FIVE LECTURES ON THE COMMON LAW WITH COMPARATIVE REFERENCE TO THE LAW IN CHINA

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Jeremy Gans & Edwin Simpson*

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Abstract

In April 2014, leading scholars came to China to deliver lectures addressing fundamental areas of the common law, including property law, agency law, equity, criminal law, and tax law. These lectures explore the development, features, and application of their respective areas of the common law. In addition, the lectures compare aspects of the common law with the approach in civil law jurisdictions and, in particular, in China. By examining the development of the common law and stare decisis, one may gain insights into common law concepts, many of which are similar to those in the Chinese legal system.

I. INTRODUCTION

In April 2014, a lecture series was hosted in China exploring several areas of the common law. Two teachers from each of the following law schools: Melbourne Law School, National University of Singapore Faculty of Law, and University of Oxford Faculty of Law delivered the lectures. Their visit was made possible through the generous support of Allan and Maria Myers and four Chinese law schools: Tsinghua University School of Law, Peking University Law School, Fudan University Law School and KoGuan Law School of Shanghai, Jiaotong University.

For the purpose of recording some of these lectures for future reference, and also as an expression of appreciation, we have decided to publish five of these lectures. The lectures address five fundamental areas of common law: property law, agency law, equity, criminal law, and tax law. Each lecture may be read together with the other lectures or separately.

These lectures explore the development, features, and application of their respective areas of the common law. In addition, the lectures compare aspects of the common law with the approach in civil law countries and, in particular, in China. Various themes emerge from the lectures in terms of the common law. Four of these themes are explored below.

1 Jeremy Gans and Andrew Godwin.
2 Dora Neo and Tan Cheng-Han.
3 Paul Davies and Edwin Simpson.
4 Mr. Allan Myers QC is a prominent alumnus of Melbourne Law School and the Faculty of Law, University of Oxford.
A. The Definition of “Common Law” Depends on the Context

When developing an understanding of the common law, law students and lawyers from other legal systems face certain challenges. One of these challenges is determining what the term “common law” actually means and how the term is used. It is important to note that there are at least three contexts in which the term may be used:

1. When comparing legal systems between countries: to refer to the legal system that emerged in England and to distinguish it from other legal systems, such as the civil law system that emerged in continental Europe and China’s own distinctive legal system (for insights into this, see the lectures by Gans, Godwin and Tan);

2. When comparing sources of law within common law jurisdictions: to refer to case law (i.e. law made by judges when they decide cases) and to distinguish it from statute law that is enacted by Parliament (for insights into this, see the lectures by Gans, Godwin and Simpson);

3. When comparing sources of case law within common law jurisdictions: to refer to the body of case law that was originally made by judges in the “common law courts” and to distinguish it from “equity”; namely, the body of law that was made by judges in the “courts of equity” (for insights into this, see the lectures by Davies and Godwin).

As a result, an understanding of the context is very important to an understanding of how the term is used.

B. Case Law (Judge-Made Law) is a Source of Law in its Own Right

In common law jurisdictions, the role of case law as a source of law is underpinned by the doctrine of precedent – also known by its Latin name stare decisis, which literally means “to stand by the decision”. According to the doctrine, courts must abide by the decisions of higher courts and must not overturn their own precedents without good reason. In fact, it was only relatively recently in the history of English common law – 1966 – that the Supreme Court of the United Kingdom (formerly, the House of Lords) expressly decided that it was not bound by its previous decisions.

Although the doctrine of precedent does not apply in China, the referential value of case law has become greater as a result of the adoption of a guiding case system by the Supreme People’s Court in 2011.

To understand how the doctrine of precedent works, it is essential to bear in mind that it is not the decision in its entirety that is binding. It is the legal reason or legal principle on which the decision was based that is binding. This is often referred to by the Latin
phrase *ratio decidendi*, which can be translated as “the reason for what was decided”. In addition, when hearing a case, a court will only be bound to follow the decision in a previous case if the facts of the current case come within the scope of what was contemplated by the *ratio decidendi* of the previous decision. If the facts do not come within the scope of the *ratio decidendi*, the court will distinguish the previous decision “on its facts” and, although it might be persuasive, the previous decision will not be binding.

It is also important to note that any statements made by a judge that do not form part of the *ratio decidendi* are not binding, although they might be persuasive. Such statements are referred to by the Latin phrase *obiter dicta* (literally, “statements in passing”).

As noted by Davies in his lecture, it is often difficult to identify the *ratio decidendi* of a case and debate about legal principles has been the subject of many appeals and academic commentaries over the years. This is perhaps one of the greatest disadvantages of case-law. At the same time, it could be argued that it is also one of its greatest strengths, as it permits legal principles to be adapted to meet the circumstances of specific cases.

The use of case law as a source of law (i.e. in addition to statutes enacted by Parliament) has certain advantages and disadvantages. One of the advantages is that the common law can be developed incrementally by courts as and when disputes arise, and does not require a statute to determine or confirm the legal position. This imbues the law with a high level of flexibility and the ability to adapt quickly to new circumstances. This is particularly advantageous to commercial transactions, where the courts in common law jurisdictions have traditionally demonstrated a pragmatic approach that attempts to balance transactional efficiency with the need to achieve fairness between the parties, including third parties. The issues discussed by Godwin and Tan illustrate the pragmatic view of the common law as it seeks to achieve an appropriate balance between persons who have competing claims or interests and also the importance that the common law attaches to achieving certainty and stability in commercial transactions.

On the other hand, one of the disadvantages with the use of case law as a source of law is that in its attempts to achieve certainty and stability, it may not always adopt the most logical approach. This is illustrated by Tan, who discusses issues concerning agency law and the retrospective effect of ratification. In addition, it may leave certain issues unresolved or unsettled, as explained by Godwin in relation to the effect of contractual restrictions on the assignment of debts.

Further, certainty and stability may be undermined if a decision by the highest court in a common law jurisdiction reinterprets or overturns established doctrine without any advance warning. This is
illustrated by Davies, who notes that the Supreme Court of England and Wales has recently held that a fiduciary holds a bribe on constructive trust for the beneficiary. It is in such circumstances that it may be necessary for Parliament to enact a statute to clarify or override the position under case law.

Even where the field is substantially covered by statute such as in the case of criminal law and taxation, judges still have a crucial role in interpreting the law and applying it to new situations. In doing so, judges continue to make law that either plugs gaps left by statute or supplements existing statutory provisions. This is illustrated by Gans, who examines the emergence of statutory offences to replace the old common law crimes and notes that in many common law jurisdictions, statutes are still read by courts in special ways that reflect the approach of past judges to criminal responsibility. It is also illustrated by Simpson, who examines the often-controversial interplay between the judicial and legislative roles in analysing and responding to the challenges posed by tax avoidance activities. In particular, through an examination of case law, Simpson highlights the challenges that courts face when they interpret a taxation statute and endeavour to give effect to the intention of Parliament by identifying the statutory question that they have to answer and the facts that are relevant to determining how the statutory question is to be answered.

C. Equity Performs a Vital Role in Common Law Jurisdictions

As explained by Davies, the body of law that is called “equity” was originally developed by the judges in the Chancery courts to “to soften and mollify” the harshness and inflexibility of the law developed in the common law courts. Although law and equity are now administered by the same courts as a result of statutory developments in the nineteenth century, equity remains a separate body of law and, like the common law, is developed by judges in a principled, incremental manner.

Equity is crucial to understanding fundamental aspects of common law systems. Perhaps the best example of this is the use and operation of the trust. Described by some as “England’s greatest contribution to legal science”, the trust performs a pivotal role in terms of the way in which transactions are structured and proprietary rights are recognised and protected.

The relevance of the trust is illustrated by Godwin, who examines the circumstances in which a proprietary right or interest is recognised on the basis of a trust. It is also illustrated by Davies, who examines the nature of a fiduciary duty that a trustee owes to the beneficiaries and the question as to whether a proprietary remedy based on a trust is available where there is a breach of that duty.
D. Although Distinctive in its Origins and Development, the Common Law Often Simply Represents an Alternative Way of Achieving the Same Result as in Other Legal Systems

The distinctiveness of the common law, when compared with other legal systems, often masks an underlying reality; namely, all legal systems must deal with similar challenges and design solutions to overcome those challenges. Sometimes the result is exactly the same and the only difference between legal systems is the method used to arrive at the result.

This reality is illustrated by Gans in response to the question “who decides whether to start a criminal prosecution?” Gans notes that both the common law and civil law systems reach a similar answer; namely, the decision is made by a protected decision-maker with independence from the government. In civil law systems, that decision-maker is a court or a court officer. In common law decisions that decision-maker is now typically an independent public prosecutor.

Importantly, Gans also notes that attention to tradition is necessary for a full understanding of criminal law in common law jurisdictions. This is a common theme that runs through all of the lectures. The relevance and importance of tradition should come as no surprise when it is realised that the common law has evolved incrementally and uninterrupted for almost one millennium.

We hope that these lectures will prove useful to students in China and to others who would like to gain a better understanding of the common law and its rich and diverse traditions.

II. PROPERTY LAW: PROPERTY VS NON-PROPERTY
Andrew Godwin

A. Introduction

This lecture examines some fundamental issues concerning the basis on which the common law recognises and protects rights and interests in property and draws some comparisons with civil law.

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5 For our purposes, the terms “rights” and “interests” are used synonymously. The term “right” is commonly used when referring to the specific rights that attach to an interest in property (e.g. the right to possess, use and assign property). The term “interest” is commonly used when distinguishing a “legal interest” (i.e. an interest that is recognised by the “common law” or “at law”, as contrasted with “equity” or “in equity”) from an “equitable interest” (i.e. an interest that is recognised in equity and is sometimes referred to as a “beneficial interest”). Thus, we talk about the equitable interest of a purchaser under a contract for the sale of an interest in land. See further in Section V below. The term “title” is often used synonymously with “ownership” to describe the fullest rights that a person can enjoy in relation to property. However, it is also used in a narrower sense as in the case of a “possessory title” (see Section IV below).
jurisdictions and China. It discusses the characteristics or features of a proprietary right, as recognised in common law jurisdictions, and explores where the common law draws a line between “proprietary rights” and “non-proprietary rights” (e.g. rights that are purely contractual in nature). In particular, it explains why the question of whether a proprietary right exists matters, and also how the common law deals with the challenges that arise when the position from a property law perspective conflicts with the position from a contract law perspective.

B. The Distinctive Features of the Common Law Approach to Property

All of the lectures in this series have identified certain features of the common law that are common to all of the topics. These features include the existence of judge-made law (case law) and the associated doctrine of precedent; the gradual or incremental way in which the common law has evolved to meet new challenges; and also the importance that the common law attaches to achieving certainty and stability in civil relationships and commercial transactions. All of this suggests that the common law has traditionally adopted a pragmatic approach to resolving challenges and achieving an appropriate balance between competing rights or claims.

This pragmatic approach is particularly relevant to the development of property law. Since its inception, the common law has recognised three important realities about proprietary rights. First, private property is a fundamental aspect of modern society and our capitalist or market-based economy. In other words, our modern society and market-based economy could not operate without laws that recognise and protect private property. Secondly, the protection of private property is an important check or restraint on arbitrary power by the state and is an essential element for maintaining civil order in society. Thirdly, the distinctive nature of certain types of property means that special procedures and special remedies need to be recognised to protect proprietary rights.

Like contract law, much of the content of property law is still largely derived from case law, supplemented by statutes that deal with issues such as the transfer of interests in land, registration of title, and residential tenancies. In this lecture, I will discuss a couple

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6 See Davies, infra, Equity and the Common Law: Remedies for Breach of Fiduciary Duty.
7 See Tan, infra, Agency law: Unauthorised Agency and the Undisclosed Principal.
8 This is reflected in the basic principle, recognised in most jurisdictions, that the state should not expropriate private property except for just cause and for the fair and reasonable payment of compensation.
9 See further in Section V below.
of cases to illustrate how property law has developed in the pragmatic way that I have just outlined.

Note that when I talk about the common law in this context, I am including the body of law that we call “equity”. In other words, I am adopting a broad definition of common law to include equity and equitable principles.

**C. Three Fundamental Questions**

Before we examine details of the way in which property law has developed in common law jurisdictions, let’s spend some time considering three fundamental questions. The first question is as follows:

Why is private property a fundamental aspect of modern society and our capitalist or market-based economy?

H.F. Schurmann, an economic historian who researched traditional property concepts in China, wrote in 1956:

> It is not wrong to say that the nature and intent of a society reveal themselves in the legal and customary concepts of property held by the various members and classes of that society. These property concepts do not change without an incipient or fundamental change in the nature of the society itself. The history of property relations in a given society is thus, in a way, the history of the society itself.\(^\text{10}\)

In other words, it is through an understanding of the legal and customary concepts of property that we gain an understanding of society itself.

Private property is an integral part of our own personal identity. For better or worse, a large part of our identity is defined by reference to the power that we exercise over the things around us. Some of these things are basic necessities. For example, we need food and water and protection from the forces of nature (e.g. clothes and shelter) in order to survive. Once it is accepted that we need to have some power or control over basic necessities, it is not difficult to understand how our need or desire to control things extends to non-necessities and how those things become part of our own personal identity.

Some non-necessities, such as mobile phones, are easily replaced. In other words, if you lost your mobile phone, it could be easily

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on another phone. On the other hand, some non-necessities have a unique or special nature or value. For example, I wear a watch that belonged to my grandfather (his initials are inscribed on the back) and had been given to him when he retired in 1964. Every time I look at my watch, I think of my grandfather. If I lost my grandfather’s watch, I would of course be able to replace it with another watch that told the time. However, I would not be able to replace it with a watch that had the same sentimental value. In this sense, my grandfather’s watch is unique and irreplaceable.

This leads me to the second question:

Why is there such a close relationship between law and property?

Jeremy Bentham, the 19th-Century English philosopher wrote that “Property and law are born together, and die together. Before laws were made there was no property; take away laws, and property ceases.”

One of the reasons why there is a close relationship between law and property is that it is often only the existence of a legal remedy that determines whether a property right can be asserted and enjoyed. To put it differently, in some cases, a proprietary right could not exist if the law did not provide a remedy to protect it. It is not possible to have one without the other. This is particularly relevant in the case of intangible property rights; namely, rights that you cannot touch or physically possess. I will return to this concept later when I discuss the type of proprietary right that we refer to as a “chose in action.”

Let’s now consider the third question:

What is property?

It might come as a surprise to you to learn that this is a question that the common law has always struggled to answer; namely, what are the essential characteristics or features of a proprietary right? Where do you draw the line between property and non-property?

Before we consider this question, let’s examine the ways in which the common law categorises property or proprietary rights. There are two main categories: (1) real property – this refers to interests in land and is the equivalent of “immovable” property in civil law jurisdictions and China; and (2) personal property – this refers to everything else and is the equivalent of “movable” property in civil law jurisdictions and China.

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11 Of course, it might not be so easy to replace the information that you had stored in your mobile phone!

12 JEREMY BENTHAM, THEORY OF LEGISLATION 113 (R. Hildreth trans., Trübner & Co. 2d ed. 1956).

13 See Section VI below.

14 不动产. The word “real” derives from the Latin word res, meaning “thing”.

15 动产.
Personal property is further divided into tangible property (i.e. property that you can physically possess) and intangible property. An example of tangible property is my grandfather’s watch. An example of intangible property is the copyright that I might claim in relation to this lecture.

I mentioned that the common law has struggled to identify the essential characteristics or features of a proprietary right and what it is that makes a right a proprietary right? Some scholars have argued that a proprietary right must be capable of being assigned. Others have argued that it must allow the owner to exclude everyone else from enjoying the right (i.e. it must confer an exclusive right on the owner to use and enjoy property).

However, these arguments have often proven to be deficient. At the very least, most people would agree that the concept of property involves a relationship between a person and a thing and the right to exercise a degree of control over a valuable resource and to protect that right from interference against the whole world. In addition, most people would agree that proprietary rights may consist of a range or “bundle” of rights depending on the circumstances.

\textit{D. The Importance of Possession}

I mentioned earlier that the common law has adopted a pragmatic approach to the recognition and protection of proprietary rights. This is particularly reflected in the importance that the common law attaches to possession as it relates to land and tangible personal property.

An interesting fact about property law in common law jurisdictions is that mere possession of property is considered to confer a proprietary right. We call this a possessory title.

Let me give you an example:

Imagine that you lend one of your books to a friend and the friend, without your authority, passes possession of your book to a third party. The common law recognises that the third party has obtained a proprietary right simply on the basis of acquiring possession. What if another friend saw your book in the possession of the third party and decided to take it and return it to you – would this be possible? The common law would not allow your other friend to do this, at least not without the consent of the third party. Why is this? It is because a person in possession of property can protect that possession against everyone else, except somebody who has a better claim to possession; namely, yourself.\footnote{The situation would be different if you had authorised your other friend to retrieve possession of the book on your behalf.}

\footnote{16}
The general principle under common law is that a person in possession of land or goods is entitled to take action against anyone interfering with possession unless the person interfering is able to demonstrate a better claim to possession.

This principle is particularly relevant where somebody finds an object and the true owner cannot be found and was confirmed by the English Court of Appeal in *Parker v. British Airways Board.* This decision is a very good example of how common law judges apply precedent and how they resolve disputes by reference to the facts of the case. Indeed, the facts of this case were very interesting. As the judge, Donaldson LJ explained:

On November 15 1978, the plaintiff, Alan George Parker, had a date with fate – and perhaps with legal immortality. He found himself in the international executive lounge at terminal one, Heathrow Airport. And that was not all that he found. He also found a gold bracelet lying on the floor.

Mr. Parker gave the bracelet to the airport lounge official with a note asking for the bracelet to be returned to him if the owner did not claim it. The lounge later sold it for £850 and kept the proceeds. When he discovered what the lounge had done, Mr. Parker sued the manager of the lounge, British Airways Board, arguing that he had a right to the bracelet as a finder. At first instance, Mr. Parker was awarded damages of £850 and £50 as interest. The British Airways Board subsequently appealed to the Court of Appeal. Its argument was based on the proposition that at common law, an occupier of land has rights over all lost objects that are found on that land, whether or not the occupier knows of their existence. In other words, as the occupier of the land on which the gold bracelet was found, the British Airways Board should be considered to have a better claim to the bracelet than Mr. Parker enjoyed as the finder of the bracelet.

The Court of Appeal rejected the appeal, confirming the ancient common law rule that a person who finds property has a proprietary right based on possession and can protect that right against everyone except the true owner. Donaldson LJ further suggested that the rule made sense on public policy grounds and that if the rights of finders were not protected, “lost property would be subject to a free-for-all in which the physically weak would go to the wall”.

However, reflecting the pragmatic approach of the common law, Donaldson LJ recognised certain limitations to the rule. First, an employee or agent who finds a chattel in the course of employment and who takes it into his or her care and control does so on behalf of

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17 Parker v. British Airways Board [1982] 1 All ER 834 (Eng.).
his or her employer who acquires a finder’s rights. What this means if that if Mr. Parker had been an employee of the British Airways Board (e.g. a manager or cleaner of the lounge) and had found the bracelet during the course of his employment, he would have found the bracelet on behalf of the British Airways Board.

Secondly, a finder has an obligation to take such measures as are reasonable to ascertain the true owner and to care for the chattel. Thirdly, an occupier of a building has superior rights to a finder if, but only if, before the chattel is found, the occupier has manifested an intention to exercise control over the building and the things that may be upon it or in it. In this case, the British Airways Board had not manifested such an intention; for example, there were no signs or instructions in the lounge that confirmed that the British Airways Board was responsible for any lost items found in the lounge. Finally, the “finders” rule does not protect trespassers. If, for example, Mr. Parker had been a trespasser (i.e. he did not have any authority to enter the lounge), the British Airways Board would have had the better claim.

E. When is a Proprietary Right or Interest Recognised?

I would now like to discuss the question as to when a proprietary right or interest is recognised. This question is of critical importance as it will determine if and when legal remedies may be available to protect the proprietary right against third parties.

Let me give you an example. Let’s say that you sign a contract to purchase a house and you pay a deposit to the seller. When do you actually obtain a proprietary interest in the house? Is it when you sign the contract and pay the deposit or is it only when the house is formally registered in your name? The reason why this question is so important is that it will determine whether you can seek a proprietary remedy to protect your interest in the house.

Let’s say that after you sign the contract but before the house is formally registered in your name, the seller enters into a contract to sell the house to a third party, maybe because the third party was willing to pay a higher price for the property. Are you able to obtain a legal remedy to defeat the claim by the third party and ensure that you become the registered owner of the house?

Of course, if the seller enters into a contract to sell the house to a third party, this would constitute a breach of the contract that you had signed and you would be entitled to sue the seller for compensation or damages to cover any loss that you may incur as a result of the breach. However, let’s say that you don’t want to claim compensation for losses; instead, you want the house. Is there a remedy that requires the seller to transfer the house into your name
or prevents the seller from registering the transfer in the name of the third party?

In common law jurisdictions, an important remedy – one that is recognised in equity – is an order for specific performance. When a court makes an order for specific performance, it orders a party to a contract to perform its obligations under the contract. Importantly, a court will only make an order for specific performance in such circumstances if you have a proprietary interest in the house. And you will only have a proprietary interest in the house if you can obtain a proprietary remedy that enables you to assert or enjoy that interest. In this way, we see the close, inter-dependent relationship between law and property.

So, we return to the initial question. At what point do you obtain a proprietary interest in the house? In common law jurisdictions such as England and Australia, the law recognises that you have a proprietary interest – one that is recognised in equity – once you have signed a valid, unconditional contract for the purchase of an interest in land. The doctrinal basis of this is the trust: the law recognises that once you have signed the contract with the seller, the seller holds the title of the house as trustee for your benefit.

What this means is that you are considered to be the beneficial or equitable owner of the house, even before the house is formally registered in your name. On this basis, you can protect your proprietary interest by seeking an appropriate order from a court. It might be an order of specific performance, requiring the seller to perform its contract with you. In addition, you might seek another equitable remedy, called an injunction, which is an order preventing the seller from completing the sale to the third party.

Now, you might be thinking: what happens if the house has already been registered in the name of the third party and the third party has not been involved in any wrongdoing itself? In other words, what happens if you are too late in seeking a remedy and the formal title to the house has already been transferred into the name of the third party? In such circumstances, you would have the right to make a claim in respect of the sale proceeds from the seller; in other words, you would be able to claim the money that the seller has received from the third party or, more accurately, the difference between the price that you agreed to pay and the price that the third party agreed to pay. This is because the law recognises that if the seller sells the house to a third party in breach of the trust, then you – as the beneficiary – will be able to claim the proceeds from the sale of the trust property.

An important question that has been considered in common law jurisdictions – one that has not been conclusively settled – is whether this concept applies not just to real property but also to personal property. In some cases, courts are prepared to recognise that it
applies to personal property, particularly where the property has a special nature and is not fungible (i.e. it cannot easily be replaced).

The above concept demonstrates that the common law recognises the special nature of certain property, the need to achieve an appropriate balance between persons who have competing claims and also the importance of achieving certainty and stability in commercial transactions.

**F. The Conflict Between the Position under Property Law and the Position under Contract Law**

I would now like to discuss two other questions that are very important, particularly in finance transactions. The first question is: do the rights and benefits under a contract constitute property? The second question is: if the rights and benefits under a contract do constitute property, is it possible to assign this type of property to a third party?

Let me give you an example of what I am talking about. Let’s say that a creditor lends some money to a debtor pursuant to a loan agreement. In common law jurisdictions, the law recognises that the benefit and rights that the creditor enjoys under the loan agreement – namely, the right to be paid and to take legal action to recover the debt if the debtor does not pay – is a proprietary right. It is formally referred to as a “chose in action”, which is a technical name for an intangible proprietary right that can only be claimed or enforced through legal action. The term “chose” means “thing” and a “chose in action” literally means a thing that can only be claimed or enforced through legal action. It is distinguished from a “chose in possession” which refers to a thing that can be possessed.

This leads me to the second question: if the rights and benefit under the loan agreement constitute a proprietary right, is it possible to assign the proprietary right to a third party? And if it is possible to assign the proprietary right to a third party assignee, does that mean that the debtor has an obligation to make payment to the assignee and that the assignee can take legal action against – or sue – the debtor directly to recover the debt in the event that the debtor does not repay the debt when due?

From a public policy perspective, the assignment or transfer of a tangible asset is much less complicated than the assignment of an intangible asset. This is because a tangible asset has a separate existence, which is not dependent on the acts or obligations of another party. So long as the person in possession of the asset is also its owner and has clean title to the asset, no third parties will be adversely affected by the transfer.

In the case of the assignment of the rights and benefit under a contract that creates a debt, however, the asset consists of a right to
claim payment from another party – namely, the debtor. The debtor will be affected by the assignment as it may be asked to make payment to a third party assignee.

In England, prior to 1873, an assignment of a debt was recognised only in equity. What this meant is that although the assignment was effective between the original creditor and the assignee, the assignment was not effective against the debtor. In other words, the debtor’s obligations were not affected by the assignment – the debtor could disregard the assignment and continue to treat the original creditor as the party to whom it owed the debt. If the debtor failed to repay the debt, the assignee would need to request the original creditor to sue the debtor in its name to recover the debt.

In 1873, however, a piece of legislation called the Judicature Act recognised what we call a “legal assignment” of a chose in action. Under a legal assignment, the assignee may claim payment directly from the debtor if certain conditions are satisfied, including the requirement that the assignment be in writing and that written notice of the assignment has been given to the debtor.

The relevant provision is one of the most important statutory provisions in commerce as it underpins the trade in financial assets and supports many financial transactions such as securitisation. This is an example of the way in which legislation has intervened to supplement the position under case law.

There is, however, a complex question that needs to be resolved: what is the legal position if the contract creating the debt prohibits an assignment by the creditor or provides that an assignment of the debt will not be effective without the consent of the debtor?

This is an important question. From a contract law perspective, any assignment of the debt without the consent of the debtor or in breach of a contractual prohibition would be invalid. However, from a property law perspective, if the rights and benefit under the contract creating the debt constitutes a proprietary right, it should be possible to assign the debt. How should the law reconcile this conflict between the position under contract law and the position under property law?

If a creditor assigns a debt in breach of a contractual restriction or prohibition, there are three possible outcomes:

(1) The assignment is wholly ineffective and the third party assignee does not obtain any proprietary right in relation to the debt;

(2) The assignment is ineffective against the debtor but effective between the original creditor and the third party assignee – in other words, the third party assignee obtains an equitable proprietary right in relation to the debt but cannot sue the debtor directly, or

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18 This is the same as the position in equity.
(3) The assignment is wholly effective – in other words, even though the original creditor has assigned the debt in breach of contract, the assignment itself is fully effective and the third party assignee can sue the debtor directly so long as written notice of the assignment has been given to the debtor.

Which outcome do you think is the best?

The question involves important issues of public policy as it creates a conflict between two fundamental principles: namely, the principle of freedom of trade, under which the owners of financial assets should be able to sell them freely and without restriction, and the principle of freedom of contract, under which the parties to a contract should be free to determine their respective rights and obligations without undue interference from the law.

In many jurisdictions such as China, the first outcome is likely to prevail; namely, the assignment will be wholly ineffective. In England and other common law jurisdictions, the position is not completely settled. The weight of legal opinion is in favour of treating the assignment as effective between the original creditor and the assignee (i.e. the second position as outlined above), but not between the assignee and the debtor.

In some jurisdictions such as the United States, on the other hand, the law has decided to favour freedom of trade by treating the assignment as fully effective. The Uniform Commercial Code provides that a term in any contract between a debtor and an assignor is ineffective if it prohibits the assignment of the debt or requires the debtor’s consent to an assignment.

This highlights the challenges that arise when different areas of the common law overlap and conflict with each other. Once again it demonstrates the pragmatic view of the common law as it seeks to achieve an appropriate balance between persons who have competing claims and also the importance of achieving certainty and stability in commercial transactions.

III. AGENCY LAW: UNAUTHORISED AGENCY AND THE UNDISCLOSED PRINCIPAL

Tan Cheng-Han

A. Introduction

The law of agency allows an agent acting on behalf of its principal to enter into a contract with a third party. Provided the agent has acted within the scope of the authority granted to the agent by its principal, the contract with the third party is binding on the principal who may sue and be sued on it. This is because the principal has consented to the agent acting in the manner authorised and the agent is regarded as an extension of the principal for this
purpose. The agent is therefore said to have “real” or “actual” authority which allows the agent to affect the principal’s legal position. Generally, the agent is not a party to such a contract as the agent’s role is facilitative. Accordingly, after the agent has brought about a contractual relationship between the principal and third party, the agent usually ceases to have any further role to play in that contract.

Agency law is important to commerce because it makes transacting more efficient and convenient. There are often times where, because of distance or language barriers, principals prefer to have agents act on their behalf when negotiating and entering into contracts. Certain transactions such as property purchases may also require a professional agent such as a solicitor to act on behalf of the purchaser. With the rise of the corporate form as a popular business vehicle, agents have become even more important. An artificial entity such as the corporation must usually act through agents, many of whom will also be employees of the corporation.

As agency facilitates commercial transactions, the common law’s approach to agency law is underpinned by pragmatism and flexibility, while at the same time ensuring that no unfairness is caused to the third party who deals with the agent rather than directly with the principal. As with many other areas of the common law, certainty and stability are also important considerations. These themes are well illustrated by the approach the common law takes to unauthorised agency and the doctrine of the undisclosed principal, an approach that differs from the approach in civil law jurisdictions and China in certain respects.

B. Ratification

Where an agent has entered into a contract outside the scope of what the principal authorised, the contract is \textit{prima facie} not binding on the principal or the third party. This is because the validity of an agent’s acts flows from the authority granted to it by the principal and in the absence of such authority the contract has no validity as it has not been properly formed.

The doctrine of ratification, however, allows a principal to take the benefit of an unauthorised act by the agent. Where a principal wishes to have the benefit of an unauthorised contract entered into on behalf of the principal, the principal can adopt the agent’s act. By doing so, the principal retrospectively cloaks the agent with authority such that the agent is treated as having had the requisite authority at the time the contract was entered into. In addition, ratification generally cures any breach of duty that the agent may have committed by exceeding its authority.
The common law allows this because there is no unfairness to the third party. This was a contract that the third party was prepared to enter into and ratification simply regularises a flaw in the agent’s authority. Ratification does not operate to impose a different contract on the third party. Moreover, ratification is also efficient because it renders the process of re-contracting unnecessary. Without ratification, the parties would have to renegotiate the contract and even if they were happy to enter into a contract on exactly the same terms all the formalities for re-contracting would have to be repeated. Another reason why ratification is desirable is because there may be occasions where the authority granted to the agent is ambiguous and ratification allows such ambiguity to be cured rather than for such an issue to be litigated in court to determine the proper scope of the agent’s authority.

At common law, the retrospective effect of ratification means that any attempt by the third party to withdraw from the contract before ratification takes place is ineffective. This is because the common law will deem ratification as conferring authority on the agent from the outset which means that the agent is regarded as having had the requisite authority prior to the attempted withdrawal. On one level, this approach is not entirely logical as it may be said that if withdrawal took place prior to ratification, there is nothing left to ratify. However, the common law adopted this approach in the seminal case of *Bolton Partners v. Lambert*.

Such an approach is unfortunate as it can potentially cause uncertainty and unfairness to the third party. This is because the third party does not know whether the principal will ratify and is not able to withdraw from the unformed contract while the principal decides whether to ratify or not. *Bolton Partners v. Lambert* is therefore a controversial decision that has been severely criticised. However, having stood for more than 120 years, it is unlikely to be overruled because of the need for stability and certainty in commercial law.

The common law therefore needed to react pragmatically by finding compensating doctrines to mitigate the potential harshness of *Bolton Partners v. Lambert* to third parties. The common law does this by stipulating, for instance, that ratification must take place within a reasonable time. This reduces the period of uncertainty for the third party. What constitutes a reasonable time will depend on the circumstances of each case. Ratification will also not be allowed where it would effectively allow a time limit to be exceeded. In other words, if the unauthorised contract provided that a particular act should take place by a certain time, ratification will not be allowed if it would have the effect of extending the time for such an act to take

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19 *Bolton Partners v. Lambert* (1889) 41 Ch. D. 295 (Eng.).
place. From these two examples of exceptions to the retrospective nature of ratification, it can be seen that notwithstanding the apparent harshness of *Bolton Partners v. Lambert* subsequent cases have mitigated the potential unfairness that a third party may face.

Nevertheless, this is not to say that the common law position is ideal. Indeed, the common law in the United States does not accept the *Bolton Partners v. Lambert* position. The position at civil law is also different. For example, Article 178 of the German Civil Code states that until ratification, “the other party to the contract is entitled to revoke it, unless he knew of the lack of authority on conclusion of the contract.” In China, Article 48 of the Contract Law states that “pending the ratification, the bona fide counterpart has the right to rescind. The rescission shall be made by a notice.” Such an approach is superior to the common law because it is a simpler approach that gives rise to greater certainty.

### C. Apparent Authority

The doctrine of ratification is for the principal’s benefit where the principal wishes to have the benefit of what was originally an unauthorised act on the part of the agent because the principal may regard the unauthorised transaction as nevertheless being one that is advantageous to it. On the other hand, the doctrine of apparent authority is for the benefit of the third party as it allows a third party to hold the principal to an unauthorised contract even where no ratification has taken place because the principal does not want to be bound by what the agent entered into.

The doctrine of apparent authority is premised on the fact that the agent appeared to have proper authority when the agent entered into the contract with the third party on the principal’s behalf. Such authority is not “real” but in certain circumstances the appearance of such authority can lead to legal consequences for the principal. At common law, apparent authority arises where the principal, by words or conduct, has represented to the third party that the agent has the requisite actual authority, and the third party has relied on such a representation by entering into a contract with the agent acting on behalf of the principal.

Such a doctrine is fair to the third party and also provides certainty in commercial transactions as apparent authority arises where there is a basis for the third party to reasonably believe that the agent had the requisite authority. The third party must also have relied on such belief by entering into a contract with the agent. By doing so, the third party may have forgone another contracting opportunity. All this has come about because of a representation by the principal who must therefore bear the consequences of such representation.
It must be stressed that the representation must have been made by the principal and not the agent. An agent could have made representations as to the agent’s authority but the third party is generally not entitled to rely on such representations. This is intended to ensure fairness to the principal; the principal is bound because of its acts and not those of another. In addition, if an agent’s representations could bind the principal even if the principal had not done anything to give the third party the impression that the agent could make such representations, the risk to principals may be so substantial that it would undermine the usefulness of agency.

The representation by the principal may be made orally or by conduct. Examples of the latter include a course of dealing or the appointment of a person to a particular position that would normally include the authority in question.

Even where a representation has been made, apparent authority only arises where the third party did reasonably believe that the agent had the relevant authority. Where the third party notwithstanding the representation did not believe the agent to have authority, or knew that the agent did not have authority, the third party cannot assert apparent authority against the principal. Clearly in such cases there is no reason why fairness should dictate that the principal be bound nor is the principle of commercial certainty affected since the third party did not enter into the contract on the basis of any belief in the agent’s authority. For similar reasons there can be no apparent authority where the third party knew that the agent was not acting in the best interests of the principal. An agent is regarded as a fiduciary who owes duties to the principal. Such duties include not placing itself in a position where its duty to the fiduciary and the agent’s own interests may conflict, and the requirement that the agent must always act in the best interests of the principal. Thus where it is clear that what the agent is attempting to do is not in the best interests of the principal, it would not be reasonable for a third party to rely on any representation as to the agent’s authority. Even if such a representation would normally include what the agent did, in cases where the agent is clearly not advancing the principal’s interests, it is obvious that the agent could not have been acting within the scope of the agent’s authority.

In most of the common law world, the doctrine of apparent authority is based on estoppel. The doctrine of estoppel provides that where one person makes a representation to another which has been relied upon by the representee, the representor cannot later, if sued by the representee, rely on a defence that is inconsistent with what has been represented. Thus where an unauthorised agent has entered into a contract with a third party, and the third party has done so because of a representation from the principal that the third party reasonably relied upon, if the third party sues the principal on the
contract the estoppel doctrine will prevent the principal from relying on its agent’s lack of authority as a defence because such defence would be inconsistent with the principal’s representation of authority. Accordingly, where apparent authority is applicable, the common law courts are not saying that the agent had actual/real authority; the courts are merely preventing the principal from using a defence that is inconsistent with the principal’s earlier representation to the third party.

Civil law jurisdictions and China also recognise the concept of apparent authority. In China, Article 49 of the Contract Law provides:

If an actor has no power of agency, oversteps the power of agency, or the power of agency has expired and yet concludes a contract in the principal’s name, and the counterpart has reasons to trust that the actor has the power of agency, the act of agency shall be effective.

Chinese law therefore recognises a similar concept.

D. Undisclosed Agency

While the doctrines of ratification and apparent authority have counterparts in civil law, the doctrine of the undisclosed principal is unknown to the civil law. An undisclosed principal is one whose existence is unknown to the third party that the agent is contracting with. In other words, the third party contracting with the agent does so thinking that the agent is acting for itself and does not know that the agent is in fact acting on the instructions of another person, namely the principal.

Conventional contract doctrine would suggest that where A contracts with B and there is no indication that B is acting on behalf of another person, the contract must be between A and B alone. At common law this is known as the doctrine of privity of contract and a similar approach exists in civil law. The undisclosed agency doctrine is therefore considered by many common lawyers as anomalous. For example in Keighley, Maxted & Co v. Durant, Lord Lindley opined that “as a contract is constituted by the concurrence of two or more persons and by their agreement to the same terms, there is an anomaly in holding one person bound to another of whom he knows nothing and with whom he did not, in fact, intend to contract”. However, as with Bolton Partners v. Lambert, the undisclosed principal doctrine has been in existence for a long period and as Blackburn J pointed out, while it has often been doubted whether the

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20 Keighley, Maxted & Co. v. Durant [1901] AC 240 (Eng.).
doctrine is correct, such doubts have come too late as the doctrine was too well settled.

The undisclosed principal doctrine provides that where the agent acts for an undisclosed principal within the scope of the agent’s authority, such principal may subsequently bring its existence to the attention of the third party and by doing so becomes entitled to sue the third party on the contract. Similarly, if the third party discovers that the person it contracted with was in fact an agent for an undisclosed principal, the third party may in the event of a breach choose to sue the agent as a party to the contract or the principal such agent was acting for.

Whatever the doctrinal difficulties, it is clear that undisclosed agency has commercial advantages and this undoubtedly was the reason why the common law developed such a doctrine. A principal may have very good reasons why it does not wish its involvement to be known such as where such knowledge may invite extortionate behaviour. An illustration can be found in the United States case of Senor v. Bangor Mills, Inc.21 In that case, demand for nylon yarn exceeded supply and the sole producer of the yarn allocated such supply as there was to members of the trade. The shortage led to the development of a secondary market where some of the purchasers from the manufacturer sold to other users for a profit rather than use the yarn themselves. Senor was such a seller and Bangor Mills was a large user of the yarn that required frequent purchases of the product to maintain its production level. As Bangor Mills’ need for the yarn was well known, as was its economic position, it was able to make purchases of the yarn on the secondary market only by paying prices that were very high. It therefore sought to make purchases of the yarn through an intermediary that did not disclose that it was acting on behalf of Bangor Mills. The court upheld such an arrangement.

An alternative method of attempting to achieve the same result as undisclosed agency is for A to contract with B for B to perform an act, e.g. A and B contract that B will purchase a piece of land from C for a certain price and after doing so will sell it to A for a stipulated price. B then subsequently purchases the land from C and on-sells such land to A. In such a situation there is no agency relationship. The relationship is a conventional contractual one where B agrees with A that B will be the purchaser of land and will sell such land to A when it is procured. Nevertheless if B manages to fulfil his part of the bargain A becomes the owner of the land notwithstanding the absence of an agency relationship. In civil law countries this method of contracting is the alternative to undisclosed agency at common law.

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Arguably, the common law position has certain advantages. In a conventional contractual relationship, B is the only party to the contract with C and should B become insolvent the completion of the contract may not be possible and there is nothing that A can do because A does not have a contractual relationship with C. Second, should B choose not to enforce the contract with C, A cannot sue C directly but must first sue B and ask the court to compel B to lend B’s name to a subsequent action against C. This is a more circuitous route than undisclosed agency which allows the principal to sue the third party directly. The bankruptcy of the agent should also generally not affect the completion of the contract with the third party since the principal can complete the transaction without the agent’s further involvement.

Although the doctrine of the undisclosed principal has commercial advantages and is efficient as shown by the preceding paragraph, the fact remains that the third party will find itself contracting with someone that it did not know was to be a party to the contract. In most cases this will not matter because the common law assumes that in cases of ordinary commercial contracts the third party is willing to contract both with the agent and with any party that the agent is authorised to act for even if the agent did not mention this to the third party. For example a party selling raw materials to B usually does not care whether B is the actual buyer or if B is in fact buying for someone else.

However, in some cases the third party may care who the real contracting party is. For example, it may be important to the third party that only the person with whom the third party contracted with can perform the service contracted for. In such a case the law will not, out of fairness to the third party, allow someone else to perform the service even if that someone else was the undisclosed principal of the person that contracted with the third party. For instance in the case of Said v. Butt the plaintiff who was a theatre critic wanted to be present on the opening night of a play but knew that he was unlikely to be given a ticket because of his previous criticisms of the staff of the theatre. Indeed, two previous applications by him had been rejected. He therefore procured a friend to obtain a ticket for him but when he showed up he was turned away. He sued for breach of contract but the action failed. McCardie J explained that opening nights were important events to theatres and therefore the identity of those that the management wanted to sell tickets to was important. Given that the identity of the contracting party was important, the plaintiff could not claim any contractual rights to the ticket purchased by his friend even if his friend was an agent.

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Other instances where the identity of the contracting party may be important to the counterparty are where the counterparty seeks the services of a well-known lawyer to represent him in an important arbitration, or where the services of an experienced surgeon are required for a delicate operation, or where a well-known painter has been commissioned to produce a work. In all these cases it is extremely unlikely that the law would allow another person to perform the service even if such person was an undisclosed principal.

Another instance of the common law being mindful of the need to ensure fairness to the third party can be seen from the rule that where the undisclosed principal intervenes on the contract, e.g. by bringing a claim against the third party for breach of contract, the undisclosed principal does so subject to all defences the third party may assert against the agent, even though the agent is not the person suing on the contract. As the third party contracted with the agent believing that the agent was the only contracting party, it would be unfair if the law deprived the third party of any defence or counterclaim the third party would have against the agent should the principal intervene on the contract. The fact that it is the undisclosed principal who sues the third party should not deprive the third party of a defence or counterclaim that the third party would have had against the person the third party thought it was contracting with, namely the agent.

Although undisclosed agency does not exist in civil law, it appears that China has adopted the doctrine of the undisclosed principal. Article 403 of the Contract Law provides as follows:

When an agent concludes a contract with a third party in its own name, and the third party is not aware of the agency relationship between the agent and the principal, if the agent does not perform its obligation to the principal for reasons attributable to the third party, the agent shall disclose the third party to the principal. The principal may consequently exercise the agent’s rights against the third party, except where the third party would not have entered into the contract if the third party had known of the principal at the time the contract was entered into between the third party and the agent.

If the agent does not perform its obligation to the third party for reasons attributable to the principal, the agent shall disclose the principal to the third party and the third party may consequently choose whether to assert its rights against the agent or the principal as the counterparty, but the third party may not change the counterparty that it has chosen.

Where the principal exercises the rights of the agent against the third party, the third party may assert against the
principal any defences that it has against the agent. Where the third party chooses the principal as its counterparty, the principal may assert against the third party any defences that it has against the agent and any defences that the agent has against the third party.

E. Conclusion

The law of agency is intended to facilitate commercial transactions and accordingly the law does not always regard unauthorised acts of agents as having no legal validity. To do so in all cases would be inefficient and also unfair. However, where unauthorised acts do lead to enforceable rights, the law tries to strike a balance to ensure that either no real prejudice is caused to any party and/or it is obviously fair that one party should be entitled to enforce the transaction notwithstanding the lack of authority.

The overwhelming objective of facilitating commercial transactions also explains the doctrine of the undisclosed principal. Notwithstanding the theoretical difficulties of explaining this doctrine the common law has taken a pragmatic view. As with unauthorised agency, the common law has also built in many safeguards to ensure that this doctrine does not cause unfairness to third parties who were ignorant of the existence of the principal.

IV. EQUITY AND THE COMMON LAW: REMEDIES FOR BREACH OF FIDUCIARY DUTY

Paul S. Davies

A. Introduction

“Common Law” is used in a variety of different senses. Judge-made law is often called the “common law”. But “Common Law” can be used in another, more specific sense, to indicate the body of law developed by the judges in the Common Law courts. This might be contrasted with the body of law which was made and developed by the judges in the Chancery courts. It is this latter body of law that is called “Equity”.

Equity has certain characteristics that distinguish it from the Common Law. These derive from the historical origins of the equitable jurisdiction. From medieval times, the Common Law was a formalistic body of rules which were interpreted strictly. Where the Common Law did not provide a remedy or where the result reached by the Common Law was harsh, it was possible to petition the King, and later the Lord Chancellor, to provide a remedy through the exercise of his discretion. Eventually, so many petitions came to the Chancellor that it was necessary to establish a separate court, known
as the Court of Chancery, to deal with them. The law that was applied in this Court became known as Equity.

In the *Earl of Oxford’s case*, Lord Chancellor Ellesmere recognised that Equity’s function was “to soften and mollify the extremity of the law”, and where there is a conflict between Equity and the Common Law, Equity should prevail. Since equitable relief depended upon the Chancellor’s discretion, results could be unpredictable; for some time it was thought that “Equity varies with the length of the Chancellor’s foot”. However, this no longer reflects the current state of the law. Equity has become more rule-based and principled, mainly because the Equity jurisdiction was transferred from the Chancellor to judges, whose decisions had value as precedent for future decisions so that like cases could be treated alike. Moreover, it is no longer necessary to seek relief from the Common Law courts and then petition the Chancery courts. The Judicature Acts of 1873 and 1875 abolished the Common Law and Chancery courts and replaced them with a single High Court. The effect of this legislation was to fuse the administration of Common Law and Equity. The Judicature Acts emphasised that Equity, as a body of law, could be applied in any court. It is important to appreciate that although the Common Law and Equity have been fused as a matter of procedure, the substantive body of law produced in the Chancery courts remains vital, and the function of Equity remains the same. Principles of Equity, just like principles of Common Law, are developed by judges in a principled, incremental manner. Equity is crucial to understanding fundamental aspects of common law systems. Although the equitable concept of the trust has counterparts in other jurisdictions, including China, the doctrinal basis in Equity for the trust remains unique.

B. Development of the Trust and Fiduciary Obligations

The trust has been described as “England’s greatest contribution to legal science”. The origins of the trust can be traced back to the thirteenth century, when it was essentially a conveyancing device for the holding of land to avoid financial liabilities and restrictions on the inheritance of property. It was developed and recognised by judges, and remains uncodified by legislation. A person could transfer his land to others who would hold it for the use of the transferor for life and then for selected family members. The person who transferred the land would today be called the settlor, but he

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23 Earl of Oxford’s case (1615) 21 ER 485 (Eng.).
might alternatively be described as the trustor, since he trusted the transferee to hold the land for the benefit of himself or somebody else. The transferee of the land was called a trustee, because he was trusted by the transferor. The person for whom the land was held was called the beneficiary, because he benefited from the use of the land.

This was an imaginative development by judges developing principles of law. But for it to work, Equity was crucial. This is because the owner of the land at Common Law is the trustee, but the beneficiary might be said to be the owner in Equity. So legal title to the land rests with the trustee, and equitable, beneficial title with the beneficiary. Since Equity trumps the Common Law where the two conflict, this means that, if the beneficiaries are all agreed, they can collapse the trust and order the trustees to convey legal title to them.\(^26\) But there are a number of advantages to giving property to trustees to hold on trust rather than to the beneficiaries as an outright gift. In the family context, a trust can enable the settlor or testator to provide for the successive enjoyment of property, such as when property is left to a wife for life with remainder to the testator’s children. This means that the wife will have the benefit of the property for her life, but, on her death, the property will pass to the children. More commercially, there may be particular advantages in having trustees manage and administer the property on behalf of the beneficiaries; the trustees might have particular financial and investment experience. It may be commercially useful for a group of people to be able to invest their funds by means of a unit or investment trust, under which trustees hold investments in a range of securities in trust for investors who have purchased units or shares in the trust fund. Trusts have the further advantage of protecting the beneficiaries in the event of the trustee’s insolvency; if the trustee becomes insolvent, the trust assets will not be available for the trustee’s creditors because the assets belong to the beneficiaries in Equity and cannot be exploited by the trustees for their own ends.

Judges have also developed a notion of “fiduciary obligations” through equitable principles. A good example of a person who owes fiduciary obligations is the trustee of an express trust. The trustee owes a duty of loyalty to the beneficiaries; the trustee must not allow the trustee’s personal interests to conflict with the interests of the beneficiaries. In *Bristol and West Building Society v. Mothew*,\(^27\) Millett LJ identified the essential characteristics of a fiduciary as follows:

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\(^{26}\) Saunders v. Vautier (1841) 4 Beav. 115 (Eng.).

\(^{27}\) Bristol and West Building Society v. Mothew [1998] Ch. 1 (Eng.).
A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr. Finn pointed out in his classic work Fiduciary Obligations (1977), p. 2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary.

Significantly, judges have continued to develop the categories of relationship where fiduciary obligations are owed. They all bear the key characteristic that it is appropriate for the fiduciary to abnegate his own self-interest in favour of the interest of the beneficiaries. For example, it is now clear that agents, solicitors, company directors, and partners all owe fiduciary duties.

C. Remedies for Breach of Fiduciary Duty: Analysing Boardman v. Phipps

One of the principal reasons claimants seek to establish that another owes them fiduciary duties – rather than simply contractual duties, for example – is that the remedies for breach of fiduciary duty are typically more advantageous than common law remedies. Whereas it is very difficult to obtain gain-based relief for breach of contract, the prima facie remedy for breach of fiduciary duty is an account of profits. The fiduciary will have to give up any gains made as a result of the breach, regardless of whether or not the principal suffered any loss, even if the fiduciary acted in good faith. Such gain-based, or restitutionary, remedies are largely justified on the basis that they deter the fiduciary from breaching his fiduciary duties. There is no incentive to breach a fiduciary duty if the fiduciary will not be able to gain from the breach. This is particularly important in the context of fiduciary relationships, where the beneficiaries will generally be in a weak or vulnerable position, and can expect their fiduciary to act in their best interests.

The principles concerning remedies for breach of fiduciary duty have been developed incrementally by judges on the basis of clear principles. It is particularly instructive to examine the judicial reasoning in a leading case which continues to prove controversial: *Boardman v. Phipps.* This decision of the House of Lords was decided by a bare majority of the panel – 3:2 – and includes two strong dissents which have also proved to be influential. It is a good example of common law reasoning in the equitable sphere: all the judges rely on guiding principles in reaching their answer. However, it is not easy clearly to discern the *ratio decidendi* of the case. *Boardman v. Phipps* highlights that the future direction of legal development generally rests in the hands of the judges; a differently-constituted judicial panel of the House of Lords may have sent the law down a different course. Indeed, across the common law world there is some divergence of approach to the decision in *Boardman v. Phipps*, which will be further discussed below.

1. The facts

Mr. Phipps left his residuary estate, which included 27% of the shares in Lester and Harris Ltd, on trust for his widow for life and after her death for his four children. The trustees in 1955 were his widow (the life tenant), Mrs. Noble (his daughter), and Mr. Fox (a professional trustee and an accountant).

In 1956, Tom Phipps, a son of the testator and one of the beneficiaries, and Mr. Boardman, the solicitor to the trust, were dissatisfied with the way in which the business of Lester and Harris Ltd was conducted. They unsuccessfully sought to effect change at the company’s annual general meeting, and then encouraged the trust to invest in the company in order to improve its performance. Mrs Noble and Mr. Fox insisted that the trust was in no position to buy the remaining shares in the company, and would not consider doing so under any circumstances. The trustees were not authorised to purchase the shares and would have had to apply to the court for permission to do so; the active trustees refused to do this. The third trustee, the testator’s widow, was senile and not consulted. Whilst acting on behalf of the trust in dealing with the company, Mr. Boardman obtained valuable information which he thought he could exploit to make the business more profitable. He wrote to the testator’s four children to ask for their consent to his negotiating for his own personal interest, and assumed that silence meant that consent had tacitly been given. Ultimately, Mr. Boardman and Tom Phipps purchased all the shares in Lester and Harris Ltd other than those owned by the trust. They reorganized the business, and greatly

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29 Boardman v. Phipps [1967] 2 A.C. at 46 (Eng.).
improved the fortunes of the company. This clearly benefited Boardman, Phipps, and indeed the trust, which maintained a shareholding in the company.

On this summary it would appear as if everybody was a winner: the fortunes of the company improved, the trust’s shareholding improved, and Boardman and Phipps also made a profit. Nevertheless, John Phipps, one of the testator’s sons and one of the beneficiaries under the trust, successfully sued Boardman for breach of fiduciary duty.

2. Breach of fiduciary duty

Lord Guest said that “from first to last Boardman was acting in a fiduciary capacity to the trustees”. This may well be right, but it does not satisfactorily explain why John Phipps was able to sue Boardman for breach of fiduciary duty. This appears to be an important question, but does not seem to have been clearly addressed either by counsel arguing the case or by the judges. Lord Upjohn commented that “[w]hether [Boardman] was ever in a fiduciary capacity to the respondent was not debated before your Lordships and I do not think it matters”. Although not articulated in the case itself, it might be that by participating in the negotiations with the company, and acting as an agent of the trust, Boardman somehow owed fiduciary obligations not only to the trustees, but also to the beneficiaries of the trust.

One strand of reasoning in the House of Lords is that Boardman had to account for his gains since he exploited trust property. But what property of the trust had he used in order to make his profits? There is some suggestion in the judgments that the information Boardman obtained whilst negotiating with the company on behalf of the trust should be considered to be trust property. This view was put forward by both Lord Hodson and Lord Guest, but the third member of the majority, Lord Cohen, was much more cautious on this point, and both Lord Upjohn and Viscount Dilhorne, the dissenting judges, insisted that information is not property at all. Information is generally free to all, and can be properly protected by the law of confidence; there is no need to strain the boundaries of “property” in this context.

The majority decision is better explained on the basis of a strict application of the principle that a fiduciary should not profit from his position as a fiduciary. Indeed, all members of the majority relied on the previous decision of the House of Lords in *Regal (Hastings) Ltd v. Gulliver*[^30] to this effect. For example, Lord Guest said:

[^30]: *Regal (Hastings) Ltd v. Gulliver* [1967] 2 A.C. at 134 (Eng.).
Boardman and Tom Phipps... placed themselves in a special position which was of a fiduciary character in relation to the negotiations with the directors of Lester & Harris relating to the trust shares. Out of such special position and in the course of such negotiations they obtained the opportunity to make a profit out of the shares and knowledge that the profit was there to be made. A profit was made and they are accountable accordingly.

This is a strict version of the no-profit principle since it appears all-encompassing: any profits derived from the position of being a fiduciary must be accounted for. This appeared harsh to the minority, who thought that the no-profit rule was simply part of the wider principle that a fiduciary must not be in a position where his own self-interest and the interests of the beneficiary conflict. The minority insisted that there was no real conflict of interest here, since the trust was never going to invest in the company.

The minority’s view was forcefully expressed. Viscount Dilhorne said:

On the facts of this case there was not, in my opinion, any conflict or possibility of a conflict between the personal interests of the appellants and those of the trust. There was no possibility so long as Mr. Fox was opposed to the trust buying any of the shares of any conflict of interest arising through the purchase of the shares by the appellants.

Lord Upjohn similarly held that the relevant test was

that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.

In fact, this test for whether or not there is a conflict of the fiduciary’s own interest with the interest of the beneficiary enunciated by Lord Upjohn has been regularly cited with approval. However, in Boardman itself the majority found that even a remote possibility of conflict was sufficient to engage the no-conflict principle. It is not clear whether this also constitutes a “real sensible possibility”: it might be suggested that even a remote possibility can be real and sensible. Given the frequency with which Lord Upjohn’s test is cited and applied, it may be best to conclude that Lord Upjohn
was not dissenting on the nature of the legal test to be employed, but only on the application of the test to the facts of the case. Whereas the majority thought that there was a conflict, the minority did not. Such differences of opinion on the facts of cases are not infrequent in the common law, but it does show that the relevant legal principle may be found in a dissenting speech, and that the application of principles to particular disputes may not be entirely straightforward.

Although Boardman might reasonably have thought that no conflict existed, a strict rule could be justified on the basis that it is always possible for the fiduciary in such a situation to obtain the fully informed consent of his principal, thereby precluding any claim against him. Once Boardman knew that he would be buying the shares at a very advantageous, low price, perhaps he ought to have informed the trust of this and allowed the trust the option of making the most of this opportunity. However, it is not clear how realistic it is to expect parties to do this during the course of confidential and protracted negotiations.

3. Remedy for breach of fiduciary duty

Since Boardman had breached his fiduciary duty of loyalty, he was ordered to account for all the profits he had made from the breach. The process of taking an account involves determining the gains made and then deducting expenses properly incurred in order to reach a net figure for the profits made. However, all members of the House of Lords recognised that making Boardman disgorge all the gains he had made from his breach of duty would be a very harsh outcome. To alleviate the rigours of this restitutory remedy, the court exercised its discretion to grant Boardman an allowance calculated on a “liberal scale” for his skill and work in making profits by improving the fortunes of the purchased company. This allowance is of long-standing. It highlights that whilst judges have developed a strict approach to restitutory remedies, Equity is sufficiently flexible to temper its rigours in appropriate cases. This equitable allowance is best explained on the basis that not all the profits were caused by the breach of fiduciary duty, but rather by the work of the fiduciary.

4. Remedies for breach of fiduciary duty across the common law world

Boardman v. Phipps remains the leading English decision on remedies for breach of fiduciary duty. However, as soon as Phipps was decided, it was the subject of academic criticism. For example, Professor Jones considered that

To say that the fiduciaries’ profit was made solely through the use of property (the information) received qua fiduciaries,
when the trust could not have utilised it and when the
negotiations would have failed but for Boardman’s business
acumen and Boardman and Phipps’ financial intervention,
offends legal as well as common sense…

It would be possible to adopt a more relaxed approach to breach
of fiduciary duty, and allow a fiduciary to justify his actions where
he acted prudently and in the principal’s best interests. Such conduct
could still be considered to be loyal. In fact, some other jurisdictions
do not seem to take as strict an approach as the English courts. For
example, in *Peso-Silver Mines Ltd v. Cropper*, the Supreme Court
of Canada held that an account of profits would not be awarded
where the fiduciary exploited an opportunity which had previously
been declined by the principal. A similar approach has been favoured
in Australia, and is consistent with the advice of the Privy Council in
*Queensland Mines v. Hudson*. Mr. Hudson was the managing
director of a company who obtained licences to develop a mine. He
did this for the benefit of Queensland Mines, but this company was
unable to carry out further work on the project due to financial
difficulties. With the full consent of the board of the company, the
managing director resigned and exploited the mine himself. The
Privy Council held that he was able to keep the profits gained.
Moreover, there have been strong calls for reform of the strict
application of the no-profit rule in cases such as *Phipps* by some
American scholars in particular, partly influenced by reasoning from
an economic perspective. For example, had Boardman sought but
failed to obtain the consent of his principals, then he would not have
been able to invest in the company, so the company would probably
have continued to be unprofitable, and as a result the shareholding
of the trust fund would not have made the gains it did. It might seem
odd for the law to demand this: the stultification of economically
advantageous conduct would appear to be the result.

English law does take into consideration what happens in other
common law jurisdictions, just as other jurisdictions reflect upon
developments in English law. This is because the principles and
reasoning developed by judges in one jurisdiction may well be
relevant in another. For example, in *Murad v. Al-Saraj*, the Court
of Appeal suggested that the strict approach in *Boardman v. Phipps*
should perhaps be relaxed, citing as examples *Peso Silver Mines and

34 See eg J Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*,
35 *Murad v. Al-Saraj* [2005] EWCA (Civ) 959, (Eng.).
Hudson. However, the system of precedent clearly precluded the Court of Appeal from departing from the House of Lords’ decision in Boardman v. Phipps. Ultimately, there is some tension between allowing a fiduciary to act prudently in the best interests of a principal, and adopting a consistently strict approach in order always to protect the duties a fiduciary owes. The latter is clearly English law; given that the courts might grant an equitable allowance to prevent full disgorgement of profits, and that a fiduciary could have obtained the prior fully informed consent of his principal, this approach seems set to be maintained for some time to come. Differences across the common law jurisdictions may best be explained as reflecting particular social expectations in different jurisdictions, as well as precedent requiring lower courts to adhere to the decisions of the appellate tribunals in each jurisdiction.

D. Postscript

There is a further, important issue concerning whether a fiduciary who makes a profit from a breach of fiduciary duty only has to account for the value of the gains made, or actually has to give up the particular gains made in specie. In other words, the question is whether the beneficiary only has a personal claim against the fiduciary, or whether the beneficiary also has a proprietary remedy under a (constructive) trust. The difference between the personal and proprietary remedy may be particularly important where the fiduciary is insolvent, since the beneficiary will have priority over the fiduciary’s other unsecured creditors, and the beneficiary will be able to trace into substitute assets acquired by the fiduciary, only if the beneficiary enjoys a proprietary interest under a constructive trust. In Boardman v. Phipps, the claimant beneficiary did not mind whether the remedy granted was personal or proprietary: the fiduciary was solvent, the profits easy to ascertain, and there was no question of tracing into subsequently-acquired assets. However, at first instance, Wilberforce J imposed a constructive trust on the profits made by Boardman.

In the context of fiduciaries who receive bribes and secret commissions, there has been a great deal of controversy about whether or not the fiduciary should be considered to hold the bribe on constructive trust: a proprietary remedy strengthens the beneficiary’s position, but correspondingly weakens the protection afforded to the fiduciary’s unsecured creditors. Most common law jurisdictions have consistently insisted that a fiduciary’s duty of loyalty means that the fiduciary can only ever receive profits or bribes on behalf of the principal, and that a constructive trust is therefore an appropriate remedy. But in England, a concern to protect the fiduciary’s creditors in the event of insolvency has led to some
desire to restrict the operation of the constructive trust. However, after this lecture was delivered, the Supreme Court handed down judgment in *FHR European Ventures LLP & Ors v. Cedar Capital Partners LLC* and made it clear that the wrongdoing fiduciary does hold the bribe on trust for the principal. In so doing, the Supreme Court departed from an earlier decision of the House of Lords in *Tyrell v. Bank of London*, clarified the law, and, importantly, relied on developments elsewhere in the common law world. Lord Neuberger, giving the judgment of the Court, said:

> As overseas countries secede from the jurisdiction of the Privy Council, it is inevitable that inconsistencies in the common law will develop between different jurisdictions. However, it seems to us highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world.

This sentiment has already been endorsed by a differently constituted Supreme Court. The common law does not stand still, and a judicial dialogue remains open between courts throughout the common law world. Cases such as *FHR* illustrate that Equity must be included and has an important role to play in this judge-led process. The Common Law can be better understood by appreciating that it operates in tandem with Equity. And both the Common Law and Equity continue to develop and adapt.

**V. Common Law Criminal Law: Who Decides Whether Someone Will Be Prosecuted?**

Jeremy Gans

This lecture examines a distinctive feature of common law criminal law: who decides to start a criminal prosecution? In contrast to civil law criminal law systems, the decision is not made by a court or anyone employed by a court. Indeed, the decision-maker may not be employed by the state at all. Here, I consider an example of an Australian criminal prosecution and discuss the role of private individuals, government officials and independent public prosecutors.
in the decision to start (and end) that prosecution. It is interesting to note that private individuals may initiate prosecutions in China under the Criminal Procedure Law of the People’s Republic of China. However, the People’s Court may end the private prosecution if evidence is lacking.

A. An Example: an Unusual Incident in Sydney, Australia

In early September 2007, Sydney in the Australian state of New South Wales hosted the Asia-Pacific Economic Co-operation Leaders’ Week. World leaders in attendance included the Presidents of the People’s Republic of China, the United States of America and the Russian Federation. Because of risks of terrorism and (as occurred a decade earlier in Canada) political protest, Australian authorities initiated dedicated security procedures, including the erection of fences and checkpoints in parts of the Central Business District of Sydney. These measures, a rarity in Australia, themselves became the subject of public debate.

During this period, a group of comedians who called themselves “The Chaser” appeared in a popular television program. The program was a satire called “The Chaser’s War on Everything”. One theme of the program was the alleged absurdity of security measures introduced in Australia to counter terrorism, which the comedians portrayed as ineffectual and intrusive. To demonstrate this concern in a humorous way, the television program would often include video recordings of public interactions between the comedians and security officials. Depending on their reaction, the security officials would typically be portrayed as either too lax (given that the comedians were overtly breaching security rules) or too officious (given that the comedians were obviously harmless).

On 6 September 2007, the comedians and several others hired to assist on that day approached one of the APEC security checkpoints. They intended to ask the police to admit Osama bin Laden (actually one of the comedians in disguise) to the leaders’ summit. The comedians drove inside three black cars with small Canadian flags attached to them, accompanied by jogging men carrying video cameras. Apparently thinking the comedians were government officials, the police allowed them through that checkpoint and a further one marked as a ‘restricted zone’. The comedians eventually reached the front of a hotel where President George W. Bush was staying. At that point, the comedians emerged from the car and were arrested.40

This incident prompted mixed reactions. To some, it was a humorous incident that revealed that the security around the APEC summit was poor and inappropriate. To others, the comedians’ behaviour was an embarrassment to Australia and an insult to visiting leaders. To some, the incident represented a genuine threat to public safety, because it might have led some police to discharge their weapons in the mistaken belief that the comedians were terrorists.

The incident may also have prompted a number of legal actions, for example private law actions in tort, defamation or nuisance, or administrative actions, such as orders to bar the broadcast of the incident. In such matters, the decision to start an action would be in the hands of whoever was damaged by the incident (for example, an embarrassed police officer) or whoever was seeking a remedy (for example, the government of NSW). Instead, in this case, the incident was the subject of a criminal prosecution.

Who decides whether or not to initiate a criminal prosecution in a common law system? In contrast to civil law systems, the decision is not made by a criminal court or by an employee of a court. Because most common law courts, including courts with criminal jurisdiction, use adversarial procedures, those courts do not decide to bring criminal prosecutions. Instead, just like private law actions, a common law criminal action is initiated by someone outside of the court. The remainder of this lecture discusses the three types of people who may initiate a common law criminal action.

B. The Role of Private Individuals

In this section, I discuss a feature of common law criminal law that is quite different to the civil law: in general, anyone can start a common law criminal law prosecution. That is, the comedians could have been prosecuted by anyone in the Australian state of New South Wales. In particular, the “prosecutor” in such an action could be a “private” person, who does not work for the government in any way. For example, the prosecutor could be a person who happened to witness the event, either in person or when it was later shown on the comedians’ television program. It could even have been me.

To understand why common law criminal law works in this way, it is useful to think about another difference between civil law systems and common law ones: the source of the law. The common law allows some parts of the law to be developed by the courts, rather than by statutes. Many of the private law actions that are still available in common law systems, including the law of negligence, were developed in this way. And so were many common law crimes, including the law of murder. Private law actions and crimes were typically developed in similar ways and were often hard to
distinguish from one another. For example, an assault can be both a private law action and a crime. Some of the older crimes resembled private law actions even in their remedy. For example, the old (and now abolished) common law crime of “being a common scold” allowed people who could prove that a woman in their town was causing trouble by gossiping or complaining to place the woman in a “ducking stool” to dip her in cold water (supposedly to deter her from continuing!) These sorts of crimes reflected life in rural communities with little in the way of formal government. It is easy to see why prosecutions of such crimes could be – and often were – initiated by private people with a particular interest in the matter. Reflecting that history, private people continue to have the ability to initiate prosecutions even today in most common law systems.

To be sure, it is now very rare for people who aren’t employed by the government in some way to prosecute someone for a criminal offence. In part, that is because of changes imposed by modern statutes, which I will discuss in the next section. However, the main reason is that there is little reason for a private individual to prosecute someone. For example, even if I was very offended by the comedians’ behaviour at APEC in Sydney, I would have no reason to prosecute them. I could instead voice my displeasure to my friends or online or (if my contribution was accepted) in the media. I certainly don’t have either the resources or the interest to spend the considerable time and money required to prosecute someone. In contrast to a private law action, I would not generally be able to recover the costs of a prosecution even if I was successful. And if I was unsuccessful, I might be sued by the comedians if they could establish the tort action of “malicious prosecution”.

Instead, nearly all prosecutions in common law systems are now carried out by government employees. In the case of the comedians, the prosecution was commenced by a police officer. Police officers are not only paid to police, but also to prosecute minor offences as they see fit (and will be indemnified for their costs by the government, including if they are successfully sued by the comedians). However, the fact that anyone can prosecute still has an important effect on this process. Government officials who prosecute typically do so without any specific statute empowering them to prosecute. Instead, they rely on the fact that anyone can bring a prosecution. For example, there was no law in NSW that said that a police officer can bring prosecutions, either in general or specifically in relation to APEC. Instead, the police officer simply brought the prosecution as a private individual.

An example of how the principle of private prosecution is important in practice today can be seen in a decision of the United
Kingdom Supreme Court in 2010. The case was *R v. Rollins*.\(^{41}\) ‘R’ is shorthand for the Queen (‘Regina’ in Latin) of the United Kingdom. However, the Queen was not the prosecutor. Instead, “R” is often used in criminal prosecutions because serious criminal prosecutions are regarded as brought in the name of the Queen. The actual prosecutor in the case was England’s Financial Services Authority, that nation’s financial regulator. “Rollins”, the defendant in this proceeding, was a senior manager of a waste managing firm. The FSA prosecuted Rollins for insider dealing (after he and his wife sold his stake in the firm just before the firm issued a profits warning) and money laundering (because it was alleged that he tried to cover up the insider dealing by placing the proceeds in an account in his father’s name).

In the Supreme Court, Rollins argued that the Financial Services Authority could not bring a prosecution for money laundering. The Authority’s statute allowed the Authority to bring prosecutions for insider dealing and money laundering, but the latter only applied if there were “prescribed regulations” allowing such a prosecution.\(^{42}\) There were no such regulations. Nevertheless, the Supreme Court unanimously held that the Authority could still bring a prosecution for money laundering because of the principle that “every person has the right to bring a private prosecution”. The Court observed:

> The general position, therefore, is that the FSA has always been able to bring any prosecution subject to statutory restrictions and conditions and provided that it is permitted to do so by its memorandum and articles of association. Most statutes which create offences do not specify who may prosecute or on what conditions. Typically, they simply state that a person who is guilty of the offence in question shall be liable to a specified maximum penalty, it being assumed that anybody may bring the prosecution.

The Court went on to hold that this position was not changed by the Authority’s statute, because – amongst other reasons – it would be “perverse” to bar the Authority from bringing money laundering prosecutions while allowing “anyone else, including private individuals”, to do so.

So, the principle that anyone can prosecute is important even today because it confirms that government regulators can prosecute for any offence. I should also mention that the principle also applies to defendants. For common law offences, anyone can be a defendant.


\(^{42}\) Financial Services and Markets Act 2000 (UK), § 402(1)(b).
Importantly, that includes people employed by the government, even when the alleged crime was part of their employment. For example, Australia’s High Court has held that employees of the Australian Security Intelligence Service could be prosecuted for crimes of assault and property damage committed as part of a (misguided) training exercise. Likewise, the fact that the comedians in the APEC incident were actually engaged by a state-owned broadcaster (the Australian Broadcasting Corporation, who broadcast their television program) would not prevent their prosecution for a common law offence.

C. The Role of Governments

We have seen that governments can prosecute in common law systems because everyone can prosecute in common law systems. However, the full picture is more complex, because, increasingly, governments, rather than courts, are the source of law in common law systems. In a common law system, a statute, passed by the legislature, can be an alternative source of the law and it can also replace the common law. Both these effects of statutes can affect who prosecutes in common law criminal law.

Statutes play an important role in modern criminal law because the crimes developed by courts centuries ago are often not useful for dealing with modern problems. The comedians could perhaps have been prosecuted for common law crimes like “breach of the peace” and “outraging public decency” and “being a common barrator” (the male counterpart to being a common scold), but these crimes rely on shared standards of proper behaviour that aren’t suited to unusual and complex national events like the events at APEC 2007. Instead, in advance of the Leaders’ Week, the Parliament of the Australian state of New South Wales enacted a special statute dealing with security measures, the APEC Meeting (Police Powers) Act 2007.

That statute mainly consisted of special powers for the police to do things like put up security fences, search people in the security zone and remove unauthorised people. However, the statute also contained a criminal offence in section 19:

19 Offence: entering restricted area without special justification

(1) A person must not, without special justification, enter a restricted area or any part of a restricted area.

Maximum penalty: 6 months imprisonment or, if circumstances of aggravation exist in relation to the offence, 2 years imprisonment.

(2) For the purposes of this section, circumstances of aggravation exist in relation to an offence under this section if (but only if):
(a) the person was in possession or had control of a prohibited item, and
(b) the person had no special justification to be in possession or have control of the item.

A statutory provision such as this is seen as creating a criminal offence in the same way that the courts in centuries past have created criminal offences.

There are now thousands of such offences and they have largely or wholly replaced judge-made offences in most common law countries. However, in NSW and some other common law countries, such statutes are still read by courts in special ways that reflect the approach of past judges to criminal responsibility. For example, the above statute would be read by a NSW judge as not applying where the defendant had an honest and reasonable mistake of fact that, if true, would have meant that his or her acts were innocent. I should mention that the precise way criminal statutes are read varies greatly amongst different common law jurisdictions, because contemporary ideas about criminal responsibility developed only after the various common law systems became independent from the United Kingdom and one another.

The statutory source of the criminal law in common law systems has three general effects:
First, as the above statute shows, statutory offences are accompanied by statutory penalties. Indeed, common law penalties like the “duking stool” for being a common scold have been almost entirely replaced by statutory penalties in all common law countries. Unsurprisingly, statutory penalties are almost exclusively penalties performed by the state itself. In modern common law countries like Australia, private criminal punishments are almost unimaginable.

This change created difficulties in one case in the 1990s, where an Australian citizen was allegedly killed by two British nationals in Saudi Arabia. 44 Because Saudi Arabia follows sharia law, the criminal law of murder was governed by the Huddud system, which is derived from the system of personal justice in nomadic tribes.

Under that law, the Australian citizen’s brother had the role of choosing a range of personal punishment options, including beheading and accepting so-called “blood” money. This created a personal dilemma for him (as he would have preferred the state to decide and administer punishment, for example prison, the usual penalty for murder in Australia) and a social problem in Australia (where the death penalty was abolished in the 1980s.) An interesting court proceeding was initiated in Australia to determine whether a privately-ordered death penalty was contrary to Australian law. However, the case did not proceed as the brother opted to receive money from the British nationals (in fact, supplied by the British government, which was keen to avoid an international incident).

Second, statutory offences may be accompanied by restrictions on who can prosecute. For example, the statute that created England’s Financial Services Authority barred anyone else from prosecuting the specialized offences set out in that statute (although that bar did not apply to offences in other statutes, such as insider dealing and money laundering).45 The purpose of such limitations is to control when the courts’ resources and powers are used in modern settings. Many common law systems also impose general controls on serious prosecutions, in some cases barring private prosecutions, in others imposing special controls on such prosecutions.

The classic common law approach is that the courts themselves do not decide whether a serious prosecution should go ahead. Because courts follow the adversarial system in which the role of the courts is to adjudicate lawsuits and not to initiate lawsuits, the decision on whether or not to prosecute cannot be made by a judge. Instead, the historical method, still used in some parts of the United States, is for the court to commission a “grand” jury of 23 people that decides by majority (as distinct from the “petit” jury of 12 people that decides guilt or innocence unanimously) to inquire into and decide whether the prosecution can proceed. In most common law countries, including Australia (whose origins as a penal colony precluded such dramatic lay involvement in the justice system), the function is instead given to a lawyer paid by the government to make this decision.

Importantly, these controls on the decision to prosecute are statutory exceptions to the common law rule that anyone can prosecute. If the exceptions do not apply, then the common law rule remains. In the case of section 19 of the APEC Meeting (Police Powers) Act, there were no statutory restrictions on who can prosecute. As well, the vetting process used for serious crimes did

45 Financial Services and Markets Act, 2000 (UK), § 401.
not apply because the statute itself provided that the offence was to be tried as a less-serious “summary” crime before a magistrate.\textsuperscript{46}

Finally, if a crime is set out in a statute, then that can affect who can be prosecuted. That is because statutes are sourced from the government and therefore invite an inference that they are enacted to regulate the behaviour of private individuals, rather than government actions. So, there is a rebuttable presumption that criminal statutes don’t apply to government actions (the so-called “shield of the crown.”)

An example of this presumption is a prosecution in the 1960s under a Canadian statute that prohibited commerce on a Sunday. As part of a public debate about whether such a prohibition was appropriate, the government of Ontario (a province of Canada) launched a prosecution against the Canadian Broadcasting Corporation (a state-owned broadcaster) for its conduct in broadcasting on a Sunday. The Supreme Court of Canada ruled, by majority, that the prosecution could not proceed because the Canadian ban on Sunday trading should be read as limited to private, rather than government, action.\textsuperscript{47}

Could the comedians similarly claim that they could not be prosecuted under s19 of the \textit{APEC Meeting (Police Powers) Act} because they worked for the Australian Broadcasting Corporation? In my view, this is unlikely. It is doubtful whether the comedians, who had a contractual arrangement with the ABC, were part of the “Crown” for the purposes of the “shield of the Crown” rule. And it is also not clear whether or not the “shield of the crown” presumption applies to section 19. In the end, this matter was never raised or resolved, for reasons that I will outline in the final section of this lecture.

\textbf{D. The Role of Independent Public Prosecutors}

It can be argued that the decision on whether or not to start a criminal prosecution should not be in the hands of a government. There are two reasons for that. One is that governments may be the subject of (or be otherwise affected by) criminal prosecutions. For example, it could be said that, because the comedians were working for a government broadcaster, the decision on whether or not to prosecute them should not be made by a government official. This is one of the reasons why many common law systems retain the possibility of private prosecutions, as a potential check on government bias. However, as we have seen, few private citizens are motivated to prosecute in contemporary times.

\textsuperscript{46} APEC Meeting (Police Powers) Act 2007 (NSW), § 39(1).
A second problem with government decisions to prosecute is that governments are also regulators, administrators and investigators of illegality, which means that they may not approach the question of whether to prosecute in an open-minded manner. For example, it may be said that the decision on whether or not to prosecute the comedians should not be made by the police, or anyone else connected with APEC security, as the decision may be motivated by anger or embarrassment about the comedians’ actions, rather than about the law or justice. This is one reason why civil law systems put the responsibility for continuing a prosecution in the hands of the courts. However, as we have seen, that is not an option in an adversarial system and alternatives (such as grand juries) are not feasible for minor prosecutions.

Instead, the modern solution to this problem in common law systems is the creation of a new position: the independent public prosecutor. Like government regulators such as the police, public prosecutors are funded and protected by the government. However, unlike those regulators, public prosecutors only prosecute. They do not regulate, administer or investigate breaches of the law. As well, like private citizens, independent public prosecutors are not subject to direction by the government and are often protected from interference by the government, for example, by restrictions on their dismissal and the provision of guaranteed salaries and pensions. Independent public prosecutors do not replace other prosecutors, whether government or private. Again, that is because they are too expensive a resource to be used for the many prosecutions that happen in common law courts. Instead, like everyone else, they are permitted to bring any prosecution.

However, independent public prosecutors are “first amongst equals” as prosecutors in modern common law reasons for several reasons. First, unlike other prosecutors, they are empowered to “take over” anyone else’s prosecution. They may do so where they consider that they will perform the role of prosecutor in a better way. Or they may do so where they believe that the prosecution should be stopped. As well, they typically have three other powers. First, in countries like Australia that do not have grand juries, they play the role of the court-appointed, government-funded lawyer who decides whether to bring significant prosecutions. Second, some statutes state that only they can bring certain prosecutions. Third, they can also issue guidelines on all government prosecutions.

None of these legal differences between public prosecutors and other prosecutors mattered in the case involvement the comedians. As I already noted, there were no provisions limiting who could bring prosecutions under section 19 of the APEC Act. And the then public prosecutor of New South Wales, Nick Cowdery, did not decide to exercise his legal power to “take over” the prosecution
launched by the NSW police. Instead, the NSW police asked Cowdery to take over the prosecution. I would speculate that the police did so because of the politically sensitive nature of the case, the complexities of the prosecution and the danger of further embarrassment for the police at the trial. Cowdery accepted their invitation, presumably for these reasons.

How does a public prosecutor decide whether or not to prosecute? The legal position is that there are no rules. Like everyone else, public prosecutors make their decision at their complete discretion. In Australia, the courts are steadfast that they will not interfere with those decisions (so as not to diminish the adversarial nature of court proceedings.) However, there is nevertheless a clear rule of practice. That practice was famously stated by one of the most famous prosecutors in the common law world, Hartley Shawcross, the chief prosecutor of the Nuremberg trials. After those trials, Shawcross, in his later role as Attorney-General, gave a speech in the United Kingdom Parliament, where he said:  

48 It has never been the rule in this country – I hope it never will be – that suspected criminal offences must automatically be the subject of prosecution. Indeed the very first Regulations under which the Director of Public Prosecutions worked provided that he should. . . prosecute whenever it appears that the offence or the circumstances of its commission is or are of such a nature that a prosecution in respect thereof is required in the public interest. That is still the dominant consideration.

Note that this public interest test is not one that was first articulated by a court, the executive government or a legislature, but rather just a highly respected person speaking in a public setting. Nevertheless, it is widely quoted and followed by nearly all independent public prosecutors in the common law world.

In the case of the comedians, the public prosecutor of New South Wales, Nick Cowdery, chose to end their prosecution before it proceeded to trial. Like other prosecutors, independent public prosecutors are not required to (and typically don’t) give reasons for their decisions. However, in this case, Cowdery did (and that is why I have used it as an example in this lecture). In a media release, he stated:  

49
In the cases of all 11 accused I am satisfied that on the evidence presently available the prosecution would not be able to negate, beyond reasonable doubt, the existence of an honest and reasonable (but ultimately mistaken) belief that they would not enter or be taken into the restricted area and that, when they did enter it, it was with the permission of police (given by waving them through the Bent Street intersection towards the first gate north along Macquarie Street, then allowing them through the second gate unhindered and then directing them to turn in the intersection of Bridge Street). Police permission in fact constitutes special justification for entry. Accordingly, there is no reasonable prospect of conviction and for that reason the prosecutions should not proceed.

These reasons are an assessment of the likelihood of conviction, which is part of prosecutorial decision-making in both common law and civil law systems. I would note that this assessment involves making predictions about what a court would decide, both on the evidence (for example the suggestion that the comedians might be able to argue that they reasonably thought that they hadn’t entered the restricted zone) and the substantive law (for example the suggestion that this apparent mistake of law, or a police permission clearly given because the comedians were disguised as officials, would be a proper answer to a criminal prosecution).

Cowdery’s reasons also touched on the further public interest test referred to by Baron Shawcross. After suggesting that all of the comedians apart from their leader (Julian Morrow) may also be able to claim a special justification under section 19 that they entered the restricted zone for a “work-related purpose”, he stated:

I am also satisfied that, if the prosecution proceeded against Morrow only on the basis that his situation could be distinguished from the rest, the court would be bound to find that the motorcade entered the restricted area in error and if the offence were otherwise proved (which I consider unlikely) it would be probable that a magistrate would dismiss the charge without conviction under section 10 of the Crimes (Sentencing Procedure) Act 1999 (considering also Morrow’s otherwise good character). That would provide an additional discretionary basis for not proceeding in Morrow’s case, in accordance with the Prosecution Guidelines.

Again, these judgments replicate court decision-making, and also perhaps suggest that section 19’s terms are too broad. I would also tentatively suggest that a further, unstated (but more convincing) reason not to prosecute is that all of these issues would draw further
public scrutiny to the failings of the NSW police in their task of securing APEC and give further publicity to the comedians’ stunt. As Morrow himself wryly observed about the prosecutor’s statement, “I think it’s great that justice hasn’t been done”.

E. Conclusion

In answer to the question “who decides whether to start a criminal prosecution?”, both the common law and civil law systems reach a similar answer in important cases: the decision is made by a protected decision-maker with independence from the government. In civil law systems, that decision-maker is a court or a court officer. In common law decisions that decision-maker is now typically an independent public prosecutor.

However, behind this similarity is an important difference in history and in practice. While court decision-making is the default approach in civil law systems, decision-making by independent public prosecutors is a recent approach that supplements a tradition of allowing anyone to be a prosecutor. Attention to tradition is necessary to fully understand important parts of modern common law criminal law, including the contemporary role of government regulators, statutory rules and procedures, and prosecutorial guidelines in criminal justice decision-making.

VI. COMMON LAW AND TAXATION

Edwin Simpson

The topic of taxation is possibly not the most obvious one for a collection of papers considering central features of the common law, but it nevertheless offers a striking example of the interface between judge-made law (and it is this sense of the term “common law” that is the primary focus of this paper) and statute law. In approaching some legal issues, such as the question of whether persons other than the actual parties to a contract should be allowed to enforce some or all of its terms, it may not matter a great deal whether the answer is to be found in a judicial decision or in a statutory provision. But it does matter in the context of taxation within common law systems, and for two (related) reasons. The first is a constitutional axiom; the second is the Bill of Rights of 1688.

50 See Godwin, supra, Introduction, for discussion of other meanings of the term “common law”.
51 This interface creates challenges that are not present in jurisdictions such as China, where taxation is governed by legislation and court decisions do not constitute a parallel source of binding law.
A. Constitutional orthodoxy

The axiom is that taxation is peculiarly a matter for Parliament rather than any other limb of government or organ of the constitution. The strong protection of private property rights respected within so-called “Westminster model” constitutions requires democratic consent from the citizenry (given by their elected representatives in Parliament) if property is legitimately to be expropriated for the public functions of the state.

Article 4 of the Bill of Rights of 1688 (itself no more than a piece of ordinary legislation by the UK Parliament) confirms the position in Early Modern English spelling as follows:

That levying Money for or to the Use of the Crowne by pretence of Prerogative without Grant of Parlyament for longer time or in other manner than the same is or shall be granted is Illegall.  

Parliament at the time plainly had restraint of the Crowne (i.e., then, of the King) in mind rather than judges, but the principle has been extended not only to constrain the whole machinery of modern government outside of Parliament (i.e. the so called “executive” limb of the constitution), but also to support a limited conception of the judicial role when interpreting tax statutes. Article 4 has therefore conventionally been interpreted to require judges to stick particularly closely to the words of a taxing statute for fear otherwise of appearing to raise a tax themselves. Numerous judicial statements could be cited to this effect, for example Rowlatt J in Cape Brandy

52 Godwin, supra, Property Law: Property vs Non-Property.
53 A term referring to the location of the UK Parliament in the Palace of Westminster, with its famous clock tower.
54 I Will and Mar Sess 2, c 2. In Woolwich Building Society v. Inland Revenue Commissioners [1993] A.C. 70 the House of Lords accepted that a taxpayer has an automatic right to restitution of money demanded by the Inland Revenue without authority, relying in part on the argument that this should follow automatically from Article 4: see Lord Goff, at 172: “the retention by the state of taxes unlawfully executed is particularly obnoxious, because it is one of the fundamental principles of our law - enshrined in a famous constitutional document, the Bill of Rights 1688 - that taxes should not be levied without the authority of Parliament, and full effect can only be given to that principle if the return of taxes enacted under an unlawful demand can be explained as a matter of right.”
56 See for example Attorney-General v. Wiltshire United Dairies [1922] 38 TLR 781, in which the House of Lords held that a power given to a government Minister to make orders regulating the production, distribution, supply, sale and purchase of dairy products could not be used, even in war time, to impose a tax.
Syndicate v. Inland Revenue Commissioners.\textsuperscript{57} The role of the judge is:

\ldots to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

\textbf{B. The Difficulties Caused by Tax “Avoidance” in the Context of Capital Gains Tax}

This starting point to the analysis by judges of Parliament’s tax-raising legislation (i.e. the “construction” by a Court of the effect which Parliament must be taken to have intended its words to have) has caused particular difficulty in the context of so-called tax avoidance schemes. It is one thing where a citizen seeks to “evade” a tax (say, by concealing income from the Inland Revenue, or by making false claims to deduct losses from capital gains), which will be action tantamount to fraud, and likely to involve the commission of a criminal offence;\textsuperscript{58} but what if a citizen merely goes to considerable lengths to organise his or her affairs so as to attract particular treatment – albeit tax-relieving treatment – from very specific Parliamentary words?

A colourful account of such activity was given by Lord Wilberforce in the seminal UK cases (heard by the House of Lords together) of Ramsay v. IRC and Eilbeck v. Rawling:\textsuperscript{59}

In each case we have a taxpayer who has realised an ascertained and quantified gain: in Ramsay £187,977, in Rawling £355,094. He is then advised to consult specialists willing to provide, for a fee, a preconceived and ready made plan designed to produce an equivalent allowable loss. The taxpayer merely has to state the figure involved, i.e. the amount of the gain he desires to counteract, and the necessary particulars are inserted into the scheme.

The scheme consists, as do others which have come to the notice of the courts, of a number of steps to be carried out, documents to be executed, payments to be made, according to a timetable, in each case rapid. In each case two assets

\textsuperscript{57} Cape Brandy Syndicate v. Inland Revenue Commissioners [1921] 1 KB 64, at 71.


appear, like “particles” in a gas chamber with opposite charges, one of which is used to create the loss, the other of which gives rise to an equivalent gain which prevents the taxpayer from supporting any real loss, and which gain is intended not to be taxable. Like the particles, these assets have a very short life. Having served their purpose they cancel each other out and disappear. At the end of the series of operations, the taxpayer’s financial position is precisely as it was at the beginning, except that he has paid a fee, and certain expenses, to the promoter of the scheme.

On facts of that type, where the capital gains and losses were so interdependent as to be almost inseparable, the House of Lords decided to treat them as such, and so to regard the schemed transactions together as of no fiscal consequence. The gains and losses within the scheme were self-cancelling and so no claim to an allowable loss could be generated by them.

These cases alone might not seem to represent much of a departure from the conventional judicial approach set out above – after all the judges have to characterise the facts in front of them as part of the application of a statute to them, and it is a legitimate part of the judicial function to frame the elements of the parties’ action by reference to the question that the statute requires to be answered. But such reasoning quickly led to decisions which may be thought to have gone further than this.

For example, in *Furniss v. Dawson* the House of Lords considered the proper capital gains treatment of a disposal of shares in certain family companies in favour of a separate corporate purchaser, Wood Bastow Holdings Ltd. Rather than a straightforward sale, however, and on the basis of tax-motivated advice, the sale was not made directly to Wood Bastow, but instead following an exchange of the original family company shares for shares in an investment company incorporated in the Isle of Man, Greenjacket. By virtue of this exchange, the Dawsons (whose proper tax treatment was in issue) acquired Greenjacket shares in return for their original shares in the family companies, and Greenjacket then sold on those shares for the cash consideration from Wood Bastow. The two-step approach was designed to defer capital gains tax, relying upon an exception in the context of company reorganisations to the general principle that a charge is made on the disposal of assets giving rise to a capital gain. This exception applied at the time to exchanges of shares whereby the transferee company (Greenjacket) obtained control of the companies whose shares it acquired (the

60 Finance Act 1965, § 19.
Dawson family companies).⁶¹ In such a case the detailed statutory code appeared to provide that there would be deemed to be no disposal of the former shareholding by the transferor: the new and the old shareholding would simply be treated as the same asset. If these provisions applied to the facts just described, then tax would be postponed until the Dawsons might later dispose of their Greenjacket shares.

As a result of the approach of the House of Lords to these facts,⁶² the court decisively shifted emphasis away from factual interconnectedness, of the sort found to exist in Ramsay, towards the presence instead of a controlling will overseeing a pre-ordained scheme. What allowed a number of stages to be treated together was not factual interdependence, but the parties’ intentions towards the structure they had created – and particularly the existence of steps inserted into a transaction with no purpose other than the avoidance of tax. Lord Brightman formulated the new approach as follows:

First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. . . Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax . . .

Even once this approach had been settled, the correct application of the relevant statutory provisions to the facts of Furniss was far from straightforward. Even if only for tax purposes, it is difficult to ignore the existence of Greenjacket (in a manner similar to the way in which the House of Lords had left out of the fiscal analysis the intermediate gains and losses within the interconnected Ramsay scheme). The legislation appears specifically to require consideration of whether or not Greenjacket acquired control of the Dawson companies as a result of the initial share exchange. Nevertheless, Lord Brightman concluded as follows:

[I]f the two necessary ingredients exist, the inserted steps are to be disregarded for tax purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied. In the instant case the inserted step was the introduction of Greenjacket as a buyer from the Dawsons and as a seller to Wood Bastow. That inserted step had no business purpose apart from the deferment of tax, although it had a

⁶¹ Finance Act 1965, para, 6, Sch 7.
⁶² See IRC v. Burmah Oil [1981] 54 TC 200 at 220A.
business effect. If the sale had taken place in 1964 before capital gains tax were introduced, there would have been no Greenjacket.

This approach has led, in the very large number of appeals concerning tax avoidance schemes to have reached the higher courts since *Furniss*, to a considerable range of criticism of Lord Brightman’s approach. To begin with, there is the constitutional strangeness of appearing not to apply specific elements of the statutory provisions on their face applicable to the facts as found (see generally section I above). More broadly, Lord Brightman’s careful and precise formulation (requiring “pre-ordainment” and inserted steps with “no” purpose other than the avoidance of tax) appears itself to signal to citizens what it is they need to do in order to avoid its application. Schemes were quickly designed with an element of doubt as to whether they would be carried through; and steps inserted where tax avoidance might be argued not to be their *only* purpose.63 In a sense these difficulties might be part of a wider criticism that Lord Brightman (and the other members of the House of Lords in a unanimous decision of the court of 5 members) had perhaps gone further than judicial decision-making required and instead appeared almost to “legislate” a new anti-avoidance rule.

Lord Hoffmann, for example, in *MacNiven v. Westmoreland Investments Ltd*,64 could not accept that such an approach could be described simply as a principle of statutory construction. It looked instead like an “overriding legal doctrine” of some sort, superimposed upon the whole of revenue law without regard to the language or purpose of any particular statutory provision. While Parliament could plainly resort to such a “paramount provision”, subject to which everything else must be read – such as section 2(2) of the European Communities Act 1972 – the judges, Lord Hoffmann argued, simply lacked the constitutional authority to develop the common law in this way. Instead, if the new approach were to be justified, it would need to be shown in each case precisely why it is that statutory construction yields the particular result sought by the Inland Revenue. A related attempt to reconcile the judicial approach with constitutional orthodoxy was put forward by Lord Steyn in *IRC v. McGuckian*:65

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63 See for example Craven v. White [1989] AC 398, where three appeals were considered together by the House of Lords, leading to considerable judicial disagreement (the House split 3-2) as to the proper approach to variously ordained facts and different kinds of inserted step.
64 *MacNiven v. Westmoreland Investments Ltd* [2001] 2 WLR 377, at [28].
65 *IRC v. McGuckian* [1997] 1 WLR 991, at 1000G.
The new development was not based on a linguistic analysis of the meaning of particular words in a statute. It was founded on a broad purposive interpretation, giving effect to the intention of Parliament. And in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis.

C. The More Recent Battleground: Capital Allowance

Cases such as *Ramsay* and *Furniss* arose in the context of capital gains tax. A line of more recent cases has concerned the availability of capital allowances to those involved in carrying on a trade. The capital allowance rules permit a certain amount of money spent by a company on fixed assets to be deducted from the profits of the company before tax is imposed. The availability of capital allowances in the context of what might be thought to have been abusive arrangements has been considered by the highest Court in the UK on three occasions in the last twenty years: twice by the House of Lords in *Ensign Tankers v. Stokes* and *Barclays Mercantile Business Finance Ltd v. Mawson* (“BMBF”); and most recently by the Supreme Court in *Tower MCashback LLP v. Revenue and Customs Commissioners*.

The fiscal context of such cases was helpfully set out by Lord Nicholls in his speech, given on behalf of the whole appellate committee, in the *BMBF* case:

A trader computing his profits or losses will ordinarily make some deduction for depreciation in the value of the machinery or plant which he uses. Otherwise the computation will take no account of the need for the eventual replacement of wasting assets and the true profits will be overstated. But the computation required by [the relevant tax legislation] (whether for the purpose of income or corporation tax) has always excluded such a deduction. Parliament therefore makes separate provision for depreciation by means of capital allowances against what would otherwise be taxable income. In addition, generous initial or first-year allowances, exceeding

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68 Tower MCashback LLP v. Revenue and Customs Commissioners [2011] UKSC 19; [2011] 2 AC 457. See now too the recent decision of the Court of Appeal of 19 Feb 2015 in HMRC v. Eclipse Film Partners (No 35) LLP.
actual depreciation, are sometimes provided as a positive incentive to investment in new plant.69

Perhaps the most important thing to notice from this is that the approach taken by the fiscal regime in the capital allowances context has a degree of artificiality already built into it. The economic point is that to fail to make allowance for depreciation of capital assets of a trade will lead to material misstatement of profits. Assuming that the legislation is well designed, and that there is no abuse, a capital allowance is accordingly not exactly a windfall: it is simply a proper reflection of depreciation, appropriately reducing the amount of income or profit to be subjected to tax. The precise conditions on which the relief was available at the time of the BMBF case were set out in section 24(1) of the Capital Allowances Act 1990:

(1) Subject to the provisions of this Part, where—

(a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and
(b) in consequence of his incurring that expenditure, the machinery or plant belongs or has belonged to him,

allowances and charges shall be made to and on him in accordance with the following provisions of this section.

There is an initial strangeness in the BMBF case in that it involved claims to capital allowances in the context of the trade of finance leasing, or the provision of so-called “asset-based finance”. As an ordinary example of the operation of capital allowances, one might imagine a trader purchasing a machine to build widgets (which machine will wear out); or purchasing new robots to build cars (which robots will break down). In those cases, the relevant trade is clearly the building of widgets or the manufacturing of cars. But BMPF was the UK market leader in the trade of finance leasing, the essence of its business being to provide capital for the purchase of an asset for use by its customer in return for a series of periodic payments secured upon the asset itself. The transaction normally took the form of a purchase of the asset by BMBF, either from a third party or, by way of sale and leaseback, from the customer himself, followed by the grant of a lease at a rent calculated to secure BMBF an appropriate return. Either way, BMBF had the security of being

owner of the asset and entitled in the event of default to sell it and recover any outstanding sums.

There was no dispute in the case that BMBF, as purchaser of an asset for the purposes of its trade, was ordinarily entitled to a capital allowance under section 24(1). The asset concerned was an undersea oil pipeline linking the UK mainland and the Republic of Ireland, but the trade that BMBF was carrying on was that of finance leasing – it is not, and never has been, in the gas supply business. But it maintained that it had acquired an asset (in this instance, the pipeline) for £91 million, wholly and exclusively by way of provision for the purposes of its trade of finance leasing. As Lord Nicholls put it:

In consequence of its purchase from the third party or the customer, BMBF becomes owner of the asset and remains owner during the subsistence of the lease. Depreciation of the asset is a depreciation in the value of BMBF’s capital assets.  

Although perhaps obvious, this is significant and important – certainly so far as any purposive construction to be given to the legislation is concerned. If it is right that the purpose of capital allowances is to reflect (albeit in a somewhat artificial and indirect way) the economic reality of the depreciation of the value of capital assets over time, then there is nothing surprising per se in the owner of a capital asset for the purpose of finance leasing being able to claim such an allowance – it is his security, his asset, that is depreciating in value after all.

Lord Nicholls continued:

The present case… illustrates the need for a close analysis of what, on a purposive construction, the statute actually requires. The object of granting the allowance is, as we have said, to provide a tax equivalent to the normal accounting deduction from profits for the depreciation of machinery and plant used for the purposes of a trade. Consistently with this purpose, section 24(1) requires that a trader should have incurred capital expenditure on the provision of machinery or plant for the purposes of his trade. When the trade is finance leasing, this means that the capital expenditure should have been incurred to acquire the machinery or plant for the purpose of leasing it in the course of the trade. In such a case, it is the lessor as owner who suffers the depreciation in the value of the


71 Lord Nicholls, supra note 69.
All of that would be almost entirely uncontroversial in the case of an ordinary finance lease. But there were complexities about the particular arrangements before the court in BMBF which led some of the judges before whom the matter came to have doubts. One might have expected – certainly Park J at first instance expected – that, if this were an ordinary finance leasing transaction, then the former owner of the pipeline (BGE in this case, an Irish company) would have had some need of an injection of up-front capital leading to it seeking a financing arrangement with BMBF of this sort in the first place. But, on the particular facts, this was not the position. Instead (and through a series of convoluted – if not to say opaque – arrangements), the £91 million, as soon as paid over as the purchase price of the pipeline, was placed on deposit, via (omitting certain details) a conduit called “Deepstream” so as over the years to secure the rental payments due from BGE under the lease (see Fig 1 for a simplified diagram of the actual arrangements).

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73 In fact the scheme was suggested by an investment bank because the pipeline was not expected to earn taxable profits in a sufficiently short time to absorb capital allowances if taken directly.
In Park J’s view, finance leasing ordinarily involved the provision of “up-front finance” to the lessee: a capital sum used to buy the plant or refinance its previous acquisition:

But in the transaction involved in the present case no up-front finance was provided. BGE already owned the pipeline and had paid for it with a loan from a syndicate of banks. After the transaction BGE was still able to use the pipeline as before, though by then it did so by virtue of the lease, sublease and transportation agreement, and it still owed to the banks the money which it had borrowed. Nor was the £91m available to BGE for it to use in any other way to finance transactions or activities of its business.

On this basis, both the Special Commissioners and Park J denied BMBF its allowances. In answer to the submission that BMBF had paid the £91m in consideration of the acquisition of the pipeline and had become its owner under the acquisition agreements, Park J said:

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It is true that in a strictly legal sense one can say that BMBF incurred expenditure on the provision of the pipeline. That is what the two acquisition agreements said... However, in the light of the Ramsay authorities I consider that I have to interpret and apply the statute in a wider way... I have to ask: on what did BMBF really incur its expenditure of £91m? Was it really incurred on the provision of the pipeline, or was it really incurred on something else?... My answer is that the expenditure was really incurred on the creation or provision of a complex network of agreements under which, in an almost entirely secured way, money flows would take place annually over the next 32 or so years so as to recoup to BMBF its outlay of £91m plus a profit.\textsuperscript{75}

But the Court of Appeal and the House of Lords disagreed. In the House of Lords, Lord Nicholls shifted the focus of attention firmly on to the acts of the lessor only:

These statutory requirements, as it seems to us, are in the case of a finance lease concerned entirely with the acts and purposes of the lessor. The Act says nothing about what the lessee should do with the purchase price, how he should find the money to pay the rent or how he should use the plant...

... The finding of the special commissioners that the transaction “had no commercial reality” depends entirely upon an examination of what happened to the purchase price after BMBF paid it to BGE. But these matters do not affect the reality of the expenditure by BMBF and its acquisition of the pipeline for the purposes of its finance leasing trade.

If the lessee chooses to make arrangements, even as a preordained part of the transaction for the sale and leaseback, which result in the bulk of the purchase price being irrevocably committed to paying the rent, that is no concern of the lessor. From his point of view, the transaction is exactly the same. No one disputes that BMBF had acquired ownership of the pipeline or that it generated income for BMBF in the course of its trade in the form of rent chargeable to corporation tax. In return it paid £91m. The circularity of payments which so impressed Park J and the special commissioners arose because BMBF, in the ordinary course its business, borrowed the money to buy the pipeline from Barclays Bank and Barclays

\textsuperscript{75} Id. at 1102-3, [57]-[58].
happened to be the bank which provided the cash collateralised guarantee to BMBF for the payment of the rent. But these were happenstances. None of these transactions, whether circular or not, were necessary elements in creating the entitlement to the capital allowances.76

The disagreements between the judges in BMBF demonstrate very clearly the difficulties when confronted with detailed tax legislation and complex facts of identifying precisely what the relevant statutory question is, and which facts are relevant to determining how it is to be answered. Certainly the BMBF decision is far from the last word on the subject, and the Supreme Court has returned to similar provisions in Tower MCashback LLP v. Revenue and Customs Commissioners 77 concerning claims for 100% first-year allowances under (now) s 45 of the Capital Allowances Act 2001, in respect of expenditure on software rights. Here the taxpayer (which, as in the earlier Ensign decision, 78 was an LLP) entered into a software licence agreement with a vendor company, by which, for consideration of £27.5 million plus fees and expenses of £2.5 million, it acquired software usage rights and the right to 2.5% of the gross revenues from the software. £22.5 million of that consideration, however, was funded by non-recourse loans that were provided to the members of the partnership, through a series of circular transactions, by the vendor company itself. Lord Walker described the essential issue as follows:

The essential issue (simply stated but not simply resolved) is whether the LLPs incurred capital expenditure, to the extent of the whole stated consideration, in acquiring software rights for the purposes of their trades. The revenue’s case is that in relation to each of the LLPs there was a single composite transaction (that much, at least, is common ground, as the LLPs’ printed case refers to “the wider transaction”) and that by that transaction, realistically assessed, much less than the full claimed amount of the expenditure was incurred on the acquisition of software rights.

What in the end placed the facts of MCashback on the unacceptable side of the line (unlike the facts in BMBF) was the nature of the non-recourse loan. The uncommercial terms of that borrowing, provided as it was by the vendor of the software itself, was held to rob the payments of the character of being the taxpayer’s to expend for the purposes of the capital allowances legislation.

There were key differences between MCashback and BMBF – not least in that MCashback (unlike BGE in BMBF) really did need up-front finance in order to roll out its software and give effect to its business plan. But in MCashback the Supreme Court held that, although there was a loan, there was not, in any meaningful sense, an incurring of expenditure of the borrowed money in the acquisition of software rights. It went into a loop in order to enable the LLPs to indulge in a tax avoidance scheme. The transfer of ownership (or at least of rights) in connection with the software indicated the reality of some expenditure on acquiring those rights, but was not conclusive as to the whole of the expenditure having been for that purpose. Lord Walker summed up the differences as follows:

One of the lessons of the [BMBF case] is that it is not enough for the revenue, in attacking a scheme of this sort, to point to the money going round in a circle. Closer analysis is required. In the [BMBF case] the whole £91m was borrowed by Barclays Finance from Barclays Bank on fully commercial terms (though they were companies in the same group) and Barclays Finance’s acquisition of the pipeline was on fully commercial terms. BGE had the whole £91m at its disposal, and though it was disposed of at once under further pre-arranged transactions, those transactions were entirely for the benefit of BGE. BGE had no pressing need for up-front finance (which is not, contrary to what Park J supposed, an essential feature of a leasing scheme capable of generating capital allowances). In the present case, by contrast, the borrowed money did not go to MCashback, even temporarily; it passed, in accordance with a solicitor’s undertaking, straight to [a third party investment company] where it produced no economic activity (except a minimal spread for the two Guernsey banks) until clearing fees began to flow from MCashback to the LLPs (in an arrangement comparable, though not closely similar, to the arrangements between LPI and VP in the [Ensign case].

D. The Brave New Future of the UK GAAR

Any honest analyst of the line of House of Lords and Supreme Court cases from Ramsay to MCashback will face considerable difficulty in attempting to reconcile each of the decisions – none of which a later Court has suggested to have been wrongly decided – with one another. Certainly the differing outcomes in Ensign, BMBF and MCashback are not straightforwardly explained. This difficulty of predictability of outcome in tax avoidance cases is itself a ground of criticism of the law involved, and may be part of the reason that the UK Parliament has itself recently been moved to supplement the judicial developments described in this paper by a statutory general anti-abuse rule (GAAR) contained in Part 5 and Sch 43 of Finance Act 2013.80 The GAAR came into force with respect to certain taxes with effect from 17 July 2013. Its aim is to apply to “tax arrangements” which are “abusive”. In broad terms, a tax arrangement is an arrangement which, viewed objectively, has the obtaining of a tax advantage as its main purpose or one of its main purposes; but it needs also to be shown that an arrangement is “abusive”. The test of what constitutes “abuse” is designed to recognise that:

[Un]der the UK’s detailed tax rules taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made. The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable.81

This so-called “double reasonableness” standard (together with other safeguards built into the structure of the GAAR)82 would seem to restrict the ambit of the UK GAAR to a relatively small category of “abusive” avoidance activity, where the taxpayer’s conduct can,

82 See Id, and the relevant provisions of Finance Act 2013.
on no reasonable view, be said to be reasonable. In such circumstances, it seems likely that UK judges may well wish to continue to develop their own approaches to target, in appropriate circumstances, avoidance activity of a wider type than that targeted by the GAAR. It is in any event hoped that this examination of the interplay between the judicial and legislative roles in analysing and responding to the challenges posed by tax avoidance activities will be of interest as a peculiar but intriguing aspect of the wider relationship between the judicial and the legislative branches of common law legal systems.