputy Judge Jack disagreed, on the grounds that such damages are “an alternative to an order for rescission or the upholding of a prior rescission by the representee if that has occurred”.

These contradictory conclusions illustrate how elastic statutory construction can be. Deputy Judge Jack regarded the phrase “in lieu of”, and indeed the language throughout the subsection, as contemplating “a balancing exercise” between two alternatives, while Jacob J. found this construction “strange” (after all, it is plausible, if slightly stilted, English usage to say, “I am going to the cinema, in lieu of my trip to the theatre which has been cancelled”). Jacob J. was convinced that Parliament would not have made the discretion to award damages vanish once rescission is barred, since the bars so often depend “on a host of factors which have nothing to do with the behaviour of either party”. Deputy Judge Jack’s answer was that there is also a claim to damages under section 2(1), “though here as a matter of policy it has been enacted that there should be the reasonable-grounds-of-belief defence”.

It is of course now permissible to seek guidance in *Hansard* when interpreting ambiguous statutes, but that may simply shift the interpretative process down a layer: after all, *Hansard* is a text, too, with just as much scope for nuances of language and context. For example, Jacob J. in *Thomas Witter* placed considerable weight on a reply by the Solicitor-General during the debate on the Mis-representation Bill, which suggested that damages under section 2(2) did not depend on an extant right to rescission. Deputy Judge Jack relegated this reply to the Parliamentary equivalent of obiter dicta by a dissenting judge giving an unreserved judgment, observing that it was “an extemporaneous answer given a little after 3 o’clock in the morning”, which “did not accord with other statements”. Instead he found assistance in the Law Reform Committee’s Report, which recommended the section 2(2) discretion in order to counterbalance the abolition (in section 1) of the bar that existed at common law to rescission of an executed contract.

Whichever interpretation is preferred in the abstract, both can be understood best by being considered in the context of the striking contrast between the merits of the two cases. The *Thomas Witter* claimants had purchased a carpet business relying on the sellers’ misrepresentations, but found rescission barred essentially
because their efforts to run the business, reorganising its structure and mortgaging business property, meant they were unable to make *restitutio in integrum*. Zanzibar, on the other hand, threw away any opportunity to pursue BAe for breach of warranty by the combined effect of the novation arrangements and its failure to pay its rent triggering termination of the CIBC lease: hardly a pressing case for discretionary damages in lieu of rescission.

The same contractual context undermined Zanzibar’s remaining claim for damages under section 2(1), which BAe argued was prohibited by an exclusion clause. Zanzibar retorted that the clause was unreasonable and thus ineffective under section 3, again relying on the decision in *Thomas Witter*, where the judge had held that a similar clause (in which the parties agreed that no reliance had been placed on any pre-contractual representations) was broad enough to cover fraudulent misrepresentations and therefore unreasonable. Deputy Judge Jack could not resolve the question of whether the clause was reasonable on an application for summary judgment, so was obliged to allow part of Zanzibar’s claim to proceed to trial, but gave a strong indication that he disagreed with Jacob J.’s construction, which he found strained. With respect, this is most welcome. Exclusion clauses, so undesirable for consumers, are essential in commercial contracts: “It is legitimate, and commercially desirable, that both parties should be able to measure the risk, and agree the price, on the basis of the warranties which have been given and accepted”. On balance, this case is a commercially sensitive application of the complexities contained in the troublesome statute, though it is unlikely to be the last word on the interpretation of section 2(2).

**JANET O’SULLIVAN**

**BLIND EYE PRIVITY AND BAD FAITH IN INSURANCE CLAIMS**

In *The Star Sea* (*Manifest Shipping Co. Ltd. v. Uni-Polaris Shipping Co. Ltd.* [2001] 2 W.L.R. 170) the main judgment was given by Lord Hobhouse with whom Lord Steyn and Lord Hoffmann agreed. An insurance claim in respect of the loss of the eponymous vessel was unsuccessfully defended on two grounds.

The first defence was that the vessel had been sent to sea in an unseaworthy state, unseaworthiness being admitted in that the master was incompetent, “with the privity of the assured”: a breach of warranty under section 39(5) of the Marine Insurance Act 1906 (MIA). The *Star Sea* was registered in Cyprus and owned by the
claimant, company A, which was managed by English company B, whereas operations in Greece were conducted through company C. The policy described the insured as B and associated or affiliated companies. In this situation the courts largely ignored the corporate structure and looked for the natural persons who conducted the relevant aspects of the management of the business, in particular, the decision to send the vessel to sea. These persons turned out to be certain directors of B and C. They did not have actual knowledge of the incompetence of the master. Therefore the question was whether they had “blind eye” knowledge, i.e., that one or more of them had “some consciousness or suspicion that the ship is unseaworthy which is disregarded so that the person concerned does not know for certain”: p. 179 per Lord Hobhouse quoting The Eurythenes [1977] 1 Q.B. 49, 76 per Roskill L.J. Lord Hobhouse continued: “The illuminating question therefore becomes ‘why did he not inquire?’ If the judge is satisfied that it was because he did not want to know for certain, then a finding of privity should be made. If, on the other hand, he did not enquire because he was too lazy or he was grossly negligent or believed that there was nothing wrong, then privity has not been made out.”


The second defence was that the insured had not observed utmost good faith, as required by MIA s. 17, and that therefore the insurer was entitled to avoid the contract of insurance. Specifically, the defence was that the duty had been broken by the insured’s claiming legal privilege for a document (a report on defects in the vessel) which might have assisted the insurer to resist the claim. This defence failed also; however, the decision has an important bearing on the duty, mutual between insurer and insured, of utmost good faith, which, as was common ground between counsel in the case, “is not confined to marine insurance; it is applicable to all forms of insurance”.

As regards the duration of the duty, Lord Hobhouse observed that “the utmost good faith is a principle of fair dealing which does not come to an end when the contract has been made”. However, “the content of the obligation to observe good faith has a different application and content in different situations”.

As regards the general nature of good faith post-contract, Lord Hobhouse said that once parties are in a contractual relationship, “the source of their obligations the one to the other is the contract (although the contract is not necessarily conclusive . . .)”; and that a “coherent scheme can be achieved by distinguishing a lack of good
faith which is material to the making of the contract itself (or some variation of it) and a lack of good faith during the performance of the contract”. The former “derives from requirements of the law which pre-exist the contract” and the latter “can derive from express or implied terms of the contract”.

As regards performance of the post-contract duty to disclose information concerning a variation in the contract, Lord Hobhouse said that

facts must be disclosed which are material to the additional risk being accepted by the variation. It is not necessary to disclose facts occurring, or discovered, since the original risk was accepted material to the acceptance and rating of the risk. Logic would suggest that such new information might be valuable to the underwriter. It might affect how hard a bargain he would drive in exchange for agreeing to the variation; it might be relevant to his reinsurance decisions. But it need not be disclosed.

As regards the duty to disclose information when a claim is made, however, nothing short of fraud in the presentation of the claim will amount to breach of the duty. Anything to the contrary in the judgment of Hirst J. in The Litsion Pride [1985] 1 Lloyd’s Rep. 437 must now be rejected as incorrect; see Lord Hobhouse and Lord Scott: respectively p. 195 and pp. 205ff.

As regards the effect of fraud in a claim, Lord Hobhouse said that it would be expected that any question “would be answered by construing the contract in accordance with its terms, both express and implied by law”. However, the law is that “the insured who has made a fraudulent claim may not recover the claim which could have been honestly made ….. The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing”. Such was the case in Galloway v. GRE [1999] Lloyd’s Rep. I.R. 209 (C.A.). However, as regards the question, academic in the Star Sea except as a pleading point, whether the making of a fraudulent claim would entitle the insurer to avoid the contract ab initio, Lord Hoffmann found that previous cases and dicta were not decisive. He said little to encourage the view that there could be retrospective avoidance under section 17. Lord Scott thought the point debatable but declined to debate it as it was not necessary to decide the point.

If, as regards the effect of fraud in a claim, the basis were not section 17 but breach of contract, however, Lord Hobhouse noted that, on termination of a contract for breach, release of duties “only applies prospectively and does not affect accrued rights”. He
went on to distinguish the right of rescission under section 17, which “totally nullifies the contract”. This, he observed, “is appropriate where the cause, the want of good faith, has preceded and been material to the making of the contract. But, where the want of good faith first occurs later, it becomes anomalous and disproportionate that it should be so categorised and entitle the aggrieved party to such an outcome.” That, he noted, would be the effect of accepting the defendant insurer’s argument in the case. The idea that a failure of good faith by the insured at the end of the insurance period should entitle the insurer to recover the amount of a good faith claim paid earlier in the period “cannot be reconciled with principle”.

Finally, concerning “whether the duty of good faith and disclosure continues to apply unqualified once the parties are engaged in hostile litigation”, Lord Hobhouse said that when a writ is issued, “the rights of the parties are crystallised”. He noted that there “is no longer a community of interests. The parties are in dispute and their interests are opposed. Their relationships and rights are now governed by the rules of procedure … The battle lines have been drawn and new remedies are available to the parties. The disclosure of documents and facts are provided for with appropriate sanctions.” There is no longer the need for a remedy outside the rules of procedure. The House affirmed the decision of the Court Appeal, which included the view of Leggatt L.J. ([1997] 1 Lloyd’s Rep. 360, 372) that there is “no reason why adversaries should be under a duty to provide ammunition to one another”.

MALCOLM CLARKE

LITIGATION BY SHAREHOLDERS AND REFLECTIVE LOSS

Many of the details surrounding the circumstances when shareholders can sue are shrouded in obscurity, but it is clear that where a company and a shareholder have overlapping claims the shareholder cannot pursue its personal claim if its loss is merely reflective of the company’s loss. The scope and rationale of the rule barring shareholders from bringing personal actions to recover reflective loss were authoritatively restated by the House of Lords in Johnson v. Gore Wood & Co. [2001] 2 W.L.R. 72.

A simple example can set the scene: take a company with a net present value of £1 million and four shareholders, A, B, C and D; £2 million has been extracted from the company by wrongdoers in
breach of duties owed to the company and to its shareholders personally. All four shareholders would be fully and equally compensated if the company sued successfully to recover the lost £2 million: the shareholders’ loss is **reflective** of the company’s loss. What if, say, A, could sue personally to recover its share of the loss as reflected in the value of its shares—£500,000? That £500,000 would be for A’s benefit alone. If the company were then to pursue its claim, the wrongdoers could not be held liable for more than £1.5 million since that would offend against basic principles. Should the company succeed, the value of each individual shareholding would increase to £625,000, not the £750,000 that would have been recovered if the company had been able to sue for the full £2 million. But in the absence of court orders taking into account what has already occurred, A would end up considerably better off than the others since it holds shares now worth £625,000 plus the £500,000 recovered in its personal action.

The House of Lords in *Johnson* has held that in these circumstances A cannot sue. But why not? According to *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 222–223, A would not have suffered any personal loss, but this denial of the existence of any personal loss caused difficulty in later cases and attracted academic criticism. In *Johnson* Lord Hutton acknowledged the force of the criticism of the *Prudential* approach: that there is personal loss in these circumstances “is a more realistic assessment” (at 113). But for Lord Millett, whose speech contains the most persuasive analysis of the position, whilst there is a personal loss to the shareholder, that is not the decisive point. Instead, the disallowance of A’s claim is driven by policy considerations.

In principle, the problems generated by the simple example above could be solved either by disallowing the corporate claim and requiring each of the shareholders to sue individually or by disallowing the individual claims. Lord Millett explained that the principal policy consideration in favour of the latter approach relates to the position of creditors. Supposing a company becomes insolvent as a result of wrongdoing, it would be its creditors, not shareholders, that would benefit from the corporate action. Disallowing the company’s claim would prejudice its creditors since it would subvert the normal respective positions of creditors and shareholders in insolvency. In effect, an asset that should have been available to the creditors—the right to sue the wrongdoers—would have gone to the shareholders instead.

The clear ruling that creditor considerations give the corporate claim precedence over the shareholders’ personal action removes
doubt that had stemmed from the New Zealand Court of Appeal
suggested that there was no necessary reason why the company’s
claim should “trump” that of the shareholder. Secondary policy
considerations also come into play to explain the absolute nature of
the rule that A cannot sue for reflective loss where the company also
has a cause of action. If a company agrees a compromise settlement
with a defendant, principles of certainty and fairness dictate that
shareholders should not then be able to re-open the case by seeking
to pursue the defendant in a personal capacity. Shareholder
complaints about the terms of a compromise should properly be
directed at those who agreed the compromise on the company’s
behalf, not the original wrongdoer. This point was particularly
relevant in Johnson where the shareholder who sought to bring the
personal action controlled the company and had made the decision
to compromise the company’s claim; as Lord Millett noted, “Mr
Johnson cannot be permitted to challenge in one capacity the
adequacy of the terms he agreed in another” (at 125).

Johnson was a decision on a strike out application. Nevertheless,
it can be argued that, rather than classifying shareholder claims for
reflective loss as being irrecoverable as a matter of law, it could be
left to trial judges to evolve detailed principles for the protection of
creditors and other shareholders in such cases. So it could be left to
the trial judge to devise orders ensuring that A in our example does
not achieve a better position than that of the other shareholders.
However, shareholders should not recover at the expense of
creditors or other shareholders and the absolute disallowance of
shareholder reflective loss claims, as firmly endorsed in Johnson
(albeit with a difficult speech from Lord Cooke), is an efficient way
of achieving that result. The position is entirely different if the loss
is not reflective and the interesting questions now relate to drawing
the line between reflective and other losses. Marginal cases need to
be considered at trial, as their Lordships accepted. One issue that
Johnson raises that will require close examination should the case
proceed to trial concerns the loss suffered by, for example, an
employee who is also a shareholder, for this is irrecoverable
reflective loss. With the D.T.I. inspectors’ report on the collapse of
the Maxwell empire finally published, restrictions, both in terms of
duties and of recoverable losses, on when employee-shareholders
can proceed directly against fraudsters who abscond with company
funds that had been earmarked for the employees’ pension fund
have a heightened contemporary relevance.

Eilis Ferran
ADVERSE possession is a contentious subject. The possibility of a squatter knowingly acquiring title to land “as of wrong” is one which disturbs the general public and indeed causes qualms in some members of the judiciary. Thus, at first instance, Neuberger J. felt very unhappy with the jurisprudence that caused him to find for the squatter in *J.A. Pye (Oxford) Ltd. v. Graham* [2000] Ch. 676. The Court of Appeal (*The Times*, 13 February 2001) has now reversed this decision, and has upheld the title of the registered proprietor to the disputed land. However, although the result may seem desirable with regard to fairness and the integrity of land registration, the judgments seem less satisfactory, and only serve to re-emphasise the difficulties in this area of the law.

The facts of the case are unexceptional. In 1977, the Pye group of companies had acquired an estate near Newbury in Berkshire with an eye to its long-term development potential, and one of its companies had been registered as proprietor at the Land Registry. Pye thereupon sold off the farmhouse with the land which it did not require. It carefully retained the four fields of pasture—amounting to some 25 hectares—which it had identified as promising, to await the glad day when planning permission for development would be granted. In the meantime, Pye, lacking agricultural ambition, had no particular use for the retained land. But the farming family which had bought the rest of the estate, the Grahams, most certainly had a use in mind. They were running a mixed livestock and arable farm, and very much wanted to use the grazing available in the four fields. And so they negotiated a grazing licence with Pye. The licence ran out in December 1983. The Grahams requested a new licence, but were refused. Pye believed that a planning application would have more chance of success if the land were “in hand”; so the most it would allow for 1984 was a single cut of hay. Thereafter, Pye refused any permission for the land to be used, and failed to respond to the Grahams’ requests. Understandably in the circumstances, the Grahams grazed their cattle on the land anyway and farmed the fields as part of their farm. They harrowed, rolled and fertilised, maintained the ditches, hedges and fences, and generally displayed good husbandry with regard to the disputed land—to such an extent, indeed, that neighbours and friends believed the land was part and parcel of the farm.

Unfortunately for Pye, the desired planning permission failed to materialise as quickly as it would have liked, and so the years passed. No doubt Pye was involved in other, more fruitful ventures
while the Grahams happily continued farming the land. Eventually, of course, the possibility of adverse possession arose and, after some preliminary skirmishes, Pye issued a writ for the recovery of the land in January 1999. The Grahams resisted the claim and the case came to court. Sadly, Michael Graham had died in 1998, but he had prepared a witness statement which was received in evidence. He had said: “my intention was to carry on using the land for grazing until I was requested not to ... I would have preferred to obtain a formal agreement but in the absence of one I continued to farm the Land ... I continued to use the Land to what I considered to be its best use ... I believed ... it was possible to obtain ownership of Land after it had been occupied for a sufficient number of years ...”.

At first instance, Neuberger J. held that the Grahams enjoyed factual possession which was adverse to Pye, and had the necessary animus possidendi in respect of the disputed land from September 1984 onwards. He therefore concluded that the Grahams were entitled to be registered as proprietors of the disputed land at the Land Registry.

Pye appealed on two points—the issue of intention to possess and that of human rights. (The second point deserves full treatment elsewhere.) With regard to the intention to possess, readers of The Conveyancer will be aware that the subject is contentious. The prevailing orthodoxy, as explained in Buckinghamshire County Council v. Moran [1990] Ch. 623, is that the squatter must show a continuing intention to possess the land for the time being—but this need not amount to an intention to own or to acquire ownership of the land. Applying this rather subtle principle, Neuberger J. had found for the Grahams. Applying the selfsame principle, the Court of Appeal disagreed. Mummery L.J., who gave the only reasoned judgment on this point, considered that Neuberger J. had given insufficient weight to the statement of Michael Graham.

The way in which the Court of Appeal interpreted the evidence is surprising. It in effect held that a farmer who was carefully farming (not casually grazing, but actively farming) farm land in what he considered the most appropriate way did not intend to possess that land for the time being. In fact he possessed the land, but he lacked sufficient intention to accompany the factual possession. The crucial evidence for this unlikely result was the witness statement provided by the hapless Michael. It is doubtful that either he or his legal advisers expected his statement to be interpreted as it was.
The trouble is that the necessary intention to support adverse possession is an artificial construct. As well as being artificial, it is challengingly subtle. An intention to “possess” but not to own, an intention to exclude everyone else, including the paper owner, but only as far as is reasonably practicable and only so far as the processes of the law will allow, is precise to an extreme. It bears little relationship to how people think in real life, nor is it expressed in language that ordinary people use to describe or explain their intentions. It seems very likely, from his actions and from his statement, that Michael Graham intended to farm the fields as part of his farm, and from day to day intended to keep the rest of the world out of the fields. But the reality gap between how people actually think and express their thoughts, and the convolutions of the judicially required intention, allowed the Court of Appeal room to manoeuvre. No doubt it wished to find for Pye. The result seems fair, but the analysis by which the result was achieved seems strained and implausible.

The Grahams are seeking leave to appeal to the House of Lords and the Appeal Committee is presently considering their petition. It is to be hoped that the House of Lords will indeed hear an appeal, so that the whole question of the necessary intention to found a claim in adverse possession can be fully considered.

Louise Tee

UNDUE INFLUENCE AND PARALLEL PROCEEDINGS

The relationship between ancillary relief and undue influence was considered by the Court of Appeal in First National Bank plc v. Walker [2001] 1 F.L.R. 505. The case is a warning to practitioners that unless carefully advised, divorcing clients may be precluded as a result of ancillary relief proceedings from alleging an O’Brien defence of undue influence in subsequent possession proceedings. The facts of Walker were that husband and wife were joint tenants of the matrimonial home. Three mortgages of the house had been executed: first and third mortgages in favour of Barclays Bank and Lloyds Bank, and the disputed second charge in favour of First National Bank (FNB). This disputed mortgage, created in 1991, was to secure a loan made for the sole business purposes of Mr. Walker and his then partner. The marriage founedered, as did the husband’s business. A decree absolute of divorce was granted in 1993, and in 1994 Mrs. Walker’s petition for ancillary relief was heard. The court ordered that Mr. Walker transfer to his former
wife his interest in the matrimonial home and in an endowment policy; an order for nominal periodical payments (of five pence per year) was also made. The transfer was completed in 1995. Mrs. Walker subsequently sought to defend possession proceedings brought by FNB on the ground, *inter alia*, that her execution of the charge had been procured by her husband’s undue influence and that the bank had actual or constructive notice of the relevant facts.

The Court of Appeal, allowing FNB’s appeal from a trial of the preliminary issue, held that a claim of undue influence against a bank mortgagee is secondary to and parasitic on the existence of such a claim by one debtor against the other. Mrs. Walker, in entering into the conveyance in the terms in which she did, abandoned any right to invoke her husband’s undue influence against him, and in so doing she necessarily also abandoned any right to invoke undue influence against the bank. The issue was not *res inter alios acta* because of the parasitic nature of the claim.

It seems that almost any such transfer of mortgaged land from one co-owner to another will have the effect of affirming the validity of a disputed charge. Clause 4 of the conveyance, drawn up by Mrs. Walker’s solicitors, read: “Nothing in this Deed shall affect or prejudice the continuing nature of the First Second and Third Mortgages which shall be a security for all liabilities present and future of the Wife and the Husband to the Bank which the Wife and the Husband hereby acknowledge”. Sir Andrew Morriss V.-C. construed this clause as “specifically acknowledging the existence and validity of the second charge, as between her and the husband”. In his view Clause 4 was crucial to the outcome: “if the conveyance had been silent about incumbrances then it would have taken effect subject to such of them as were valid and enforceable”. But the judgments of Chadwick and Rix L.JJ. suggest that the general tenor of the conveyance, even without Clause 4, constituted an election by Mrs. Walker not to pursue any claim of undue influence. Mrs. Walker “was facing in two directions” and could not pursue inconsistent remedies. She had obtained relief in the matrimonial proceedings on the basis that the charge was a subsisting charge which bound her as well as her husband; she could not subsequently in the possession action seek to set the charge aside on the basis that it did not bind her but only her husband. Sir Andrew Morriss expressed the view that any reservation against the mortgagee would have no effect. It remains possible (but not certain) that affirmation might be avoided by express reservation in the conveyance of the claimant’s rights against both the other debtor and the mortgagee.
The decision follows a line of recent cases on undue influence (appeals against several of which are shortly to be heard by the House of Lords) in which wives fare badly when courts are called upon to balance commercial against family interests. Mrs. Walker acted unwisely, but the price she paid was high.

*The bank:* If the claim of undue influence had succeeded, the bank could not have enforced its security against the property as a whole and could have looked only to Mr. Walker for repayment. Nevertheless, as pointed out by Chadwick L.J., the bank would still have been able to enforce its charge over the interest Mr. Walker owned in the property at the time when the mortgage was executed, treating the equitable joint tenancy as severed at that time. The Court of Appeal was concerned that the family court might not have made the orders it did had it been aware of Mrs. Walker's intention to challenge the validity of the charge. It is likely that the court would still have ordered the transfer of the house, although less likely that it would also have ordered the transfer of the endowment policy. The outcome of *Walker* might be said to have created a windfall for the bank, which enjoyed greater security than it would have had, had it discharged its duty to ensure that Mrs. Walker received independent legal advice.

*The husband:* Mr. Walker received an even greater windfall. If undue influence had been established, he would have been solely rather than jointly and severally liable to repay the loan. And doubtless the bank will enforce the charge against the house before it sues on the personal covenant to repay. It is unfortunate that the real wrongdoer—the perpetrator of the undue influence—is the party who benefited most from the Court's decision.

*The wife:* Mrs. Walker could have avoided the result if she had disclosed to the divorce court her intention to claim undue influence in respect of the FNB mortgage; or if, once she knew of that possibility, she had gone back and informed the court of the change of position. In the result she and the children pay the entire price of the husband's wrongdoing and are likely to lose their home. If the house is repossessed and she shoulders more than half the debt, she will have a right of contribution and indemnity against Mr. Walker, but that must seem small consolation. If undue influence had been established, Mrs. Walker's interest in the equity of redemption would have risen from £5,000 to £16,000. The interest transferred to her would have been worth nothing in monetary terms—but it would not for that have been worthless to her, since it represented the security of a family home for herself and the children.
A perhaps more equitable result would have been to permit the defence, subject to terms that required the transfer back of the endowment policy, thus improving the bank’s chances of eventual recovery against the former husband. The lack of flexibility as regards remedies for undue influence has been problematic in the past (see, e.g., T.S.B. v. Camfield [1995] 1 W.L.R. 430). Perhaps only legislation can provide a cure.

MIKA OLDHAM

COMMUNITY DIRECTIVES: EXPLAINING CIA SECURITY?

Case C–443/98 Unilever Italia v. Central Food (judgment of 26 September 2000) concerned a dispute between two private undertakings over a contract for the supply of olive oil. Central Food refused to accept delivery because the oil did not comply with labelling requirements imposed by recent Italian legislation. Unilever claimed that the Italian rules were themselves governed by the provisions of Directive 83/189 [1983] O.J. L109/8. Under Article 8 of the Directive, member States must notify draft technical regulations to the Commission. In Case C–194/94 CIA Security [1996] ECR I–2201, the ECJ held that breach of this obligation rendered the relevant technical regulations inapplicable, and thus unenforceable before the national courts, even in a dispute between two private parties based on domestic rules prohibiting unfair trading. Italy had notified its draft labelling rules to the Commission as required by Article 8, but nevertheless continued to enact those proposals into law contrary to the standstill obligations contained in Article 9. Unilever argued that the principle in CIA Security should extend also to Article 9, obliging Central Food to accept delivery in accordance with its contractual duties.

On an Article 234 reference, the ECJ held that breach by a member State of either the duty to notify or the standstill provisions constituted a “substantial procedural defect” which rendered the relevant technical regulations inapplicable. Departing from the advice of Advocate General Jacobs, the Court further asserted that this legal sanction could be invoked in civil proceedings between private parties concerning their contractual rights, especially since application of the Italian labelling rules would hinder the marketing of olive oil by Unilever and thus frustrate the free movement aims of the Directive. How was this conclusion to be reconciled with the rule that directives cannot of themselves impose obligations upon, and cannot be relied on
against, private individuals (Case C–91/92 Facchin Dori [1994] ECR I–3325)? The ECJ reasoned thus. Unlike the measures at issue in cases such as Dori, Directive 83/189 does not in any way define the substantive scope of the legal rules on the basis of which the national court must decide the case before it, and creates neither rights nor obligations for individuals. A breach of Article 8 or 9 simply renders the offending technical regulations inapplicable in so far as they hinder the marketing of a non-compliant product, and regardless of the vertical or horizontal nature of the specific dispute before the national court.

CIA Security and Unilever carve out a bold exception to the Dori rule. In the event of conflict between an “ordinary” directive and national law, the doctrine of supremacy ensures that the Community norm prevails—but only if triggered by the principle of direct effect and therefore provided that the provision in question will not impose novel obligations upon private individuals. In the event of conflict between Directive 83/189 and national rules, the imperative of supremacy again ensures that the offending domestic provisions are disappplied—but this time, the requisite trigger lies in the member State’s substantial procedural defect, and free from any prohibition against affecting the legal position of private parties. By this means, Unilever explains why the citizen can appear to rely on a breach of Directive 83/189 against not only the defaulting member State but also another private individual: there is no question of recognising an unauthorised pattern of horizontal enforcement when the traditional framework of direct effect has just been excluded from consideration, and replaced by an alternative conceptual perspective for understanding the process by which directives produce independent legal results within the domestic legal orders.

This explanation is open to criticism.

First, was the ECJ right in its initial supposition that Directive 83/189 is essentially different from other directives? True: the Directive does not provide a traditional template for the transposition into the national legal orders of a static regulatory code aimed at governing relations between individuals, being more concerned with the dynamic legislative and administrative conduct of the member State vis-à-vis other Community institutions. To that extent true also: the black letter of the Directive does not define the substantive legal rules for determining the dispute at hand and does not in that sense seek to create rights or obligations for individuals. Yet the very consequence of rendering offending national regulations inapplicable is precisely to transform the Directive into a measure which determines the substantive legal rules applicable to
the case and whose effect is precisely to create rights and obligations for the relevant protagonists, e.g., to the extent that Unilever could enforce entitlements and Central Foods would be bound by duties not recognised as such under existing Italian law. By reasoning forwards from the skeletal text of the Directive rather than backwards from the ultimate outcome of its own judgment, the Court escapes having to acknowledge the otherwise clear equivalence which exists between Directive 83/189 and the “ordinary” measures contemplated by Dori, and thus avoids having to address the otherwise compelling case for saying that Directive 83/189 should be governed by the same principles of and limits to direct effect as propounded in that judgment.

Secondly, even accepting that the ECJ has chosen to describe the legal effects of Directive 83/189 through the medium of “substantial procedural defects” rather than the more familiar principles of direct effect, questions still remain about whether this provides convincing grounds upon which to distinguish CIA/Unilever from the treatment of cases such as Dori. For example, the Court makes no attempt to explain why a substantial procedural defect (non-notification or enactment of technical regulations in breach of Directive 83/189) should be treated any differently from a substantial substantive defect (failure to implement or to implement correctly the provisions of any binding Community directive). It is far from self-evident that there is any necessary distinction between these two situations in terms of, e.g., the culpability of the member State, the potential threat to the attainment of Treaty policy objectives, or the scale of third party interest invested in the factual scenario which falls under the shadow of the relevant legislative framework.

As it stands, the outcome in both CIA and Unilever was that a private individual suffered the consequences of the member State’s failure to comply with the terms of a Community directive. To describe this outcome in the novel terms of a “substantial procedural defect” and consequent “sanction of inapplicability” is to dress the operation of judicial policy in the garb of logical exigency. The Court has opted to exempt Directive 83/189 from the normal principles which apply to its designated category of legislative instrument, and adopted an analysis which expands the possibilities for domestic enforcement beyond those one would expect in cases where the member State has failed to comply with its obligations under Article 249 EC. Indeed, the Court’s reasoning in Unilever operates, in effect, to alter the underlying legislative nature of Directive 83/189: it becomes less like a directive within the terms of Article 249 EC, and more akin to a regulation in its
ability to produce binding legal effects between private parties independently of implementation by the member State. This might seem a little ironic, given that one of the grounds relied on by the ECJ to resist the possibility of full horizontal direct effect for directives is its reluctance to fashion some hybrid species of legislative act which finds no firm legal parentage in the Treaty. Moreover, the odd result of the Court’s approach in Unilever is that a measure (such as Directive 83/189) which is intended to govern inter-institutional relations between member State and Commission can legitimately produce binding effects for the legal position of third parties, whilst a measure (such as the Doorstep Selling Directive) which is specifically intended to govern relations between private individuals is prohibited from having any such consequences—surely the opposite of what a coherent legal system should seek to achieve.

Finally, the ECJ’s explanation for the relationship between CIA/Unilever and Dori does nothing to resolve continuing discomfort over the status of other judgments which demonstrate the potential for un- or incorrectly implemented directives to impose novel obligations on or affect the interests of private parties, and thus raise similar concerns about the full integrity of the Dori rule (e.g. Case C–77/97 Smithkline Beecham [1999] ECR I–431; Case C–441/93 Pafitis [1996] ECR I–1347; cf. M. Dougan, (2000) 59 C.L.J. 586; also M. Lenz, D.S. Tynes, L. Young, (2000) 25 E.L.Rev. 509). Indeed, by offering an analysis so closely tied to the specific provisions of Directive 83/189, the ECJ in Unilever is perhaps hinting that the search for any single theory which seeks to present these judgments as a coherent juridical phenomenon will prove ultimately to be a vain task.

MICHAEL DOUGAN

GERMAN CONSTITUTIONAL COURT BOWS TO EUROPE

The relationship between national legal orders and Community law is one of the most difficult problems of European legal integration. In an order of 7 June 2000 (2 BvL 1/97, text at <http://www.bverfg.de>, English translation in (2000) 21 H.R.L.J. 251), the German Federal Constitutional Court (FCC) had to address one aspect of this problem, namely the question to what extent national courts are competent to review Community legislation by reference to the standards of national constitutions. While the order first and
foremost is concerned with German constitutional law, it touches upon a general problem facing the courts in all EU member States.

Like a whole series of important judicial decisions, the present case arose out of a controversy about the EC bananas marketing scheme. This scheme—adopted by Regulation 404/93 (O.J. 1993 L47, p. 1)—introduces detailed rules on the import of bananas which restrict the economic liberties of importers. Although it violates WTO law, the ECJ has ruled that the scheme conforms to the fundamental rights guarantees of Community law (see, e.g., Case C–280/93 Germany v. Council [1994] E.C.R. I–4973; Case C–466/93 Atlanta [1995] E.C.R. 1995 I–3799). Importers of bananas have therefore sought judicial protection against the scheme before national courts of member States. In the present case, the administrative tribunal in Frankfurt found that Regulation 404/93 violated fundamental rights protected by the German Basic Law (Grundgesetz), notably the right of property and the freedom of occupation of bananas importers. Under German constitutional law, the tribunal had to stay proceedings and seek a decision of the FCC on the matter. Irrespective of the substantive issues at stake, the FCC had to address an issue of jurisdiction: it had to decide whether, as a national court, it was competent to review secondary Community legislation by reference to the standards of national constitutional law.

This question is one of the most puzzling aspects of the relationship between EC law and member States’ national legal orders. The basic dilemma may be described as follows: on the one hand, Community legislation today affects nearly all aspects of everyday life. If national constitutional guarantees do not apply to Community legislation, the effective protection of rights under member States’ constitutional orders could therefore be undermined. On the other hand, it seems equally dangerous to grant to national courts the competence to review Community legislation by the standard of national constitutions: not only would this mean that each and every Community act had to respect 15 divergent sets of domestic fundamental rights guarantees, but, more importantly, it would also subject EC legislation to 15 (divergent) interpretations by member States courts, and thereby endanger the unity of Community law.

The German judiciary’s approach to this question has been developed in three decisions, which provide the background to the present order. In the 1974 Solange I judgment (English translation in A. Oppenheimer (ed.), The Relationship between European Community Law and National Law: The Cases (Cambridge 1994), p. 419), the FCC upheld its competence to review Community acts
by the standard of the German Basic Law. In the 1986 Solange II judgment (Oppenheimer, p. 461), it took the opposite view: since the standards of protection of fundamental rights under Community and national law were substantially similar, the Court decided no longer to exercise its jurisdiction over Community acts. The 1993 Maastricht judgment (Oppenheimer, p. 527) again marked a shift of emphasis: the protection of fundamental rights—so the FCC said—was to be effected in “co-operation” between itself and the ECJ. While the ECJ would assume the principal role in this regard, the FCC asserted a “reserve competence”, which was to be activated in two situations. First, the FCC held that it would exercise jurisdiction if the protection of a fundamental right under Community law was no longer “substantively equivalent” to the standard of protection under the German Basic Law. And second, it would examine whether acts of EC organs, which pursuant to the FCC’s, own assessment were ultra vires, conformed with German constitutional provisions. The rather nebulous phrasing of these exceptions prompted speculation about the exact content of the “relationship of co-operation” and the circumstances under which the Court would activate its reserve competence.

In the reference which gave rise to the order under discussion, the administrative tribunal of Frankfurt had argued that the case came under the first exception: as the bananas marketing scheme was in conformity with Community law, but violated—in the view of the tribunal—the right of property and professional liberties as protected under the German Basic Law, the standard of protection was no longer “substantively equivalent”. The FCC disagreed and took a more restrictive view of the Maastricht judgment. Reinterpreting the scope of the first exception, it stressed that the standards of protection of EC and German national law did not have to be “congruent”, but that it was sufficient if EC law protected an “indispensable core” (Wesensgehalt) of German fundamental rights. When assessing the standard of protection, courts furthermore should not compare specific guarantees—e.g., property rights under EC and German law—but the general levels of protection. A “reserve competence” would thus only be activated if the EC’s standard of protection of fundamental rights generally dropped below the required minimum standard.

The implications of this re-definition are far-reaching. Under the Maastricht formula, there seemed to be a real possibility of the review of EC legislation by the FCC, which could have provoked an open confrontation between the FCC and the ECJ. Under the new interpretation, this possibility—at least with regard to the first exception—is effectively excluded. It is suggested that this is a
welcome readjustment of the FCC’s position, which effectively removes one of the major sources of conflict between the FCC and the ECJ. Despite this clarification, at least two problems remain: first, the order did not discuss the scope of the second exception enunciated in Maastricht, namely the FCC’s alleged competence to review ultra vires acts of EC organs. Secondly, on a conceptual level, some may find it difficult to accept that the FCC continues to assert a “reserve competence” over secondary EC legislation. However, it should be said that after the decision in the Bananas case, this important conceptual problem is unlikely to become relevant in practice.

CHRISTIAN J. TAMS

THE TAX AVOIDANCE ROLLERCOASTER: YET ANOTHER NEW APPROACH

Over the last 20 years judicial attitudes to tax avoidance schemes have varied dramatically, especially in the House of Lords. The judicial power to ignore tax avoidance schemes was first recognised in Ramsay [1982] A.C. 300 and reached its high-point of principled analysis in Furniss v. Dawson [1984] A.C. 474. There followed a period of a generally restrictive interpretation of the law, but recently there have been signs of a more interventionist approach, in McGuckian [1997] 1 W.L.R. 991 especially. But with the most recent decision in Macniven v. Westmoreland Investments Ltd. [2001] 2 W.L.R. 377 it is clear that the House of Lords has again sought to curtail its power to deal with tax avoidance schemes.

In Macniven a pension fund lent money to a company which the company used to repay interest it owed to the pension fund. The reason for this transaction was that, since the payment of interest constituted a charge on income (within section 338 of the Income and Corporation Taxes Act 1988) which is an allowable deduction in computing profits or losses for the purposes of corporation tax liability, payment of the interest would make the company more attractive to any prospective purchaser. The company paid the pension fund an amount net of tax and accounted to the Revenue for the tax due on the payment. Since the pension fund was exempt from tax liability it sought to reclaim the tax which had been deducted. This was the cause of the dispute in this case, for, if the tax could be recovered, it followed that the company and the pension fund were in exactly the same position as they started, save that the company now had the tax benefit of the charge on income.
At first sight it would seem that this transaction was caught by the strict application of the *Ramsay* principle, as Lords Nicholls and Hope acknowledged. The parties had entered into a circular pre-ordained transaction into which steps had been inserted for no commercial purpose other than to save tax. But all the judges accepted that the scheme was effective and that the courts could not interfere with it.

Whilst Lord Nicholls bravely sought to justify his decision with reference to the “*Ramsay* aid to construction”, as he called it, Lord Hoffmann, with whom all the other members of the House agreed, created a new approach for dealing with tax avoidance schemes, although he purported to do so within the constraints of the existing authorities. The essence of this new approach involves drawing a fundamental distinction between commercial and legal concepts in statutory provisions. Certain concepts may be construed in a broad commercial sense, which means that they should be given a commercial meaning. Legal concepts, however, are confined to their strict legal meaning and are to be interpreted without regard to their commercial context. So, for example, in *Ramsay* itself the crucial issue concerned whether the taxpayer had suffered a loss. Since, as Lord Hoffmann recognised, this could be characterised as a commercial concept, it was possible to consider whether, as a matter of commercial reality, the taxpayer had truly suffered a loss. Since this was not the case, the scheme was not effective. In *Macniven*, however, the crucial question was whether the company had really paid interest to the pension fund. The concept of payment is a legal one and, since the effect in law of the payment was to discharge an actual debt relating to interest, it followed that the interest had indeed been paid and so the scheme was effective. Although the scheme did involve the replacement of one debt for another, the new debt was distinct and so did not undermine the legal validity of the payment of interest.

Two key questions need to be asked concerning the application of this new approach. First, how is it possible to distinguish between legal and commercial concepts? Lord Hoffmann suggested that the proper approach was to ask whether a commercial person would be able to define the concept or would refer the matter to a lawyer. But surely this is too uncertain, particularly in the context of taxation. Why, for example, should it follow that “loss” is treated as a commercial concept whereas “payment” is legal? Also, what is the reason for treating the concept of “disposal”, the key word in *Furniss v. Dawson*, as a commercial concept, save that such a characterisation meant that the result of the earlier case could be defended? How will other key concepts be characterised? What
about “distributions” for example? Possibly business people
could define such a concept without resorting to a lawyer, whereas
lawyers know that the legal definition of distribution is a matter of
some complexity. To complicate matters even more, Lord
Hoffmann accepted that particular concepts may be characterised in
different ways depending upon their statutory context.

Secondly, what is the status of the *Ramsay* principle now?
Whilst all the judges sought to emphasise that *Ramsay* does not
create any legal principle as such but simply provides an aid to
statutory construction, it is clear that the decision as it had been
interpreted in subsequent cases did more than this since particular
tests involving pre-ordained schemes and commercial purposes had
been identified to determine whether a scheme was effective to
avoid tax. But, as Lord Hoffmann recognised, these tests can only
now be considered where particular concepts are given a
commercial meaning. Even then, the *Ramsay* “approach” cannot be
applied rigidly but is simply an aid to construction of the statute.
Paradoxically, even though the House of Lords purported to reject
the *Ramsay* principle, it has created a new principle which is
found on the fundamental distinction between legal and
commercial concepts.

Lord Hoffmann’s apparent motive for this new approach is
laudable. He has sought to reconcile the judicial approach to tax
avoidance with constitutional considerations of the appropriate role
of Parliament and the courts in tax affairs, by minimising the
situations where the courts will intervene, and so to create certainty
in a notoriously uncertain area of the law. In fact, he has achieved
the opposite effect. We are left with a situation where the efficacy
of any tax avoidance scheme turns on the inherently vague
distinction between legal and commercial concepts. The judiciary
have not been given any adequate guidance as to how this
distinction can be drawn and so they will act very much like
Humpty Dumpty, for whom words meant what he chose them to
mean. The only matter about which we can now be sure is that
there is no longer a question of whether we will ever have a
General Anti-Avoidance Provision in this country, but when.

**GRAHAM VIRGO**

**ELECTION LATEST**

Depending on your point of view, the appeal in *Cerberus Software Ltd. v. Rowley* [2001] I.R.L.R. 160 involved either a “troublesome
little point” or a “fundamental issue” of employment law (per Ward and Sedley L.JJ. respectively). Where an employment contract contains provision for a payment in lieu of notice, does a summary dismissal, not justified on grounds of gross misconduct, constitute a breach of the obligation to give notice or an election to make the payment in lieu?

John Rowley was summarily sacked as sales and marketing director of Cerberus Software in June 1996. Responding admirably to what was a “contrived and fabricated” dismissal, Mr. Rowley almost immediately secured alternative employment at a significantly higher salary before recovering judgment for nearly £25,000 against the company for unfair dismissal and breach of contract. That award, comprising mostly the salary he would have received during his six-month notice period, was upheld by the Employment Appeal Tribunal.

But a majority of the Court of Appeal ordered that the tribunal’s award be set aside and be replaced by the much smaller amount of damages for the brief period between the date of dismissal and the start of the new employment. Ward L.J., with whom Jonathan Parker L.J. agreed, held that the relevant obligation was to give notice. By dismissing summarily, the employer had broken this duty and was liable for wrongful dismissal. That liability was subject to the duty to mitigate. Ward L.J. rejected Mr. Rowley’s claim that there had been a duty to make a payment in lieu. The contract provided that the employer “may make” a payment in lieu to the employee (Ward L.J.’s emphasis). Such language was, he said, “totally inconsistent” with Mr. Rowley having any right to insist on such a payment. In effect, that right was contingent on Cerberus electing to exercise its power to make the payment. The employer denied having made such an election and Mr. Rowley’s own evidence did not suggest a belief that the dismissal had been intended to be lawful.

Ward L.J.’s judgment is also noteworthy for distinguishing *Abrahams v. Performing Rights Society* [1995] I.C.R. 1028. The terms of the contracts in the two cases were, he said, “very different”. Mr. Abrahams’ contract provided that, in the absence of gross misconduct, he was entitled to two years’ notice or a payment in lieu. But it could be suggested that any difference is superficial and that it is preferable to treat the contracts alike. Both gave the employer two means of ending the employment in the absence of gross misconduct. The argument in *Abrahams* that the employer “was not electing between two modes of performance but instead intimating that he would perform neither” mirrors that in *Cerberus* that it is “always open to a contracting party to break the contract
provided it is willing to pay the price fixed by law for doing so”. In *Abrahams* the Court of Appeal concluded that it would have been “absurd to treat the defendant’s termination otherwise than as an election not to serve notice”. In *Cerberus* the majority thought otherwise.

It is worth referring briefly here to the elective and automatic theories of termination. According to the former, an employee can refuse to accept the employer’s repudiatory breach as ending the contract and apply to the court for relief. The court can, by means of injunction, prevent the employer from terminating the contract otherwise than in accordance with its terms—*i.e.* on notice or by payment in lieu. While Ward L.J. thought it unnecessary to “wade through” these “murky waters”, it should be noted that the Court of Appeal did not hear legal argument on the issue; Mr. Rowley was not represented.

Sedley L.J., dissenting, preferred the approach of the earlier tribunals. The Employment Tribunal had held that the payment in lieu provision meant that the dismissal was lawful. According to the E.A.T., when the employer chose to give no notice the employee became entitled to be paid in lieu. Implicit here is the idea that the act of dismissal was not a breach of the duty to give notice but an election to make a payment in lieu. Sedley L.J. adopted this approach since it “carries into effect the parties’ plain intentions”.

There is a good deal to this point. Payment in lieu provisions are generally inserted by the employer to enable him to get rid of the employee immediately and lawfully, thereby maintaining the validity of any restrictive covenants. At the time of the contract the employer is probably happy to be seen as contemplating only dismissal by notice or with a payment in lieu. This leads to a presumption that the parties intended that an instant dismissal would, in the absence of gross misconduct, constitute an election by the employer to make the payment in lieu. The trick of such a construction is that it neatly sidesteps the argument that an employer can always break his contract and pay damages. By treating the dismissal as a lawful election the breach disappears.

It is plain that Sedley L.J. was motivated by a strong ethical impulse. If the employer’s arguments correctly represented the law, “there is”, he said, “something wrong with it”. He referred to the principle that parties should honour their contracts and noted that, were the company’s arguments to be accepted, employers who broke their contracts could frequently expect to do a great deal better than those who abided by them. The outcome he proposed
not only gave effect to the parties’ supposed intentions but also met the “undoubted morality of the case”.

Presumptions as to parties’ intentions can be rebutted by clear words in a contract. It is not easy to envisage wording reserving the power to effect a lawful summary dismissal without excluding the “right” to dismiss instantly and wrongfully. Perhaps this bears out a different sort of rule: you can’t have your cake and eat it.

DAVID PEARCE