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Settlement agreements, legal information and the mistake of law rule in contract

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Abstract

The extent of the doctrine of contractual mistake of law is evaluated in light of the Court of Appeal's decision in Brennan *v* Bolt Burdon *through the lens of economic efficiency, the associated incentivisation of productive information acquisition and contractual risk allocation. The* Brennan *court's decision limits the relief available for claims of mistake grounded in unanticipated changes in the law to mistakes involving exceptional errors. In so doing it acknowledges the risk inherent in accepting contractual settlement offers as a matter of commercial risk taking which can be offset through express contractual limitation, subject to public policy concerns. The article considers the effects of such contractual risk allocation as well as the cost of dispelling ignorance to recommend a clarification of the scope of the mistake of law. This rule is based upon the gains to be achieved from the underlying contract to the contractual parties as well as advantages to society engendered by the dissemination of information about the law itself.*

1 Introduction

In entering a contract for the settlement of a civil claim based upon the perception that the suit may fail due to the status of a particular precedent or statutory provision, both the claimant and the defendant undertake the risk that the law may not be as they understand it to be and consequently their decision to abandon a claim or defence may be unwise. A wide ambit for the doctrine of mistake of law could vitiate this concern, allowing parties to renege on such agreements when based upon flawed assumptions about the ongoing validity of the law. In so doing, the precise application of this doctrine will have significant effects upon the behaviour of settling parties, most notably those attempting to reach a pre-trial compromise in litigation. This behaviour may have effects beyond the particular transaction because of the important role legal information plays in society.

This article will consider the scope of the mistake of law rule in contract from an economic perspective. It will analyse the ways in which a narrow interpretation of this rule, as seen in the Court of Appeal decision in *Brennan* v *Bolt Burdon*,[1] may affect both the acquisition of productive information and foster contractual risk allocation, ultimately

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1 [2004] EWCA Civ 1017 (hereinafter *Brennan*).

contributing to the enhancement of social welfare. The discussion will offer a more clearly delineated test for the mistake of law rule in contract that explicitly takes into account the costs of resolving uncertainty and more complete contract drafting compared to the gains of underlying transaction, which include the avoidance of trial in the case of settlements as well as the dissemination of useful information regarding the law. This article will not examine restitutionary mistake, such as that involved with the payment of money based upon mistake.[2] Rather it will draw upon economic concepts to focus on the entrance into litigation settlement agreements grounded in a mistaken understanding of the law, as seen most clearly in the context of litigation settlements as in *Brennan*. Before we consider the scope of the rule in light of this decision, it is necessary to review the economic rationale which underlies the doctrine of mistake in contract law.

2 Mistake and the social welfare of productive information

In assessing the efficiency of legal rules regarding mistake in contract, scholars have drawn a distinction between mistakes which are based upon a lack of information that could have been obtained through effort (productive information) and those based upon mistakes resulting from a lack of information that could have been casually or fortuitously acquired (non-productive or re-distributive information).[3] The former type of information is productive in that it can be used to generate greater wealth for society by allowing existing uses of goods or property to be shifted to more productive ones, such as farmland being used for oil drilling. In contrast, ordinary factual information is often merely re-distributive in that it can only be used to allocate wealth in favour of the informed party – it does not add to the knowledge base of society and as such does not improve social welfare. The logic of this distinction was noted by Kronman as the reason for the lack of a general duty to disclose relevant facts in the law of contract, allowing parties to profit from their superior knowledge.[4]

The concept of productive information is not without its critics, for example, Trebilcock has argued that the generation of allegedly productive information may lead to a waste of resources because it may already be held by others and may also be transmitted at low cost.[5] In the case of legal information, this may equate to researching a legal issue, the answer to which is already widely known.

Still, in conventional economic theory as first postulated by Rasmusen and Ayres, it follows that relief should be granted for mistake if the gains from trade for mistaken parties are negative or where the care to avoid mistake was merely re-distributive rather than productive.[6] Mistake should be found where it was based on useless information, because it would have been a waste of resources to obtain it. In the context of a settlement agreement in litigation, a negative gain will occur where the quantum of the settlement predicated upon a mistaken understanding of the law falls short of the amount that would

2 There is a substantial amount of scholarship on this topic: e.g. R Williams, "Beginnings of a public law of unjust enrichment" (2005) 16 *KCLJ* 194; M de Gregorio, "Impossible performance or excused performance – common mistake and frustration after *Great Peace Shipping*" (2005) 16 *KCLJ* 69; D Friedman "The objective principle and mistake and involuntariness in contract and restitution" (2003) 119 *LQR* 68.

3 E.g. A Kronman, "Mistake, disclosure, information and the law of contracts" (1978) 7 *J of Legal Studies* 1; J Smith and R Smith, "Contract law, mutual mistake and incentives to produce and disclose information" (1990) 19 *J of Legal Studies* 467; E Rasmusen and I Ayres, "Mutual and unilateral mistake in contract law" (1993) 22 *J of Legal Studies* 309; R Cooter and T Ulen, *Law and Economics* 4th edn (London: Pearson 2004), p. 281.

4 Kronman, "Mistake", n. 3 above.

5 M Trebilcock, *The Limits of Freedom of Contract* (Cambridge, Mass: Harvard UP 1993), p. 112.

6 Rasmusen and Ayres, "Mutual and unilateral mistake", n. 3 above, at p. 339. See also C Veljanovski, *Economic Principles of Law* (Cambridge: CUP 2007), p. 146; Cooter and Ulen, *Law and Economics*, n. 3 above, at p. 281.

have been awarded at trial, taking into consideration the foregone cost of that trial. This represents a failure to compensate claimants properly for the injuries they have sustained. In other words, mistake is paying too much or receiving too little because of a misunderstanding of one's legal rights.

However, the distinction between productive and redistributive information is largely inapplicable in the case of mistake of law because of the inherent worth in all information about the law. Acquisition of legal knowledge can be seen as the most valuable type of information because it has the potential to affect the rights of a wide segment of society, unlike information about a particular traded asset, even one that may generate vast quantities of wealth such as an oilfield, as in the example noted above. Likewise, legal research is the most productive labour undertaken by lawyers because the effort does not need to be repeated for every client, unlike, for example, work involved in familiarising oneself with a particular set of facts, such as a client's assets or liabilities. Of course, legal knowledge must be adapted somewhat to fit each client's particular fact scenario and this can be quite time-consuming. Since the law should encourage activities that enhance social welfare, a transaction founded upon a mistake induced through one party's failure to seek information about the law could be viewed as efficient in that it will incentivise greater investigation into the law for the benefit of all. Denying mistake in such circumstances will promote future aggregate social gains in terms of knowledge of precedent acquired for subsequent use, even though one party might lose out in the transaction at hand.[7] In a sense, though, such information is merely distributive rather than productive – the information was not unknown generally, just unknown to certain individuals. The social utility must be viewed in light of the, admittedly discredited, declaratory theory of law, which posits that the law has always existed and as such legal information can never really be "created" in the sense that ordinary information can. Legal information can still be uncovered and clarified through research and re-litigation.

Economic theory also suggests that for the sake of efficiency the law should assign liability for mistaken assumptions of law or fact to the party who can insure against the contingency at least cost.[8] This is because contracting parties should allocate the risk of mistake occurring to the party that can obtain information most easily and in so doing minimise the joint costs of contracting.[9] It is necessary to determine which party was better placed to obtain the information the lack of which led to the mistake. Information that might be available by chance to one party may require effort of another party to be obtained due to their relative endowments or position. Since they have possession, sellers of goods are generally seen as better able to acquire knowledge about the traded good and therefore their informational costs will be lower than those of the purchaser. Trebilcock's contention that inequality is balanced by the purchaser's superior knowledge with respect to the planned use for the good[10] is untenable as we should expect that planned uses are either obvious or else disclosed to ensure suitability for purpose. The law should therefore uphold mistakes on the part of purchasers regarding some feature of the good in question.[11]

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7 This is Kaldor–Hicks efficiency: any change to the situation will in aggregate generate more losses than gains. See e.g. A Ogus, *Costs and Cautionary Tales* (Oxford: Hart 2006), pp. 26–31.

8 Cooter and Ulen, *Law and Economics*, n. 3 above, at p. 278.

9 Kronman, "Mistake", n. 3 above, at p. 4.

10 Trebilcock, *The Limits*, n. 5 above, at p. 140.

11 The opposite conclusion was reached in the US case *Sherwood* v *Walker* 66 Mich 568 33 NW 919 [1887] where the seller was able to void the sale despite being in a better position to know that the traded good (a pregnant cow) was more valuable than both parties had originally thought.

Such logic should not strictly apply to settlement agreements which can be voided for mistake of law. While both the seller (the claimant) and the purchaser (defendant) hold private factual information regarding the strength of their respective cases, regardless of the law's attempt to correct this mutual uncertainty through disclosure rules, the law in question is common to both sides and publicly available. Relative endowments are more relevant to mistake of law in as much as wealth will augment the accessibility of legal information through the greater affordability of comprehensive legal research. This must be viewed in light of the fact that defendants (such as manufacturers) will have a greater incentive to investigate the law relating to a particular issue than will a single claimant victim because similar lawsuits will likely arise again. For some parties the burden of obtaining the necessary information to eradicate a mistake of law might exceed the efficiency gain from the transaction itself. The commercial unacceptability of this cost imbalance can be presumed via the doctrine of revealed preferences: a party prefers to incur the risk of transacting in absence of knowledge rather than incur the high cost of obtaining information. As such they are said to be rationally ignorant.[12]

The decision not to contract around risk of mistake of law, or to avoid it through research may again simply demonstrate the parties' endowments – a wealthier party is better placed to engage in speculative litigation based on an uninvestigated legal principle.[13] This could be equally indicative of the attitudes towards or understanding of risk on the part of the trading parties. As Kahneman's concept of cognitive bias indicates,[14] a decision such as whether to settle a claim or negotiate to avoid the risk that it will be avoided may be the result of "bounded rationality". For example, a solicitor or his or her clients may suffer from an irrational incapacity to appreciate that an apparently established precedent could have been overruled because this has not been directly observed by them before, whereas the burden of personally experienced past litigation costs (or failures at trial or appeal) as alternatives to settlement are much more real and memorable.[15] Such inexperience is as much a feature of professional skill as is proficiency in legal research, but importantly it should be reflected in the price of the legal services, such that it can be properly assessed as a transaction cost.

The extent to which courts have evaluated these risks of uncertainty in the rules for mistake of law will now be considered in light of the most recent English case on mistake of law in contract, *Brennan* v *Bolt Burdon*.

3 *Brennan* and mistake of law

The Court of Appeal decision in *Brennan* v *Bolt Burdon* examines the extent to which a claim of common mistake of law (both parties make the same mistake) can operate to void a contract, a principle that had been previously established in *Kleinwort Benson Ltd* v *Lincoln City Council*[16] in relation to restitutionary claims for the payment of money by mistake. In *Brennan*, the claimant was a tenant who had suffered personal injuries due to the inhalation of carbon monoxide which had resulted from the faulty operation of a boiler in the

12 This has shown to be particularly true in the case of online purchasers: R Hillman, "On-line boilerplate: would mandatory website disclosure of e-standard terms backfire?" in O Ben-Shahar (ed.), *Boilerplate: The foundation of market contracts* (Cambridge: CUP 2008).

13 This ignores the fact that wealthy parties have more to lose in litigation than poor ones.

14 D Kahneman, P Slovic and A Tversky, *Judgment under Uncertainty: Heuristics and biases* (Cambridge: CUP 1982).

15 This phenomenon is known as the "availability heuristic".

16 [1998] 4 All ER 513. *BP* v *Aon Ltd* [2006] EWHC 424 (Comm) suggests that there remains a substantial doubt as to whether *Kleinwort* applies to a contract entered into under a mistake of law (although this case did not refer to *Brennan*).

defendant Islington Council's premises during two periods of time in the 1990s. The claimant had instigated an action against the defendant but, due to an oversight by her solicitors, the claim form was not served within four months of the date of issue, in violation of the Civil Procedure Rules (CPR), Part 7, r. 5(2). Consequently, the defendants filed a motion under CPR, Part 11, r. 1, to have the claim set aside as out of time. The application was duly granted by the recorder who relied on two Court of Appeal judgments relating to the extension of time for service.[17] But before the initial claim was set aside the claimant had already launched a second action against Islington relating to the second period of time during which the boiler had caused her injuries. After the recorder's decision to set aside the first action on the grounds of breach of the CPR's timeframe, the defendant's solicitor requested that the claimant's solicitor discontinue the second action, arguing that it was inevitable that it would also be set aside for delay given that the claim form in the second action had also been served past the relevant deadline. The claimant's solicitor agreed in writing to discontinue the action provided that the defendant would not make an order for costs such that each side would be responsible for its own costs only. In essence the settlement contract was predicated upon the shared assumption that the law as it stood dictated that the claims would be stricken for delay.

However, unknown to both parties, one of the authorities[18] on which the recorder had relied in her dismissal of the original action as out of time had actually been reversed by the Court of Appeal before the settlement agreement had been concluded, the result being that the service of both claims had actually been valid. Brennan appealed the recorder's decision, arguing that that the compromise agreement was void for a common mistake as to law. The defendants asserted that their settlement agreement was binding and applied to the court to stay this appeal of the first action until Miss Brennan performed her agreement to discontinue the second action on the basis that each party would bear its own costs. This application was refused and the appeal of the first action eventually came before the Court of Appeal.

According to Maurice Kay LJ the central matter at issue was whether the compromise of proceedings entered into by the parties on the basis of common mistake of law was void by reason of that mistake. Acknowledging *Kleinwort*, the court re-iterated that a common mistake of law may now render a contract void. Furthermore, under *Huddersfield Building Company Ltd* v *Henry Lister & Son Ltd*,[19] a compromise in litigation is a contract to which the ordinary rules of contract law apply and, indeed, it can be set aside due to mistake. Relying on *The Great Peace*,[20] which established that for a common mistake to be operative it must render performance of the contract impossible, Maurice Kay ruled that the court's acceptance of the service past the due date was not truly impossible, as there was a chance that the court might have interpreted the relevant caselaw in a more lenient fashion: there would be a small but statistically significant chance of persuading the court to take a different view regarding delay of service. This probability of success fell considerably short of the unequivocal result flowing from mistake outlined in *Kleinwort* as well as *Great Peace*'s need for impossibility. The fact that Brennan's solicitor did not even inquire as to whether the relevant authority regarding extension of time for service was

17 *Godwin* v *Swindon Borough Council* [2001] 4 All ER 641 and *Anderton* v *Clwyd County Council* [2001] EWHC QB 161.

18 *Anderton* v *Clwyd County Council* [2001] EWHC QB 161. This case was unreported at the time of contracting according to A Burrows, *A Casebook on Contract* (Oxford: Hart 2007), p. 638.

19 [1895] 2 Ch 273.

20 [2002] EWCA Civ 1407 (hereinafter *Great Peace*). The unstated logic of this principle must be that a contract that is impossible to perform will obviously consume greater resources in the performance than it will produce in the execution because the execution will not take place.

under appeal or not was taken by Maurice Kay to indicate that there was a general lack of prudence on the part of the promisor and that the court should be "reluctant to countenance as a mistake of law a situation in which it is generally known or ought to be known that the law in question is about to be reconsidered on appeal".[21] Thus Brennan was seen to have born the risk that the assumption was untrue. This encapsulates the obvious difference between the case in which a lawyer overlooks a decision of the Court of Appeal and one in which the lawyer reads the cases accurately but fails to anticipate that the decision being relied upon will be overturned.

It is Maurice Kay's and Bodey LJ's comments regarding this assumption of risk in contractual relations that is most telling with respect to the economic rationale underpinning the court's decision. Drawing upon the *dicta* in *Great Peace* which referred explicitly to the need to identify which party has undertaken the risk that a contract will become impossible to perform, Maurice Kay stated:

> where a party wishes to reserve his rights in the event of subsequent judicial decision in a future case to which he is not a party, it is he who should seek and secure a term to that effect, not his opponent who should have to stipulate for protection notwithstanding the possibility of such a subsequent decision. Such a requirement is consistent with the policy of encouraging settlements and respecting their finality.[22]

He concluded by classifying the situation underlying the compromise agreement as a state of doubt rather than as a true mistake of law.[23] The risk of a future judicial decision which could be advantageous to his client was impliedly accepted and bargained away by the claimant's solicitor. Bodey stated that it is the nature of contractual transactions, such as compromise agreements in litigation, that "both parties recognize the risk that their opinions as to the point of law in question may not be right" and that later judgments may be issued which "render erroneous a former interpretation of the law which had seemed to be sound".[24] Quoting from *Kleinwort*, Bodey emphasised that a person who performs a contractual obligation when in doubt as to whether there is a requirement to do so (by either law or fact) assumes the risk of being wrong as an inescapable vagary of the common law tradition. As Peel justly notes,[25] Bodey's comments hint at the absurdity of the declaratory theory of law. Bodey goes on to state that there is no operative mistake if one party can be said to have borne the risk that the parties might be mistaken in some way.

Although the claimant's solicitor's decision to engage in the second suit at all was based upon imperfect information (it was unknown at the time that the recorder would dismiss the first claim as out of time), Maurice Kay cautions that the reliability of the information on which this decision was based could have been augmented by further inquiry into the status of the precedents at issue. Specifically, the solicitor could have learned whether the judgment upon which the recorder relied was currently before a higher authority and therefore more susceptible to reversal. However, as we shall see, this investigation would represent a further transaction cost which could either impair the settlement process or negate the benefit of avoiding greater litigation costs as Brennan had hoped to achieve.

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21 Para. 20.

22 Para. 22.

23 The practical difference between these two concepts is unclear as there is always some doubt regarding a lower court's decisions which can be readily overruled. There may be less doubt with respect to a statutory law, which although susceptible to repeal, may carry the perception of greater permanency.

24 Para. 31.

25 E Peel, *Treitel: The law of contract* (London: Thompson Sweet & Maxwell 2007), p. 326.

4 Contractual risk allocation and pricing of legal claims

Bodey's final remarks in *Brennan* illuminate the crucial role that the law plays in ascribing default terms to contracts and the implications in terms of allocative efficiency. According to him, if parties wish to accommodate the possibility that the law will change subsequent to the commencement of contractual relations then it is up to parties themselves to provide for this in the contract itself.[26] The opposite conclusion – that an express provision is needed specifically to permit the contract as written to stand in the event of a change in the law – is quite rightly seen as absurd. These statements implicitly acknowledge the Coase theorem: the efficient outcome will be achieved irrespective of the law through negotiation between the parties. However, the truth of Bodey's assertion, and indeed of the Coase theorem, depends on an assessment of the expense of including a clause such as this one in settlement agreements, as indeed in any other contract, a classic transaction cost. It is by no means clear that the *ex ante* legal costs of negotiating such a term into a compromise agreement would outweigh the gains of avoided disputes. Efficient contracting would be more likely were solicitors to use standard form compromise agreements that are exhaustive in their coverage because the marginal cost of so doing would decrease the number of situations in which such contracts were implemented. In these situations, the removal of a standard clause expressly negating the effect of any future changes in the law could further be used as a bargaining chip in the attainment of a more favourable settlement agreement or indeed a lower-priced good.[27] Clearly, the allocation of risk of mistake of law through express contractual provision will occur when contracting parties see this as the cheapest way of avoiding the risk, the only alternative risk-limiting option being the acquisition of information about the true status of the law to the point of near certainty, as we will see below.

The extent to which mistake of law or fact will be countenanced by a court in the absence of contractual stipulation may depend on the subjective perception of risk on the part of the party making the claim, which, as we have noted above, may be irrationally founded. Burrows holds that a party making a claim for mistake should only be denied recovery where, at the time of contracting, the party thinks that the facts are *probably* as they are in truth but contracts anyway, essentially meaning that the party had taken a substantial risk that what he or she thought was the actually truth would not be divulged.[28] Virgo takes a harsher view, suggesting that there should be no relief where the claimant was even aware that there was a *possibility* of being mistaken.[29] This latter approach appears to echo Bodey's view that any suspicions regarding the veracity of law or fact should be reflected in the text of the contract itself. It is perhaps, however, inapplicable in the context of mistake of law because of the nature of the system of precedent which by its nature obviates absolute certainty in the law at a given time, despite the declaratory theory of law's fiction of permanence in the law, if not in its interpretation.

Bodey notes a further practical difficulty that would result if the conclusion that mistakes relating to the understanding of law would permit the avoidance of contractual obligations were to stand. Inevitable uncertainty would be injected into all contracts because of the natural fluctuations in the law resulting from appeals to successive levels of court.

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26 A point noted also by Sedley at para. 61. Such "stabilisation clauses" are common in international investment contracts: S Subedi, *International Investment Law: Reconciling policy and principle* (Oxford: Hart 2008), at p. 159.

27 See, generally, J S Johnston, "Cooperative negotiations in the shadow of boilerplate" in Ben-Shahar, *Boilerplate*, n. 12 above.

28 Burrows, *Casebook*, n. 18 above, at p. 140.

29 G Virgo, *The Principles of the Law of Restitution* (Oxford: Clarendon Press 1999), p. 161.

This observation is tied to the understanding of legal claims as commodities which can be traded, an analogy reflected to an extent in the contract principle that forbearance from suit is good consideration. Legal claims are thus highly price-elastic – whether or not a settlement is reached is highly contingent upon the quantum requested.[30] Any indeterminacy in the valuation of these "goods" because of their potential to be rendered baseless through a change to the law represents what is aptly termed market failure. Legal claims will not be traded, and there will be no settlements, because it will be nearly impossible for sellers or buyers to ascribe any value to them. Of course claims are not actually bought in an open market because in a settlement negotiation there is only one buyer (the defendant) and one seller (the claimant). Legal claims are thus highly price-elastic – whether or not a settlement is reached is highly contingent upon the quantum requested.[31] There is consequently no price-setting competition except possibly that reflected in a single defendant's decision to allocate its limited resources to settle a particular claim amongst a series of claims from several claimants, a situation that is not unrealistic given the exposure of large corporations to numerous consumers. With deficient price signals for claims resulting from legal uncertainty, the only way to set a price would be to do so contingently, perhaps by multiplying the sterling sum of the claim by the probability that it is based upon a law that will not be overruled. Given the expected high propensity for error in such calculations it can be suggested that if the law wishes to facilitate settlements as a means of reducing the strain on the civil justice system,[32] then the market for claims must not be any more volatile or speculative than it is already. This leads to the unsurprising conclusion that the ambit of mistake of law must be attenuated, as the *Brennan* court appeared to do.

Uncertainty caused by the freedom of a party to escape a compromise agreement arguing mistake of law adds another layer of complexity to the strategy involved in negotiating the terms of a contract. This risk allocation also affects the decision whether to extend or accept an offer to settle. Such processes have been evaluated under game theory, where the decisions of others, such as litigants or co-contractors, are taken into account when developing a strategy for one's own decisions, which will ultimately be reflected in the price of the traded commodity.[33] For example, in a contract for the sale of land, the strategy for setting the price will require the sellers to consider whether or not they should incur the cost of investigating the full extent of legal encumbrances on that land,[34] or whether it is safe to sell in ignorance of such restrictions in anticipation that the purchasers will also not investigate. This recognises each parties' desire to minimise their own informational costs in the absence of a contractual provision regarding mistake, for example, the hiring of surveyors or lawyers, which are typically associated with confirming the full value of the assets in one's possession. A seller could risk setting a price without investigating the actual worth of the property in the hope that it is accurate or if it is excessive that the purchaser will purchase in ignorance. The purchaser could in turn submit a lower bid, but the seller

30 E.g. *Cook* v *Wright* (1861) 1 B & S 559 (the legal validity of the claim was weak but the claimants honestly believed that it was valid).

31 There is also strong policy against selling claims in that it brings the administration of justice into disrepute.

32 A goal which Bodey himself notes at para. 51.

33 Rasmusen and Ayres, "Mutual and unilateral mistake", n. 3 above, at p. 339 (in relation to mistake rules specifically). See also Cooter and Ulen, *Law and Economics*, n. 3 above, pp. 392–6, and Ogus, *Costs*, n. 7 above, pp. 23–4.

34 For example, the land may be subject to restrictive covenants or easements which may be unknown to both seller and purchaser during negotiations. This could equally be considered a question of fact.

must then risk that this lower offer is a bluff and not a more accurate assessment of the land's true value based upon research.[35]

Similarly, in choosing whether or not to settle, litigants will have to speculate as to whether their opponents have investigated the validity of a relevant legal principle. This may involve a further assessment of the resources which the opposing side have available to dedicate to litigation as well as whether there may be a cost-capping order or other judicial interference. The *ex ante* cost–benefit analysis of decisions to settle becomes that much more uncertain and therefore costly, as well as error-prone. Some contracting parties would view such tactical manoeuvring as a normal feature of the market and one which encourages the obtaining of socially productive information to improve one's chances of arriving at an efficient contractual result, but it also may operate as an impediment to settlement. Acknowledging mistake of law in a broader range of circumstances would appear to negate this type of behaviour. Although the cost of obtaining information would be minimised, uncertainty regarding enforceability would be increased. The ensuing litigation represents a cost to the civil justice system, warranting a strict approach to mistake of law.

5 Mistake of law and contract externalities

McKendrick and others suggest that the policy upon which the mistake doctrine is based is that there has been a failure of consent.[36] Accordingly, it might be argued that there should be no resulting inefficiency by permitting a wide ambit for mistake of law because, with the true status of law revealed, parties are free to manifest their genuine consent through contract at some later stage. Moreover, a transaction resulting in a net loss because of a flawed misunderstanding, such as an insufficient quantum in a settlement agreement, is negated.[37] Recognising that mistake of law will abrogate consent can also be seen as inefficient because through the voiding of contract the parties are returned to their pre-contractual position with the transaction costs of arguing mistake representing a loss.[38] There is no resulting efficiency in an aggregate sense either[39] since, again, the traded good remains in the hands of the party who held it to begin with. This is still the second-best solution to a fully informed contract because at least a negative-gain transaction is avoided.

Despite these outcomes for the parties themselves, contracting may result in effects felt by others or by society, so-called "externalities". In the context of mistake of law, the primary effect is the generation of legal knowledge. As noted above, by allowing relief through mistake of law to void settlement agreements, there will be no welfare improvement to society from the dissemination of an unknown feature of the law that could have formed part of the dispute at trial. This is because, with mistake of law readily available, contracting parties will not have an incentive to engage in legal research which can be used to consolidate their positions in the event of disputes. This lost information could have been reported for use by later litigants as precedent or be used to inform legal advice,

35 Subject to the limitation that sellers have the obligation to clarify any known misunderstanding on the part of purchasers or else a contract may be set aside for mistake, so-called unilateral mistake: *Smith* v *Hughes* (1871) LR 6 QB 597.

36 E McKendrick, *Contract Law: Text, cases and materials* 3rd edn (Oxford: OUP 2008), p. 529. See also Peel, *Treitel*, n. 25 above, at p. 310: ". . . mistake negatives consent where it puts the parties at cross purposes so as to prevent them from reaching agreement"; and E A Farnsworth, *Alleviating Mistakes: Reversal and forgiveness of flawed perceptions* (Oxford: OUP 2004), p. 124.

37 Rasmusen and Ayres, "Mutual and unilateral mistake", n. 3 above, at p. 339.

38 Thus, it does not satisfy Pareto efficiency which requires that neither party will be worse off and at least one party will gain. See Ogus, *Costs*, n. 7 above, pp. 26–9.

39 This is Kaldor–Hicks efficiency, see n. 7 above.

lowering the risk of future costly claims by driving the law towards clarity.[40] The truth of this assertion is predicated on the characterisation of information about the law as socially useful per se, unlike information about all other traded goods, for example, whether a painting is a genuine Constable or whether a certain car is an antique. Although ordinary factual information of this nature may in some circumstances benefit parties beyond the transaction at hand, such as all future purchasers or even art enthusiasts, in a welfare-enhancing sense this does not compare to the benefit of legal information that is potentially of use to all members of society through the clarification of legal rights and obligations. Legal precedents may similarly be viewed as public goods, the availability of which improves compliance with the law and thereby reduces the burden on the state, for example, by reducing the need for police, as well as the reliance upon lawyers.

Nonetheless, wide ambit for mistake of law is problematic because it could lead to moral hazard; the taking of unnecessary risks in the knowledge that they can be shifted to others. With mistake of law readily available, future contracting parties will be less likely to inform themselves about prospective changes in the law that may have inconspicuously occurred before the conclusion of a contract because they know that if such a change is later revealed they will be able to backtrack on their obligations. Thus, we will expect that more claims of mistake of law will be made in relation to compromise agreements, which again represents an efficiency loss to the civil justice system by frustrating settlement in favour of costly trials. Still, it should be acknowledged that, unlike settlements, trials lead to the development and reporting of legal precedent and as such they represent a public good. Again this must be contrasted with mistake of fact where there is no such social utility because the facts of a particular dispute are likely only relevant to the parties at hand.

The acknowledged concern for third parties with respect to mistake in contract law is the injustice that may be brought upon good-faith purchasers who discover that a commodity was obtained under a subsequently void contract such that they lose their legal entitlement to goods for which they have paid. This problem should not apply with respect to mistake of law for contracts of compromise, as in *Brennan*, because claims cannot be sold as commodities to third parties by defendants. Still, others, such as shareholders of the public corporations involved in litigation, may act in reliance upon the settlement of a claim only to discover that the settlement agreement has later been voided for mistake of law, perhaps selling or purchasing their holdings under the misapprehension that further costly litigation had been avoided.[41] The effect of litigation events therefore becomes a flawed signal for corporate performance, eroding investors' ability to gauge the value of shares, which should be viewed as an efficiency loss to society.[42] The often-cited disadvantage suffered by third-party, good-faith purchasers should persist for contracts voided for mistake of law other than settlement agreements, such as those involving the exchange of real or moveable property for which legal restrictions are unknown.

With relief for mistake limited to exceptional circumstances, as indicated in *Brennan*, the legal profession may extract rents from clients by increased fees through prolonged litigation instead of settlement. Lawyers will, however, suffer from increased exposure to

40 The relevant legal information may be transmitted when mistake is argued in court, the judgment of which may be reported.

41 The announcement of litigation events has been shown to decrease share value of public corporations: L Weissenberger and L Stigsby, "Does misconduct matter? An investigation into the effect of litigation announcements on America's most successful companies", Stockholm School of Economics (3 February 2006), www.essays.se (last accessed February 2009).

42 Of course, a similar argument could as easily be made regarding the effects of the reversal of a judicial decision on appeal.

professional negligence claims for failing to detect changes in the law which cannot be excused. This will represent a loss to their clients in the form of higher fees to offset the risk. This burden could be exacerbated by the fact that clients may honestly assert after the failure of their mistake of law claim that they would have paid for the extra research required to avoid the mistake if they had been properly informed that it might be needed, where in reality they would still have preferred a quick settlement to avoid the higher fee.[43] More expensive legal fees will naturally cause the price of entering into contractual relations to rise. This represents a barrier to commerce generally and is, thus, against the interests of social welfare. In the case of commercial contracts between affluent parties we should not expect the effect of this increase in legal fees to be commercially prohibitive and the result might even be advantageous in that the risk of missing the narrow exception for mistake of law will encourage neglectful lawyers to practise their trade with greater caution, as long as excessive caution is not taken, which would be a waste of resources.[44] Greater care might further improve the signalling expertise within an already competitive profession – the lawyers who are most fastidious are able to demonstrate this through higher fees, improving choice for consumers.

Principal–agent problems between solicitors and their clients could be exacerbated because without a broad mistake of law rule solicitors could legitimise greater billings for the purpose of legal research by reference to the unforgiving uncertainty of the law. This is especially so if they are paid by the hour and not on a conditional fee basis where the incentive to over-bill is most seductive.[45] Research into the status of the law beyond that which is actually required to meet the clients' needs may represent a further cost to society because it contributes to the rise in the price of legal services, potentially undermining access to justice without a corresponding increase in the value of those services. In this way, mistake of law should be seen as advantageous because it discourages wasteful over-searching for informational advantage.[46] This last point challenges the assumption that all legal information is necessarily beneficial, which, as Trebilcock has noted, may not be the case if the information is already widely known and can be transmitted at low cost.[47]

The *Brennan* court appears to envision that mistake of law will only be permitted in circumstances where society at large may benefit. Sedley notes the important role of public policy in determining when precisely the rule will apply.[48] Maurice Kay similarly urges that exceptions to the rule that mistake of law is available in contract should be rooted in public policy.[49] Accordingly, we should be mindful that Brennan's legally aided claimant solicitor commented that his decision to abandon the second dubious claim against Islington in exchange for the defendant's willingness to forego its right to costs against the claimant was based upon his duty to the Legal Services Commission (LSC) to minimise unnecessary costs.[50] The degree to which litigation has received public financial support may inform the issue of public policy, in particular in relation to the value of the legal information which would have resolved the mistake. If the additional billed work that was necessary to clarify an ambiguity in the law represented a significant resource drain on public funds that was disproportionate to the benefit anticipated, courts may wish to countenance the omission

43 This phenomenon is known as "hindsight bias".

44 Smith and Smith, "Contract law", n. 3 above, at p. 468.

45 Larger uplifts could also be charged on a conditional fee to reflect uncertainty and/or risk.

46 Smith and Smith, "Contract law", n. 3 above, at p. 468.

47 Trebilcock, *Limits*, n. 5 above, at p. 112.

48 Para. 63.

49 Para. 23.

50 Para. 4.

of such services by permitting the voiding of a contract entered into on the basis of inadequate knowledge. This is because the LSC will have already made its own assessment with respect to the potential public interest involved in a claim, often choosing to fund cases that may develop a novel point of law or raise an issue that affects the rights of society at large.[51] This cost–benefit analysis should not be supplanted by a judicial determination in order to extend the use of public money for the purposes of generating information about the law. On the other hand, a clear public interest element should justify greater expenditure on research.

The obligation of greater research into the law necessitates a consideration of the role of law reporters as instruments of achieving the socially desirable goal of "equality of arms" in legal representation by permitting courts to lower the cost of controlling the risk of mistake. The imperfect availability of information regarding the law exacerbates resource asymmetry between contracting parties because some parties can afford to acquire this knowledge while others cannot, especially given the considerable expense of the more comprehensive private legal research databases such as Westlaw and Lexis-Nexis. With mistake of law operating only in exceptional circumstances such that few mistakes of law will be forgiven, it may be necessary for Parliament to consider improving the availability of legal information through the expansion of coverage of free online databases of caselaw, such as Her Majesty's Court Services, the subsidisation of non-profit organisations, such as the British and Irish Legal Information Institute,[52] or the provision of private legal databases in public libraries. With legal information more readily available, we would expect mistakes of law to be less common.

The inference of causation between the lack of information-seeking activities and the resulting mistake may be fallacious because some of the legal information upon which contractual rights hinge is inherently unknowable, irrespective of resources. This is due to the nature of the legal profession as well as the uncertainty of the common law system. While counsel often rely on unreported decisions, it is not always possible to access all decisions in order to dispel mistaken assumptions about the law, especially given the volume of decisions and the time delay before some form of transcript is available.[53] Further, it is important to recognise that in *Brennan*, as Wu rightly observes, the understanding of the law upon which the consent order was based could be proved by reference to non-privileged sources: the recorder striking out the claim against several co-defendants in the same action; the recorder basing her decision on another judgment that was later overturned; and the fact that the settlement was premised on the recorder's judgment.[54] Were this information subject to strict professional privilege, a claim of mistake of law could not be substantiated, resulting in significant inequalities in terms of access to evidence between a claimant and defendant, as is often the case in a restitutionary claim for mistake of law.[55] Of course, such privately held information might not properly be termed "legal" information, in the sense of it contributing to knowledge of the law itself as a precedent or statute would; further indication of the often blurred distinction between mistakes of law and those of fact.[56] Balancing the mistake of law rule with professional privilege requires weighing the costs to

51 See the Legal Services Commission Funding Code, www.legalservices.gov.uk (last accessed January 2009).

52 See http://www.bailii.org (last accessed January 2009).

53 The reversed precedent upon which the Brennan decision turned was itself unreported.

54 T H Wu, "Legal professional privilege and restitution for mistake of law" (2004) 24 *CJQ* 246 at 254.

55 Ibid., at p. 257.

56 The distinction between mistake of law has been criticised heavily by commentators such as Peel, *Treitel*, n. 25 above, at p. 327, and often distorted, in e.g. *Solle* v *Butcher* [1950] 1 KB 671 where mistaken assumption about the applicability of the Rent Act was described as one of fact and law.

society resulting from revealing otherwise unknowable information through the suspension of professional privilege against the transaction cost reduction of providing contracting parties with more complete information. Legal professional privilege should not be restricted unduly because of the important role confidences between solicitors and their clients play in the encouragement of settlement of civil claims by encouraging clients to consult legal experts without fear, as well as permitting litigants to conceal weaknesses in their respective cases.[57]

6 Defining the optimal scope of the mistake of law rule

The ambiguity of the *Brennan* judgment with respect to the delineation of the full extent of mistake of law has been observed by some commentators[58] and can be equated with the flexibility of a standard rather than the certainty of a rule.[59] While a standard allows some room for judicial discretion relating to issues such as public policy – which may reflect the fact that parties that have acted in good faith – it runs the risk of stirring future costly litigation because of the failure to articulate a more comprehensible and predictable outcome for all cases. Trebilcock in particular has warned that changing mistake rules to accommodate different circumstances is "hopelessly indeterminate operationally and likely to significantly exacerbate uncertainty, error and adjudication costs in contracting generally".[60] Thus, in light of some of the economic considerations canvassed above, a somewhat more focused rule will now be suggested. This is a modification of the rule first suggested by Rasmusen and Ayres that accommodates greater transaction costs in the dispelling of ignorance of the law because of the inherent value in all forms of legal knowledge, as distinct from certain types of factual information.

Relief based on mistake of law in contract should be tailored to the cost of the cheaper of either obtaining the necessary information or allocating the risk of mistake, relative to the loss engendered by the overall mistaken transaction, which in the case of compromise agreements will be the difference between the quantum of settlement and what would have likely been awarded at trial, taking into consideration what the trial itself would have cost. The last two variables will typically have a high degree of uncertainty but should not be beyond meaningful contemplation in what is meant to be an exercise of general balancing rather than mathematical computation. Limiting the availability of mistake to errors resulting from information that would have been *excessively* costly to correct under this analysis (through either information acquisition or risk allocation) is, perhaps unsurprisingly, the most efficient means of circumscribing the applicability of mistake of law in contractual relations. If the cost of offsetting the risk of mistake of law through contract were to affect the price of the traded good such that a transaction would not be completed (for example, if the settlement of a claim became prohibitively expensive because of the additional layer of stipulated risk, the settlement could be withdrawn given the discovery of a mistake) then a court should not expect a contracting party to include such a provision in a contract and mistake of law should accordingly operate in default. As an alternative to unreasonable pricing for risk avoidance through contract, the court should consider the cost of dispelling ignorance of the law. If the informational cost of obtaining the necessary information

57 This logic flows from the theory that the exchange of relatively positive information about one's case with one's opponent tends to cause the opponent to feel negatively about his or her own position which in turn promotes settlement: Cooter and Ulen, *Law and Economics*, n. 3 above, pp. 406–10.

58 Peel urges that tests need to be adapted for the mistake of law rule for contracts other than settlement agreements; *Treitel*, n. 25 above, at p. 326.

59 I Ehrlich and R Posner, "An economic analysis of legal rulemaking" (1974) 3 *J of Legal Studies* 257.

60 Trebilcock, *Limits*, n. 5 above, at p. 146.

about a pertinent legal principle – for example, by paying a solicitor to engage in more comprehensive legal research – is so high that it would place an undue burden upon the party in question, assessed by reference to the profit expected from the transaction to that party (i.e. the quantum of a settlement), then the ensuing mistake should be forgiven. This is because the obtaining of the information itself would be inefficient, that is, the contract would result in a waste of resources because the process of contracting would exceed the wealth increase to the party and would therefore represent a sub-optimal outcome.[61] Evidence relating to legal search fees and billings would be needed to make this determination, as would the size of the settlement and the likelihood of victory at trial – all of which are capable of at least rudimentary consideration by courts.

When assessing the cost of negating mistake through additional research, courts must further consider the *inherent social value in the transmission of legal knowledge* which is achieved by bringing claims to a trial which is ultimately reported, notwithstanding the fact that this knowledge may have represented an excessive transaction cost to the parties at hand and may have undermined a cheaper settlement conducted in ignorance. In keeping with the principle of *Great Peace* that only the most egregious of errors will be sufficient for a finding of common mistake, only those mistake-induced settlement agreements which are severely disproportional to that which would likely have been awarded at trial should be eligible to be voided, and then only if the cost of avoiding mistake is also high relative to the public interest in disseminating knowledge of the law. This should ensure that the law is diligently but reasonably investigated by solicitors and settlement agreements are not prohibitively uncertain. Such methodology broadly echoes conclusions observed by Farnsworth who pointed out that a rule of strict liability for mistakes of law is inferior to one based on a negligence standard because the value of learning the law is higher when the law excuses reasonable mistakes, since a person who takes such steps is protected against punishment even if one is mistaken in what one learns.[62]

7 Conclusions

A contracting party wishing to avoid liability for a mistake of law has three options:

- include a contractual provision which expressly allows relief from contractual obligations due to mistakes of law (which may either prevent the contract from being commercially feasible or negate the purpose of settlement);
- obtain the necessary legal information to achieve a reasonable degree of certainty about the status of the law in question;
- or do nothing and sue one's solicitor in negligence for failing to do either of the first two options (which would likely only be an available course of action were advice on these matters not provided from the outset).

When keeping these alternative courses of action in mind, courts should not expect contracting parties to suffer disproportionately high transaction costs because of the complexity of the legal system or the expense of obtaining information on the status of the law. Unlike the simple test from *Great Peace*, which established that the common mistake of fact will depend upon the severity of the error by reference to the contractual undertaking, mistake of law should be contingent upon the magnitude of the investigation or contractual risk avoidance that would have been required to avoid the misunderstanding in relation to the contract's resulting value, much as Rasmusen and Ayres originally theorised. Unlike for

61 In the Pareto sense, n. 38 above.

62 Farnsworth, *Alleviating Mistakes*, n. 36 above, at p. 140.

mistakes of fact, this rule is subject to the crucial modification that even some inefficient contracts do generate social welfare because of the intrinsic value of legal information to a society. This rule is in keeping with economic reasoning in that it upholds contracts that are social welfare maximising and excuses those which are not.

While the developments in the law are perhaps now more complicated than ever, given the interplay of precedent in a myriad of courts and legislative instruments in the UK and EU, it has also become increasingly easy (although perhaps no less expensive) to stay informed of these changes through advances in information technology relating to the law. At the same time the need to uphold settlement agreements as a means of avoiding costly litigation remains a primary objective of the civil justice system. The *Brennan* court's decision to limit the availability of the mistake of law defence only to what might be viewed as the most economically justifiable errors is consequently welcome.

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Inquiring for truth and the re-engineering of the corporate contract

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Abstract

The British Prime Minister, Gordon Brown, has called for a global re-negotiation of a social contract between investment banking and wider society. Given the scale of the losses now borne by the taxpayer as a consequence of the global financial crisis in jurisdictions as diverse as Iceland, the United Kingdom, Ireland and the United States, the proposal has undoubted rhetorical strength. It is also exceptionally difficult to render operational, not least because of (purposive) ambiguity over what constitutes and who should decide terms of reference. Moreover, piecemeal change may not only not secure legitimacy but may also have enormous if unintended consequences for the conceptual underpinning of corporate and securities law and the resulting regulatory framework. At a national level, one mechanism proposed to address this issue is through the establishment of a "truth commission" an option chosen by Iceland. A second option is to convene an independent commission, a mechanism used throughout the Commonwealth, or an independent tribunal of inquiry, as used with increased frequency in the Republic of Ireland throughout the 1990s but rejected in relation to the global financial crisis. A third option is to convene a bi-partisan political commission, as deployed in the United States. Each option is exceptionally problematic within the domestic context, not least because of contention over remit and degree to which the findings translate into policy changes. The difficulties are compounded when applied to multi-faceted multi-jurisdictional problems such as the global financial crisis. This article examines whether – and if so how – independent commissions can provide a mechanism to re-negotiate a social and corporate contract capable of external validation and replication, critical factors for the maintenance of legitimacy, or whether official discourse simply reinforces the politics of illusion, privileging symbolic posturing over substantive change.

1 Introduction

In 1990, Michael Hammer contributed a seminal article to the *Harvard Business Review*.[1] In the face of profound changes to an operating or regulatory environment, Hammer argued that a reliance on piecemeal reform, such as merely speeding up reporting mechanisms through the more efficient deployment of information technology, pre-ordained failure. The management consultant advocated instead a re-engineering of business practice, best achieved through the obliteration of outdated rules, assumptions and processes. For Hammer, this required nothing less than a re-conceptualisation of business purpose. The approach rehearsed, without the social conscience, the "creative destruction"

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1 M Hammer, "Re-engineering work: don't automate, obliterate" (1990) 7 *Harvard Business Review* 104.

metaphor deployed almost 50 years previously by Joseph Schumpeter.[2] It was a message that simultaneously informed and legitimised the transformation from managerial to financial capitalism. A progressive hollowing out of regulatory and legal frameworks throughout the 1990s, particularly in London and New York, the demise of relational banking and the creation of a shadow banking system combined to displace rather than eliminate risk and responsibility. Fears that the increasing sophistication of financial markets inevitably would be accompanied by enhanced volatility and chronic instability were ignored.[3] The unintended implications of privileging innovation over security across the financial sector are becoming increasingly apparent for the corporation, the market in which it is nested and the underpinning legal and regulatory frameworks.[4] As a consequence, we have reached a tipping point in the theory and practice of financial regulation.[5]

At a technical level, work towards building a coordinated global framework has already taken place, particularly through the auspices of the G20. Implementation remains some way off, however, a point underscored by the Secretary General of the International Monetary Fund, Dominique Strauss-Kahn, at the World Economic Forum meeting in Davos.[6] At a regional level, progress has been equally glacial. The European Union has introduced a European Systemic Risk Board to be based at the European Central Bank in Frankfurt, with the latter providing secretariat facilities. The aim is to provide an early warning system, capable of heading off problems before they occur, the first step towards adopting a more pre-emptive approach to banking regulation. Dominated by representatives of central banks and regulatory agencies, there is a serious question over lack of industry and professional representation. As such a critical information-gathering mechanism is lost. Unresolved too are significant structural questions. In particular, there is a failure to define what constitutes systemic risk, the responsibilities of specific epistemic communities in ameliorating those undefined risks, and what conceptual re-engineering is required to take cognisance of the limitations of the efficient market hypothesis. The answers to these questions will determine the size and scope of financial markets at national, regional and global levels.

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2 J Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper & Row 1942).

3 H Minsky, *Stabilizing an Unstable Economy* (New York: McGraw Hill Professional 2002), p. 315.

4 Evidence to House Committee on Financial Services, "Regulatory restructuring and the reform of the financial system", Washington DC, 21 October 2008 (J Stiglitz); see also R Bootle, *The Trouble with Markets* (London and Boston: Nicholas Brealey 2009), p. 239; E Connors, "Future fund chief sees day of reckoning for banks", *Australian Financial Review*, 14 January 2009, pp. 1 and 38, quoting David Murray, head of the Australian Future Fund: "Everybody got carried away by the concept of a 'millionaires factory' which was not culturally good. Where you don't want your brightest, or at least too many of them, is in jobs which spend time interpreting or arbitraging rules. This is not really effective work and a lot of investment banking is that type of deal structuring, which is not very constructive. It produces over-engineered stuff that is the first to break when anything goes wrong." (at p. 38) For discussion of admission of regulatory fealty to "ideological construct", see Evidence to House Committee on Oversight and Government Reform, Washington DC, 23 October 2008 (A Greenspan).

5 See J O'Brien, "The future of financial regulation: enhancing integrity through design" (2010) *Sydney Law Review*, forthcoming.

6 BBC News, 30 January 2010 http://news.bbc.co.uk/1/hi/business/8488927.stm (last accessed 30 January 2010). In an interview with the BBC's economic editor, Stephanie Flanders, Strauss-Kahn suggested there was a serious risk of a race to the bottom in global finance as countries adopted piecemeal changes. In a second interview, the chief economics advisor to President Obama, Larry Summers, argued that the introduction of differing institutional and regulatory rules was not necessarily inconsistent with global rules on capital adequacy or limits on leverage capacity; see S Flanders, "Summers speaks", BBC News Website, 30 January 2010, www.bbc.co.uk/blogs/thereporters/stephanieflanders/2010/01/summers_speaks.html (last accessed 30 January 2010).

The roadblocks to substantive reform can, in turn, be traced to three interlinked factors. First, there is a lack of clarity over what precise combination of incremental factors caused the crisis. This makes it difficult to apportion blame and responsibility and design more effective restraining interlocks. Second, given that the crisis was, in the main, a technically legal failure in which the spirit of regulatory rules or principles was transacted around and responsibility for the impact of ethical degradation of professional norms on market integrity compartmentalised, a failure to address this dimension in policy terms preordains failure. Third, and most problematically, restricting the size of the financial sector presents significant and potentially destabilising challenges to the legitimacy and authority of financial capitalism as a distinct engine of growth.[7] Thus, despite having a seat at the table in the debate over global reform of capital markets, there is a dispiriting lack of detail emanating from Beijing, New Delhi and Brasilia over what precise recalibration is required to enhance the ethical dimension of financial capitalism. This means that the quest for change must begin – but not end – with introspection from those countries most affected.

This article examines the limitations of privileging technical solutions and placing responsibility for early warning systems in the hands of those institutions that remain wedded to outmoded conceptual frameworks which demonstrably were unfit for purpose. Second, it evaluates the possibilities of using independent commissions to provide a more granular investigation of the causes of the crisis, a necessary prerequisite for the introduction of sectoral, professional and epistemic reform. Third, it examines the risk that sub-optimally designed inquiries can exacerbate rather than ameliorate the interlocking political, regulatory and corporate crisis, with particular reference to plans for a banking inquiry in the Republic of Ireland. In the concluding section, it evaluates whether independent commissions can provide a mechanism to re-negotiate the corporate contract in a manner that is capable of external validation and replication – critical factors for the maintenance of legitimacy – or merely privilege the politics of illusion.

2 Deflecting blame: the traditional response

The global financial crisis first displayed its symptoms in the residential securitisation finance market in the United States but metastasised ferociously, particularly across the North Atlantic.[8] To be sure, the major identified causes of the meltdown were far from unique.[9] Excessive reliance on short-term calculations, for example – made manifest by flawed remuneration policies – have long exercised the academic and policy communities,

7 G Tett, "Asian banks told to seize 'once in a lifetime' chance", *Financial Times*, 30 January 2010, p. 14, quoting Tony Tan, head of the Government Investment Corporation of Singapore, the city state's largest sovereign wealth fund, questioning the efficacy of a "system of free markets and minimal regulation and large dependence on financial institutions".

8 The most complete, if US-centric and partially referenced, accounts are to be found in W Cohan, *House of Cards* (New York: Doubleday 2009); A Ross Sorkin, *Too Big to Fail* (New York: Viking 2009); G Tett, *Fool's Gold* (London: Free Press 2009): for application to economic theory, see J Cassidy, *When Markets Fail* (London: Penguin 2009); Gerald Davis, *Managed by the Markets* (Oxford: OUP 2009).

9 See C Reinhart and K Rogoff, *This Time is Different: Eight centuries of financial folly* (Princeton NJ: Princeton UP 2009), pp. 203–22, arguing that macro-economic "indicators showed the United States at high risk of a deep financial crisis in the run-up to 2007 but many of the [specific] problems were hidden in the 'plumbing' of the financial markets"(pp. 220–1); see also C Kindleberger, *Manias, Panics and Crashes: A history of financial crises* (New York: Basic Books 1989).

particularly in the United States.[10] Likewise, the dangers of chrematistic trading have long been recognised, if ignored by policy communities.[11] Less well explored are the cultural and ideational factors that coalesced to form what was presented as the economically rational but were, in fact, essentially ideological constructs. The extent of the global financial crisis has occasioned political rhetoric that holds out the tantalising promise of the most far-reaching review of corporate governance, corporate law and financial regulation in a generation.[12] The real danger, however, is that a reliance on technical considerations as cause or solution for the crisis alone preordains failure, a point highlighted by the French president at the opening session of the World Economic Forum in Davos.[13]

Unfortunately, there is little evidence that legislators have addressed in a meaningful sense these broader cultural factors, preferring instead to focus on rising capital adequacy and quality standards and emphasising structural issues, such as reducing leverage ratios or proposing as yet inchoate plans to restrict proprietary trading, as in the proposal by the Obama administration now under consideration by Congress. This attempt to force a return to utility banking and prevent banking entities from holding stakes in alternative asset classes, such as hedge funds and private equity, derives from past failure to take into consideration the consequences of allowing unregulated expansion of the financial sector or the dynamics of capital market regulation, in particular, the role played by ideational factors in privileging emasculated conceptions of regulatory and corporate responsibility.

Demonising banking executives may serve short-term political purposes but it fails to take into account political culpability. In the United Kingdom, for example, traditional forms of inquiry have been privileged, with predictable results. As with congressional hearings in Washington, in testimony provided to the Treasury Select Committee in Westminster, for example, banking executives claimed that the crisis was the result of a

10 See L Bebchuk and J Fried, *Pay without Performance* (Cambridge and London: Harvard UP 2004); L Bebchuk, J Fried and D I Walker, "Managerial power and rent extraction in the design of executive compensation" (2002) 69 *University of Chicago Law Review* 751; for application to the fall of Lehman Brothers and collapse of Bear Stearns, see L Bebchuk, A Cohen and H Spamann, "The wages of failure: executive compensation at Bear Stearns and Lehman 2000–2008", Harvard Law and Economics Discussion Paper, 24 November 2009, http://ssrn.com/abstract=1513522 (last accessed 24 January 2010).

11 See K Greenfield, *The Failure of Corporate Law* (Chicago: Chicago UP 2006).

12 See G Brown, "The global economy", speech delivered at Reuters Building, London, 13 October 2008. Gordon Brown subsequently went further, calling for international coordination and arguing that the G20 needed to "discuss whether we need a better economic and social contract to reflect the global responsibilities of financial institutions to society", press conference, G2O Finance Minister Meeting, St Andrews, Scotland, 7 November 2009; for United States, see B Obama, "Remarks on financial regulatory reform", press conference, White House, Washington DC, 17 June 2009.

13 Sarkozy described the global financial crisis as a "crisis of globalisation" and noted "the crisis we are experiencing is not a crisis of capitalism. It is a crisis of the denaturing of capitalism – a crisis linked to loss of the values and references that have always been the foundation of capitalism. Capitalism has always been inseparable from a system of values, a conception of civilisation, an idea of mankind. Purely financial capitalism is a distortion, and we have seen the risks it involves for the world economy. But anti-capitalism is a dead end that is even worse. We can only save capitalism by rebuilding it, by restoring its moral dimension. I know that this expression will call forth many questions. What do we need, in the end, if it is not rules, principles, a governance that reflects shared values, a common morality?" See N Sarkozy, speech delivered at the World Economic Forum, Davos, 27 January 2010.

"perfect storm" or "financial tsunami"; the conflation of factors beyond control.[14] The hearings and actual and proposed changes to legal and tax frameworks create a conspicuous spectacle that only partially and temporarily satisfied national unease at a crisis of confidence in public and corporate governance, which failed to prevent the meltdown and has occasioned the most significant investment by either the US or UK governments in financial services ever seen.[15]

The hearings and legal changes in both the United States and the United Kingdom served six core symbolic functions.[16] In both jurisdictions they were designed to enhance the popularity of the officeholder (or, more accurately, arrest a precipitous decline); provide reassurance that significant action was being taken; simplify a complex problem; assert a normative improvement in governance with applicability; provide an identifiable class of perpetrator, in this case investment banking and the credit-rating agencies; and posit an educative function by suggesting tangible ways in which to inculcate an ethical basis within corporate practice. An exercise in symbolism also requires an effective diffusion mechanism. Crucially, the underlying message must not be diluted by the capacity of elite groups to distort or taint the underlying message.[17] These conditions held firm initially. The scale of intervention fundamentally displaced the power of vested-interest groups. The alacrity with which loans have been paid back, particularly in the United States, however, has reduced the direct influence over internal governance arrangements, particularly executive remuneration, within what are recognised as systemically important industries.

Notwithstanding the calls for an international coordinated response to deal with the moral hazard associated with rescuing institutions deemed to be too big to fail, or increasing rhetoric over the need for these same institutions to devise living wills, actual substantive change has been illusive within both domestic and international domains. Moreover, senior banking figures, such as Goldman Sachs' chief executive, Lloyd Blankfein, have made it

14 Evidence to House Committee on Oversight and Government Reform, "Hearing on the causes and effects of the Lehman Brothers bankruptcy", Washington DC, 6 October 2008 (R Fuld). This choice of metaphor was also deployed by Alan Greenspan to deflect responsibility; see Evidence to House Committee on Oversight and Government Reform, "Hearing on the role of federal regulators in the financial crisis", Washington DC, 23 October 2008 (A Greenspan). Many of the British bankers involved in the crisis, past and present, appeared before the Treasury Select Committee. The former chief executive officer of HBOS, Andy Hornby, accepted that the bonus culture played a part in exacerbating systemic risk; see Evidence to Hearing on Banking Crisis, Treasury Select Committee, Westminster, 10 February 2009 (A Hornby). For specific compliance failure within HBOS, see explosive memo from its former head of compliance, Paul Moore, "Memo to Treasury Select Committee", Westminster, 10 February 2009: "My personal experience of being on the inside as a risk and compliance manager has shown me that, whatever the very specific, final and direct causes of the financial crisis, I strongly believe that the real underlying cause of all the problems was simply this – a total failure of all key aspects of governance. In my view and from my personal experience at HBOS, all the other specific failures stem from this one primary cause."

15 For the United States, see Troubled Asset Relief Program administered through the Economic Stabilisation Act 2008 and American Recovery and Reinvestment Act 2009; for the United Kingdom changes in banking regulation through the Banking Act 2009 and the use of fiscal policy to impose a 50 per cent tax on banking bonuses. Both serve deeply symbolic purposes, see M Edelman, "Symbols and political quiescence" (1960) 54 *American Political Science Review* 695: "It is only as symbols that these statutes have utility to most of the voters. If they function as reassurances that threats in the economic environment are under control, their indirect effect is to permit greater exploitation of tangible resources by the organized groups concerned than would be possible if the legal symbols were absent." (at p. 702); see, more generally, M Edelman, *The Symbolic Uses of Politics* (Urbana and Chicago: University of Illinois Press/Illini Books 1964); M Edelman, *Constructing the Political Spectacle* (Chicago: Chicago UP 1988).

16 See B Stolz, "The Foreign Intelligence Surveillance Act of 1978: the role of symbolic politics" (2002) 24 *Law and Policy* 269, at 271–2.

17 See J Hart, "President Clinton and the politics of symbolism: cutting the White House staff' (1995) 10 *Political Science Quarterly* 385, at 397.

clear that the febrile nature of capital markets necessitates at least the possibility of further intervention, dispelling in the process arguments that the moral hazard question has been dispensed with.[18] As such, pronouncements of control have a particularly hollow ring.

Plans by the Obama administration to reduce the capacity of banks engaging in risky behaviour through proprietary trading are a case in point. While laudable, they face a less than assured outcome. The negotiations coincide with pivotal mid-term elections and, as noted above, reflect past policy failure rather than evidence of resolve.[19] It is less than clear that the floor of the Senate or the even more rancorous House of Representatives can provide a venue for considered debate on the regulation of Wall Street,[20] not least because of the Supreme Court's decision to lift prohibitions on corporate funding of political campaigns.[21] Moreover, even if, in the unlikely event that piecemeal change within one component of the regulatory matrix, such as banking corporations, is passed, enormous if unintended consequences for the conceptual underpinning of corporate law and the resulting legal and regulatory frameworks could occur.[22]

Given the scale of the liability borne by the taxpayer as a consequence of individual, corporate and regulatory misjudgments, myopic faith in ideational constructs and the failure to resolve an existential conflict between the demands of public and private law,[23] there is undoubted rhetorical strength in calls for a re-negotiated corporate contract.[24] They are also exceptionally difficult to render operational, not least because of (purposive) ambiguity over what constitutes appropriate terms of reference. If we are, as Sarkozy and Brown have suggested, to re-engineer the corporate contract, it is essential that we understand the forces

18 Evidence to Financial Crisis Inquiry Commission, Washington DC, 14 January 2009 (L Blankfein).

19 The risks associated with proprietary trading have long been recognised, see S Strange, *Mad Money* (Manchester: Manchester UP 1998).

20 S Chan, "Dodd calls Obama's reform plan too ambitious", *New York Times*, 3 February 2010, B1, quoting the Senate Banking Committee chair, Senator Chris Dodd saying that proposals to establish a "resolution agency" to break up systemically dangerous institutions and limiting proprietary trading as "getting precariously close" to excessive ambition.

21 D McKittrick, "Lobbyists get potent weapon in campaign ruling", *New York Times*, 22 January 2010, p. 1, reporting the Supreme Courts in *Citizens United* v *Federal Election Commission* (No. 8-205) to lift bans on corporate treasuries funding political campaigns on the grounds that it violated the First Amendment and quoting President Obama that the ruling provide a "green light to a new stampede of special interest money in our politics"); see also, however, K Strassel, "Bonfire of the populists", *Wall Street Journal*, 29 January 2010, A13, noting the ease with which the Obama administration has turned to baiting Wall Street, thus following a standard pattern. For discussion of the uneasy relationship between Wall Street and Washington, see T McCraw, *Prophets of Regulation* (Cambridge: Harvard UP 1984); S Fraser, *Wall Street: A cultural history* (London: Faber & Faber 2005); K Phillips, *Wealth and Democracy: A political history of the American rich* (New York: Broadway Books 2002), pp. 347–71. For discussion of influence of money in American politics, see E Drew, *The Corruption of American Politics* (New York: Overlook Press 2000); see also F McChesney, *Money for Nothing: Politicians, rent extraction and political extortion* (Cambridge: Harvard UP 1997).

22 See P Alessandri and A Haldane, "Banking on the state", presentation at Federal Reserve Bank of Chicago International Banking Conference, Chicago, 25 September, 2009, see www.bis.org/review/r091111e.pdf (last accessed 4 February 2010) suggesting "distortions [caused by] limited liability" could be resolved by a "re-thinking of capital structure" that involves the introduction of "contingent liability" (p. 8).

23 D Millon, "Theories of the corporation" (1990) *Duke Law Journal* 201, at 201–02; see also C Stone, "Corporate vices and corporate virtues: do public/private distinctions matter" (1981) 130 *University of Pennsylvania Law Review* 1441, at 1442; for explication of the normative case for breaking down the artificial boundaries, see H Collins, *Regulating Contracts* (Oxford: OUP 1999), p. 59, noting the need for the "productive disintegration of private law".

24 See Sarkozy, Davos speech, n. 13 above. Of critical importance in this reframing is France's impending chairship of the G20, see G Tett, "Do not dismiss Sarkozy's back to the future currency plan", *Financial Times*, 29 January 2010, p. 34, in which the respected capital markets editor notes the speech "reveals more about France's determination to shape the global intellectual debate – at a time when America is looking increasingly confused – than any clear policy initiative".

that "denatured" financial capitalism. There is recognition (but not necessarily optimism) in the United States at least that a more studied approach to the problem is required.[25] The search for root causes is also a policy priority in parts of Europe, although it remains very much open to question whether, with the exception of Iceland, where a truth commission has been established, the current trajectory of official discourse can provide either answers or the intellectual underpinning for a new system of financial regulation at national or international level.

3 The role of commissions of inquiry

"We shall not grow wiser," quipped Fredrich Hayek in his influential defence of free markets "before we learn that much that we have done was very foolish."[26] Belief in the power of official discourse to provide a compelling independent account of the causes and consequences of a specific failure has been one of the main but not sole justifications for independent review.[27] Other factors include the need to be seen to deal decisively with a matter of pressing public concern, thus defusing short-term political pressures, legitimising governmental responses or providing a route-map for policy change.[28] Official discourse may also serve to legitimate existing public policy. As Burton and Carlin have claimed, it can function as a mechanism "to present failure as temporary, or not failure at all and to re-establish the image of administrative and legal coherence and rationality".[29] There is considerable evidence, for example, that commissions of inquiry served this function throughout the Northern Ireland conflict and its aftermath.[30] There is no guarantee that this will occur, especially in cases where technological advances and sophisticated uses of that technology allow for cross-referencing of disclosed source material and the creation of alternative narratives.[31] Indeed, following the Hutton Inquiry into the death of a weapons inspector, the cogency of alternative critiques was a critical factor in the decision to cede the Butler Inquiry into the legality of the decision to go to war and the quality of governance arrangements. Its decision to hold proceedings in camera, in turn, created the impetus for the convening of the Chilcott Inquiry, which culminated in a public cross-examination of the former prime minister, Tony Blair, on 29 January 2010. As was to be expected, Blair did not use the appearance to express regret, much to the chagrin of relatives of those killed in Iraq, watching from the public gallery. Nevertheless, the public nature of the hearing did perform a cathartic function. This cathartic capacity extends to

25 "Editorial: the show must not go on", *New York Times*, 17 January 2010, WK7.

26 F Hayek, *The Road to Serfdom* (Chicago and London: Chicago UP 1943), p. 177.

27 For a useful review, focusing primarily on the Commonwealth, see G Gilligan and J Pratt (eds), *Crime Truth and Justice: Official inquiry, discourse, knowledge* (Uffculme: Willan Publishing 2004).

28 See S Prasser, "Royal commissions and public inquiries: their uses and scope", in P Weller (ed.), *Royal Commissions and the Making of Public Policy* (South Melbourne: Macmillan Publishing 1994), pp. 1–21, 6–8.

29 F Burton and P Carlen, *Official Discourse: On discourse analysis, government publications, ideology and the state* (London: Routledge & Kegan Paul 1979).

30 J O'Brien, *Killing Finucane* (Dublin: Gill & Macmillan 2005), pp. 127–49.

31 A talismanic example is the Hutton Inquiry in the United Kingdom, set up to investigate the causes of the death of a British weapons inspector who committed suicide after he was disclosed as the primary source for a BBC report that accused the government of "sexing up" intelligence in the lead-up to the invasion of Iraq. The Hutton website allowed for cross-referencing of source material to an extent not seen before. See www.the-hutton-inquiry.org.uk (accessed 29 January 2010). By contrast, the Iraq Inquiry, chaired by Sir John Chilcott into the reasons for invading Iraq has a much less sophisticated website, which suggests that placing documents into the public domain is less of a priority: see www.iraqinquiry.org.uk (accessed 29 January 2010). The point here is not that the Chilcott Inquiry is less than robust or is designed blindly to advance government policy. Rather, it is to suggest that commissions with judicial authority have exceptional power to place information into the public domain and allow for electronic cross-referencing, but that that power is infrequently used.

the United States, which has privileged the use of independent commissions to deal with matters of acute public concern, such as Watergate and the 9/11 attacks on Washington and New York. As with the Royal Commission of Inquiry model in the United Kingdom, convening an inquiry provides reassurance that lessons will be drawn and acted upon (although there is no guarantee that the reform agenda will be enacted, in particular, if the investigative body lacks either subpoena power or the willingness to deploy it).[32] The decision by the United States to convene a Financial Crisis Inquiry Commission, under the auspices of the Senate, provides evidence of both dynamics.

In interpreting its terms of reference, the chair of the Financial Crisis Inquiry Commission, Phil Angelides, asserts that the commission has a mandate to provide:

> [a] full and fair investigation in the interests of the nation – pursuing the truth, uncovering the facts and providing an unbiased, historical accounting of what brought our financial system and our economy to its knees. This is what the American people deserve and this is what we are obliged to do. In this critical instance, if we do not learn from history, we are unlikely to fully recover from it.[33]

Although the commission has the capacity to subpoena documents, there is no evidence to date that it has done so. Initial public hearings with the nation's top bankers did not elicit granular information about strategic motivations and internal processes.[34] This failing was most apparent in the superficial questioning associated with the credit default swap market. In evidence to the commission, the chief executive of Goldman Sachs, Lloyd Blankfein, rejected charges that the bank was profiteering from betting against the very securities it was marketing. According to Phil Angelides, the practice "sounds to me a little like selling a car with faulty brakes and then buying an insurance policy on the drivers of those cars".[35] Blankfein claimed Goldman Sachs was compliant with disclosure obligations and was merely fulfilling market desires.[36] The exchange generated more heat than light. The critical issue was why did Goldman Sachs and other banks feel it both morally acceptable to engage in such trading activities and to design their compliance and codes of conduct accordingly?

The Financial Crisis Inquiry Commission is not scheduled to publish its final report until December 2010 so there is still time to influence the trajectory of regulatory reform. Indeed, a useful precedent can be found in the Pecora Hearings established in the aftermath of the Wall Street Crash. Pecora's critique of banking practice provided a narrative to justify the creation of the New Deal regulatory architecture.[37] There is to date, however, no sign

32 This is precisely the reason media outlets opined that it was essential for any inquiry into the financial crisis to have congressional authority, including subpoena power, with the Pecora and Watergate Hearings held up as talismanic of best practice; see "Editorial: questions for reform", *New York Times*, 29 March 2009, WK8.

33 "Opening remarks", Financial Crisis Inquiry Commission, Washington DC, 17 September 2009 (P Angelides).

34 See "Editorial", n 25 above, noting that "the primary aim is not to air issues and foster debate, but to test views, resolve contradictions and arrive at evidence-based conclusions . . . Serious investigative work is the only way to counter the banks' political power and alter a reform effort that is headed in the wrong direction."

35 Financial Crisis Inquiry Commission, Washington DC, 14 January 2010 (P Angelides).

36 Evidence to Financial Crisis Inquiry Commission, Washington DC, 14 January 2009 (L Blankfein).

37 That architecture included the Securities Act 1933 through which an independent accountant had to certify the authenticity of accounts offers by new entrants to the securities market. This was extended to cover all those trading by the Securities and Exchange Act 1934, which also transferred, in theory, the oversight function to the newly established Securities and Exchange Commission. Thirdly, Congress divined that a major contributing factor to the speculative behaviour and resulting scandal was the role played by the banking sector. Rather than accept assurances that conflicts of interest could be contained, or managed, the Glass–Steagall Act of 1933 ordered the separation of commercial and investment banking. These reforms were progressively hollowed out and in the case of Glass–Steagall repealed through the provisions of the Financial Modernization Act (1999). For background on Pecora Hearings, see C Geisst, *Wall Street* (Oxford and New York: OUP 1999), pp. 196–244.

in the United States of a reform agenda of similar vision. This can be traced to the multiplicity of domestic and foreign policy problems facing the Obama administration, the complexity of the task but also, crucially, a failure to address the critical issue that the president himself has identified; the lack of moral accountability in contemporary markets.[38] Questioning that elicited considered responses from the nation's top bankers on how to design regulatory systems that encompass the need for moral restraint would not only have narrowed and deepened the investigation, it would also have provided a template for moving forward. The failure to do so marks a missed opportunity.

Although the Financial Crisis Inquiry Commission will eventually have a full-time staff of between 40–50 investigators and an operating budget of $8m, there is a lack of detail about just what it will investigate and how. Moreover, the commission has been exceptionally tardy in creating a communications strategy, a move in sharp contrast to the Congressional Oversight Panel (COP) established to ensure that the Department of Treasury was accountable in managing the Troubled Asset Relief Program.[39] Not only did the COP hold a series of meetings outside the Washington Beltway, it actively solicited comments from the public. Moreover, the COP chair, Elizabeth Warren, used her position to advance significant policy recalibration based on a stated need, she saw as unfulfilled, to understand the root causes rather than merely the symptoms of the crisis. This myopia had, according to the COP, undermined the consistency and coherence of the Treasury's response to the crisis as well as that of other financial services regulators.[40] For the COP then, it was incumbent that any redesign must reflect the inadequacies within the theory and practice of regulation. It remains to be seen whether the Financial Crisis Inquiry Commission will examine these foundational matters, but the lack of policy coherence to date does little to inspire confidence.

Across Europe, policymakers face similar pressures, perhaps nowhere more so than Iceland, where a truth commission has been established alongside a criminal investigation headed by an investigating magistrate brought in from France to assure the public that, where possible, wrongdoing would be prosecuted.[41] The truth commission model allows for the venting and cauterisation of anger and addresses sectoral responsibilities. By providing a holistic mapping of a crisis, it can provide the evidence base on which to recalibrate policy. One of the defining aspects of the South African Truth and Reconciliation Commission was its extensive mapping of sectoral responsibility, including the complicity of the judiciary and the media. Of particularly more significance is the normative justification of introducing a re-distributive agenda that comprises political, social and economic dimensions. Establishing one, however, requires cognisance of the

38 Remarks on Financial Regulatory Reform, press conference, White House, Washington DC, 17 June 2009. According to President Obama, "in many ways, our financial system reflects us. In the aggregate of countless independent decisions, we see the potential for creativity – and the potential for abuse. We see the capacity for innovations that make our economy stronger – and for innovations that exploit our economy's weaknesses. We are called upon to put in place those reforms that allow our best qualities to flourish – while keeping those worst traits in check. We're called upon to recognise that the free market is the most powerful generative force for our prosperity – but it is not a free license to ignore the consequences of our actions."

39 For discussion of the role of the COP, see J O'Brien, *Engineering a Financial Bloodbath* (London: Imperial College Press 2009), pp. 98–104.

40 COP, *Accountability for the Troubled Asset Relief Program*, Second Report, Washington DC, 9 January 2009, p. 9: "For the panel, it was important for the Treasury and our financial services regulators to have an analysis of the causes and nature of the financial crisis to be able to craft a strategy for addressing the sources, and not solely the symptoms, of the problem or problems."

41 For background to the Icelandic crisis, see M Lewis, "Wall Street on the tundra", *Vanity Fair*, October 2009 www.vanityfair.com/politics/features/2009/04/iceland200904 (last accessed 4 November 2009).

need to address fundamental (if not revolutionary) change.[42] The chair of the Icelandic commission, Justice Pall Hreinsson, argues that "it is paramount that we understand. So that we can change the things we need to, and live with what we have to live with."[43] Iceland, outside the protection of the European Union, with a small population and facing economic devastation, had little choice but to accept a degree of collective soul-searching. As the Prime Minister, Johanna Siguroardottir puts it:

> Icelanders are both angry and full of sorrow and anxiety. They feel betrayed in many ways by the state, by the banks and by our allies. But the anger is also directed inwards – at ourselves as individuals and as a nation. Why did Icelanders let this happen? Sorting out those feelings will be a long and difficult process.[44]

Other countries at the periphery of Europe, including Ireland, attempted to cauterise the problems by blaming global forces. It is a predictable and to an extent self-serving response. In Ireland, tens of thousands have taken to the streets to protest against the costs associated with bailing out the banking sector, in particular the rescue of Anglo Irish Bank, a deeply flawed institution that has become talismanic of poor corporate governance practice.[45] The Irish government has further sought to deflect blame by commissioning a series of semi-private investigations. As will be explored below, this response presents a paradigm case in emasculated responsibility.

4 Banking on the truth?

The scale of the calamity now facing Ireland far exceeds situations faced by any of its European partners, with the possible exception of Greece. Throughout the boom years of the Celtic Tiger the population was encouraged to engage in an act of stunning self-deception. Unsustainable property valuations created not just a speculative commercial and residential bubble but also a speculative economy. In September 2008, Ireland took the unprecedented decision to provide an unlimited guarantee of all banking deposits. The move prompted large capital outflows from the rest of Europe, particularly the United Kingdom. It was designed to protect an increasingly strained domestic banking sector. In a rare admission of failure, the Taoiseach, Brian Cowen, accepted "arrogance" played a role in transforming the country from "unknown prosperity to suddenly [facing] survival

42 The South African Truth and Reconciliation Commission is paradigmatic, see S Leman-Langlois and C Shearing, "Repairing the future: the South African Truth and Reconciliation Commission at work" in G Gilligan and J Pratt (eds), *Crime Truth and Justice: Official inquiry, discourse, knowledge* (Uffculme: Willan Publishing 2004), pp. 222–42, noting that the "truths" established were not "scientific truth. The TRC Report was not science, and it was not meant to be. Commissions, and the TRC provides an excellent example, establish truths but they are not truth-finding in a scientific sense. They are rather modern morality plays that mobilise facts to articulate and promote normative agendas." (p. 231)

43 S Bowers, "Iceland one year on: small island in big trouble", *The Guardian*, 28 September 2009 www.guardian.co.uk/business/2009/sep/28/iceland-crisis-one-year-on (last accessed 3 February 2010).

44 A McDonald, "Johanna Siguroardottir interview: extended version", *New Statesman*, 15 January 2010 www.newstatesman.com/international-politics/2010/01/iceland-interview-economy (last accessed 16 January 2010).

45 M Wall and S Collins, "Change to cuts strategy ruled out as protests seek 'fairer' way", *Irish Times*, 7 November 2009, p. 1; R Brown. "Failed by Fianna", *New Statesman*, 11 January 2009 www.newstatesman.com/economy/2010/01/ireland-irish-social-dublin (last accessed 16 January 2010). For discussion of the broader issues raised by the failure of the Irish banking system, see F O'Toole, *Ship of Fools* (London: Faber & Faber 2009), in which the cultural commentator notes caustically that one consequence of the decision to nationalise Anglo Irish Bank was that "the state was making its citizens responsible for an institution whose books were the most inventive work of Irish fiction since [James Joyce's] *Ulysses*" (p. 210).

stakes".[46] Brian Cowen displayed reticence, however, in accepting political responsibility for corporate and regulatory failure.[47] At the same time, the Irish government has been slow to release information about the underlying fragility of the economy, the dependence of the banking sector on unsustainable practices and the extent to which regulatory and political authorities had knowledge of this vulnerability prior to the collapse and, just as significantly, the introduction of the banking deposit guarantee and subsequent policy recalibration, including the nationalisation of Anglo Irish Bank in January 2009 and the creation of the National Asset Management Agency (NAMA), which is designed to restore the capital adequacy of remaining banks by buying (at a discount) impaired property loan portfolios.

In January 2010, a full year after the government was forced to nationalise Anglo Irish Bank, the Finance Minister, Brian Lenihan, partially changed tack, arguing that:

> [the] public is entitled to a full examination of what went wrong in our banking system. More than that, we need an inquiry in order to restore international and domestic confidence in our banks. We need, as a country, to understand the origins of this crisis so that we can ensure that we do not make the same mistakes again.[48]

The solemnity of the announcement, made in the Irish Parliament, mirrored the rhetorical commitment offered by the Financial Crisis Inquiry Commission in the United States. Significantly, however, the terms of reference and method of inquiry differ dramatically. Although the Finance Minister has not foreclosed the possibility of a wide-ranging investigation, a truncated two-stage process is envisaged.

> First, the Government will immediately commission two separate reports – one from the Governor of the Central Bank on the performance of the functions of the Central Bank and the Financial Regulator and the second from an independent "wise" man or woman with relevant expertise to conduct a preliminary investigation into the recent crisis in our banking system and to inform the future management and regulation of the sector. These reports will also consider the international, social and macro-economic policy environment, which provided the context for the recent crisis. I expect both reports to be completed by the end of May this year and laid before the Houses shortly thereafter. The second stage of the inquiry will be the establishment of a statutory Commission of Investigation, which will be chaired by a recognised expert or experts of high standing and reputation. The terms of reference for this commission will be informed by the conclusions of the two preliminary reports. The aim will be for the commission to complete its work by the end of this year. Its report will then be laid before the Oireachtas for further consideration and action by an appropriate Oireachtas committee.[49]

The impetus is credited to the newly appointed governor of the Irish Central Bank, Patrick Honohan, who is charged with compiling the first document on regulatory failure (but not, significantly, the interaction with the political establishment). The terms of

46 Brian Cowen, speech delivered at the Chamber of Commerce Annual Dinner, Dublin, 5 February 2009, excerpted in H McGee, "Cowen says recession to cut living standards by over 10%", *Irish Times*, 6 February 2009, p. 1.

47 See J Grant and J Murray Brown, "ISE chiefs say Irish opacity must be stopped", *Financial Times*, 30 January 2010, p. 14, quoting the chief executive of the Irish Stock Exchange (ISE), Deirdre Somers, saying "companies must consider whether their historical practices, although accepted in the past, will meet market expectation in the future". The same article quotes the concerns of the chair of the ISE, Padraig O'Connor, about "a cultural malaise" that must "utterly be changed".

48 B Lenihan, "Statement by the Minister of Finance on banking", press release, Dublin, 19 January 2010, www.finance.gov.ie/viewdoc.asp?DocID=6166 (last accessed 29 January 2010).

49 Ibid.

reference also depart in fundamental ways, however, from proposals provided by the governor himself the previous month. Then the governor argued that Ireland should follow the United States in convening a broad-ranging commission.

> A hearing such as this one is fine, by and large. However, this issue is bigger and more complicated than one that can be accommodated by such a hearing as this where people present evidence and then go away. Also, the question would not be sufficiently answered by a judicial inquiry because one is not simply trying to find out what happened and the sequence of events. We should think in terms of getting experts, including experts in economics and social science and so on, and to blend them with politicians and arrive at a panel somewhat like the US congressional panels which consider particular issues on an ad hoc basis, such as the 11 September events.[50]

As Patrick Honohan intimated in his appearance at the Oireachtas:

> the crisis is not simply a question of discovering who did what and who knew what. Uncovering the deep roots of the crisis will require expertise and broad social scientific understanding more than merely forensic skills.[51]

As a former academic, the governor is well placed to begin this process. It is questionable, however, whether he is permitted publicly to disclose information,[52] a point made somewhat mischievously by the opposition Labour deputy leader, Joan Burton, and not altogether convincingly rebutted by the Irish Taoiseach, Brian Cowen. The primary problem with the Irish government's proposal, however, centres on the third component, namely the convening of a statutory Commission of Investigation whose terms of reference will be determined by the initial reports. Much depends on how the governor (if permitted) and Klaus Regling, a former senior official at the German Ministry of Finance and European Commission, appointed to draw up the second scoping document, interpret their brief and, crucially, the degree to which the subsequent Commission of Inquiry interprets both its own mandate and the lessons identified.[53] Moreover, there is a profound lack of transparency in the process, compounded by a lack of direct accountability afforded by public hearing or disclosure of documentary evidence.

A properly constituted Commission of Inquiry has a range of mandated powers including the capacity to subpoena documentary, written and oral evidence.[54] At the same time, however, it is envisaged that the investigation will be held in private unless "a witness requests that all or part of his or her evidence be heard in public and the commission accepts the request"[55] or "the commission is satisfied that it is desirable in the interests of

50 Evidence to the Joint Oireachtas Committee on Economic Regulatory Affairs, Dail Eireann, Dublin, 19 December 2009 (P Honohan). In written remarks, the governor of the Central Bank argued the need for new models of inquiry, stating "In considering how best to do this, I suggest that new models need to be explored. The crisis is not simply a question of discovering who did what and who knew what. Uncovering the deep roots of the crisis will require expertise and broad social scientific understanding more than merely forensic skills." (p. 5)

51 Written Evidence to the Joint Oireachtas Committee on Economic Regulatory Affairs, Dail Eireann, Dublin, 19 December 2009 (P Honohan), p. 5.

52 Central Bank Act 1942, s. 31 (1).

53 In a statement the Minister of Finance, Brian Lenihan, emphasised the need to analyse the "international, social and macro-economic policy environment in which the banking crisis developed". See Department of Finance, "Appointment of independent expert to conduct a preliminary investigation into banking crisis", press release, Dublin, 29 January 2010. Note that this formulation appears to downplay domestic and, in particular, political factors.

54 Commission of Investigation Act 2004, s. 16.

55 Ibid., s. 11(1)(a).

both the investigation and fair procedures to hear all or part of the evidence of a witness in public".[56] Moreover, the legislation specifically allows those giving evidence to challenge placing anything on the public record that could be deemed commercially sensitive, which is defined as the disclosure of information that:

> could reasonably be expected to—(a) materially prejudice the commercial or industrial interests of the person who provided that information to the commission or of a group or class of persons to which that person belongs, or (b) prejudice the competitive position of a person in the conduct of the person's business, profession or occupation.[57]

In announcing the terms of reference, the Finance Minister, Brian Lenihan, argued that for "an investigation to proceed speedily and cost-effectively, it must be able to conduct its business in private. The only other alternative that allows us to conclusively investigate a matter is a tribunal of inquiry" which would, he argued be too costly and protracted.[58] This is, however, political dissembling. The crisis facing the banking system is not a result of recent inept policy choices; rather it is a failure to learn the lessons exposed in a series of Tribunals of Inquiry convened throughout the late 1990s, which continue their work despite corporate obfuscation and increased political hostility. In part this can be traced to the meandering nature of the main political inquiries – an investigation into political payments made to the former Fianna Fail Taoiseach, Charles Haughey, and Michael Lowry, a former Fine Gael Minister of Communications, and a separate inquiry into corruption in the planning process in County Dublin – that became mired in judicial disputes but which also demonstrated conclusively that corruption extended well beyond the named individuals.[59] The tribunals were convened to demonstrate that Ireland was moving forward and that more accountable governance arrangements had been put in place. Attempts to compartmentalise blame – meaning effectively the denial of responsibility – along with media reporting of the costs eroded confidence in the tribunal as a mechanism of accountable governance. This calamitous failure was masked by the illusion of sustained wealth creation brought about through the inflation of a speculative bubble.

If Ireland is to emerge from the banking crisis it is essential that the nexus between the political establishment, the banking sector and the developers be explored in a much more systematic manner. This appears unlikely. The terms of reference specifically preclude discussion of political responsibility for either preventing the crisis or in responding to it, most notably the shoring up of the Irish banking system through the introduction of the blanket guarantee, the nationalisation of Anglo Irish Bank, the decision not to nationalise the remaining banks, and the decision to create the NAMA.[60] Indeed, the very existence of the NAMA reflects the degradation of Irish corporate, political and regulatory governance. As the operation of the COP demonstrated in the United States, the fact that a rescue operation is ongoing is an insufficient barrier to the introduction of effective ongoing accountability monitoring mechanisms. Moreover, the refusal to release information

56 Commission of Investigation Act 2004, s. 11(1)(b).

57 Ibid., s. 36(3).

58 M O'Halloran and M O'Regan, "Lenihan rejects Oireachtas inquiry deciding on facts or individuals", *Irish Times*, 21 January 2010, p. 5.

59 For discussion of the role of the tribunals, see J O'Brien, *The Modern Prince: Charles J Haughey and the quest for power* (Dublin: Merlin 2002).

60 See O'Brien, *Engineering a Financial Bloodbath*, n 39 above, at pp. 13–21.

provided to the government immediately prior to the introduction of the banking guarantee on the grounds of cabinet confidentiality sets a worrisome precedent.

A freedom of information request made in relation to belatedly disclosed handwritten records of two meetings at the Department of Finance on the night before the guarantee was announced has been rejected by the Office of the Information Commissioner (OIC). A preliminary finding from a senior investigator in the commission had held that:

> the public interest in the department [of finance] being held to account for its decision to commit billions of euro to the banking sector in the context of the guarantee would outweigh any damage in confidentiality in its dealings with the sector.[61]

Significantly, the Department of Finance's objection to the OIC was backed by two of Ireland's leading banks, Bank of Ireland and Allied Irish Bank, neither of which were publicly at significant risk at the time and both of which had argued that they were adequately capitalised.[62] One major identified problem in the Irish context was the lack of disclosure about how thinly capitalised the banking sector had become and the degree to which this risk was known by either the banks' boards or the regulator and actively or tacitly colluded in by adherence to government policy. Unless this is investigated, Ireland is prone to repeat its failure. It would appear likely from the *Sunday Times* precedent that the Commission of Investigation will come under significant pressure be forced not to disclose granular information on the grounds that it is commercially sensitive and that the Department of Finance, in particular, will retreat where possible to obfuscation and delay. In sharp distinction to the Icelandic investigation, which includes a degree of contrition, there is no evidence that Ireland is prepared to countenance political culpability. As such, despite nods to principles of transparency, accountability and best practice in investigative forums, official discourse remains rooted in a culture of denial.

5 Conclusion: reframing the agenda

In each of the jurisdictions surveyed here, with the exception of Iceland, official discourse has not gone substantially beyond rhetoric in either diagnosing the extent of the problem or its implications for the theory and practice of financial regulation. There is a dynamic interplay between the culpability of individual actors and the cultural and ideational factors that not only tacitly condoned but also actively encouraged the elevation of short-term considerations over longer-term interests within and across the corporate, regulatory and

61 See M Tighe, "Bank bailout meeting to stay secret", *Sunday Times* (Irish Edition), 24 January 2010 www.timesonline.co.uk/tol/news/world/ireland/article7000036.ece (last accessed 4 February 2010).

62 The Department of Finance had claimed that the account of the meeting was part of an incorporeal cabinet meeting and should remain undisclosed, see Freedom of Information Act 1997, s. 19(1)(c), authorising non-disclosure of "information (including advice) for a member of the Government, the Attorney General, a Minister of State, the Secretary to the Government or the Assistant Secretary to the Government for use by him or her solely for the purpose of the transaction of any business of the Government at a meeting of the Government". This was upheld by the OIC who argued that "in view of the unprecedented circumstance of this case, the only correct conclusion is to find that the primary use of the information was indeed to transact business of the Government at that incorporeal Government meeting". The decision includes concern that vital records were not disclosed to the OIC because of a "simple oversight . . . [that] calls into question the efforts made by the Department to fully identify all relevant documents at the outset". Moreover, although the OIC allowed the non-disclosure of two key documents, she found that "it is disappointing that it took 9 months and extensive correspondence before the Central Government Department with overall responsibility for implementing FOI policy in the public service finally accepted that most of the records it had strenuously maintained were extremely sensitive and exempt were, in fact, suitable for release". See *Sunday Times* and the Department of Finance, Case 090028 http://oic.gov.ie/en/DecisionsoftheCommissioner/LongFormDecisions/Name,11453.en.htm (last accessed 4 February 2010).

political spheres. This requires that we expand our focus beyond breaches in formal rules (which, in any case, can arguably be transacted around) or principles (that lack the definitional clarity to be enforceable). It is essential to evaluate how these rules and principles are interpreted within specific corporate, professional epistemic communities and how these influence and are influenced by regulatory practice.[63] Moreover, the dangers associated with such an emasculated approach to governance have long been apparent, most recently in the debate over the reprise of private equity, which accompanied the boom and prompted little more than hand-wringing.[64]

The rise of private equity was itself seen in some quarters as an unintended consequence of changed enforcement priorities.[65] In the United States, for example, regulators were under increasing pressure not to exercise instruments of control introduced in the aftermath of financial reporting scandal. Creative enforcement mechanisms, such as mandating governance change in exchange for a decision to stay or drop corporate prosecutions, were presented, with partial judicial justification, as the illegitimate exercise of prosecutorial discretion. More generally, the costs (generated primarily by the audit profession itself) of validating internal control processes are blamed (on the Securities and Exchange Commission) for driving business off-market and offshore. The United Kingdom luxuriated in the apparent strength of its much-vaunted system of risk-based regulation, which on the most charitable reading proved to be chimeric. While the global financial crisis

63 This requires sophisticated mapping of regulatory domains, see C Hood, H Rothstein and R Baldwin, *The Government of Risk* (Oxford: OUP 2004), p. 8. It also requires deep ethnographic investigation of actual practice and how innovation is both conceived as a social good and therefore legitimated. The classic example is insurance, see V Zelizer, *Morals and Markets: The development of life insurance in the United States* (New York: Columbia UP 1979). A similar dynamic applied to the emergence of financial derivatives. A social network comprising former regulators, academics and leading practitioners changed perception of the moral utility of options from dubious gamble to respected financial instrument, see D Mackenzie and Y Millo, "Negotiating a market, performing theory: the historical sociology of a financial derivatives exchange" (2003) 109 *American Journal of Sociology* 107. This process can generate a powerful ideational paradigm, see J Nash, "Framing effects and regulatory choice" (2006) 82 *Notre Dame Law Review* 314; see, more generally, T Porter and K Ronit, "Self-regulation as policy process: the multiple and criss-crossing stages of private rule making" (2006) 39 *Policy Sciences* 41; T Prosser, "Regulation and social solidarity" (2006) 33 *Journal of Law and Society* 364, noting that most conflicts in regulation are about fundamental values (p. 372). What is at issue, therefore, is the extent to which obligation is conceived self-reverentially in narrow technical terms or more expansively, taking into account how individual transactions, while legal, may at the same time erode market integrity, see T Arnold, "Rethinking moral economy" (2001) 95 *American Political Science Review* 85: "Constitutive social goods establish and symbolize important senses of self . . . Insofar as constitutive social goods structure the status and obligations of persons, their value includes the meaningfulness of the relationships and the sense of self generated." (pp. 90–1)

64 Financial Services Authority, *Private Equity: A discussion of risk and regulatory engagement*, Discussion Paper 06/06 (London: FSA 2006). Supporters of private equity countered that these risks were overblown, see P Yea, "Do we condemn or cheer the flight to private equity", *Financial Times*, 15 February 2007, p. 15. Yea, who is chief executive of Europe's largest private equity fund, 3i, was unapologetic: "While it may seem unfair that the private equity model has the advantage, that surely is the point of capitalism – that those with the advantage win." (p. 15)

65 McKinsey Report, *Sustaining New York's and the US' Global Financial Services Leadership* (2007), criticising "the multi-tiered and highly complex nature of the US legal system . . . [along with] the lack of coordination and clarity on the ways and means of enforcement . . . [leads to a perception that it is] neither fair nor predictable" (p. 17). The McKinsey Report endorses the findings of a separate investigation, see Committee on Capital Markets Regulation, Interim Report (2006), which suggested the "criminal enforcement system needs better balance" (p. xii). Both feed into and amplify warnings by the US Treasury Secretary to policymakers not to create or maintain "a thicket of regulation", see H Paulson, "Remarks on the competitiveness of US capital markets", speech delivered at National Economic Club of New York, 20 November 2006. Paulson's speech follows exactly the template offered two weeks earlier by the principal figures of the Committee on Capital Market Regulation, see G Hubbard and J Thornton, "Is the US losing ground", *Wall Street Journal*, 30 October 2006 (online edn).

has roots undoubtedly much deeper than the activities of private equity firms, the reliance on leverage that the asset class both caused and reflected and the calamitous failure to mitigate those dangers at policy level precisely because the debate took place at a primarily technical level have now become apparent.

Understanding the root causes of the global financial crisis requires that the debate is informed by a normative dimension; namely, what is the purpose of the financial sector and what, if any, restraints must be placed on untrammelled growth in order to protect society from externalities, conveniently excised from macro-economic models and legal and regulatory policy? This, in turn, requires a thorough investigation of the ideational terms of reference and how these were embedded and moulded by specific epistemic communities. Placed on a continuum, Iceland has gone furthest in determining sectoral responsibility while Ireland the shortest. At a global level, the concentration of resources on the resolution of technical matters within unstable conceptual frameworks provides little solace that substantive change will occur, leaving intact the privileging of the politics of illusion.

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Human rights, responsibilities and the pursuit of a realistic Utopia

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Introduction

The chorus line "Things can only get better", which heralded the arrival of New Labour in power, now has a hollow ring.[1] But, in one area, ministers may still be able to meet the gaze of an increasingly disenchanted public and talk the language of progress. For there can be no doubt that human rights have, in the years since 1997, become an evermore prominent feature of the legal and political landscape. This is a development for which New Labour can claim much of the credit. On entering office, the Blair administration produced a White Paper that spelled out its commitment to weaving human rights into the fabric of municipal law and followed this with the enactment of the Human Rights Act 1998.[2] The judiciary, legal practitioners and public officials have responded to these developments by taking human rights increasingly seriously in a wide variety of ways.[3] As a result, talk of human rights has gained currency in the wider culture (much to the annoyance of some commentators).[4]

But some have argued that the Human Rights Act and associated developments have fostered a culture in which an increasing number of rightsholders have lost sight of the legitimate interests of others and the wider community.[5] In response to this criticism, New

* I am grateful to Robert Colls, Carol Forrest, Andrew Halpin, Aileen Kavanagh, Patrick O'Callaghan, Ole Pedersen and Hillel Steiner for their comments on earlier drafts.

1 During the 1997 general election, "Things can only get better" was New Labour's campaign song. P Toynbee and D Walker, *Did Things Get Better? An audit of New Labour's successes and failures* (London: Penguin Books 2001), p. 2.

2 *Rights Brought Home: The Human Rights Bill*, White Paper Cm 3782 (Norwich: The Stationery Office 1997).

3 The developments noted in the text have occurred in public and private law. See, for example, *R* v *Bow Street Magistrates' Court, ex p Pinochet Ugarte (No 3)* [2000] 1 AC 447 (where the House of Lords held that a former head of state was liable to be extradited for alleged torture), and J Wright, *Tort Law and Human Rights* (Oxford: Hart 2001), pp. 21–33 (on the doctrine of indirect horizontal effect and its impact on tort law).

4 See e.g. M Phillips, *Londonistan: How Britain is creating a terror state within* (London: Gibson Square 2006), ch. 2.

5 The problem with which New Labour is grappling has, on some analyses, been a feature of practical life in the West since (at least) the 1960s. See, for example, F Fukuyama, *The Great Disruption: Human nature and the reconstitution of social order* (London: Profile Books 1999), p. 10 (on "excessive individualism") and pp. 13–15 (arguing that "a series of liberation movements", dating from the 1960s, have given expression to a socially damaging "no limits" message). See also J Gray, *Gray's Anatomy: Selected writings* (London: Allen Lane 2009), pp. 145–6 (arguing that the "antinomian" individualism encouraged by human rights poses a threat to the institutions that sustain a just social order).

Labour has prepared a Green Paper, *Rights and Responsibilities: Developing our constitutional framework* in which it canvasses the possibility of enacting a Bill of Rights and Responsibilities.[6] The Green Paper's authors place emphasis on responsibilities with the aim of identifying ways in which the law can more adequately accommodate the interests of all its addressees.[7]

This is an aspiration that reflects more than the practical agenda of an increasingly unpopular government keen to recommend itself to voters. It gives expression to moral impulses within a culture where, over many centuries, a distinct philosophy of government has (at first naïvely and, at later stages, more self-consciously) grown up.[8] This is the egalitarian philosophy of government, the central concern of which is to accommodate the interests of all the law's addressees defensibly. This is a philosophy of government that encourages in those who embrace it a reforming outlook that tends towards utopianism. On the analysis offered in this essay, we can find signs of utopianism in New Labour's Green Paper. However, this is not a reason to dismiss it. For John Rawls's account of a "realistic utopia" provides a basis on which to defend *Rights and Responsibilities*. But, while we can make such a defence, we should, at the same time, be alive to its limits. To this end, we will draw on the political philosophy of Michael Oakeshott and Isaiah Berlin (and the writings of Friedrich Hayek and Milan Kundera). Oakeshott and Berlin have particular relevance to this discussion since they each made anti-utopian contributions to the egalitarian philosophy of government.

Rights and Responsibilities: an overview

The authors of *Rights and Responsibilities* offer a number of rationales for a Bill of Rights and Responsibilities. They state that "people need to feel secure" in "turbulent times" and argue that increased emphasis on responsibilities may be warranted since human rights-based protections have, on some analyses, encouraged "selfish individualism".[9] While these rationales are responses to a current practical concern ("turbulent times") and a debate (concerning the possibility that rights may foster selfishness), others give expression to the agenda New Labour has pursued since 1997. This becomes clear when the authors state that increased emphasis on responsibilities affords a means by which to "strengthen communities" and address "the . . . constitutional question of the relationship between the citizen and the state".[10] For these reasons, they go on to describe *Rights and Responsibilities* as intended to advance New Labour's "progressive" agenda.[11]

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6 *Rights and Responsibilities: Developing our constitutional framework*, Green Paper Cm 7577 (London: Ministry of Justice 2009) (hereinafter RR).

7 RR is the work of the Ministry of Justice. Hence, it reflects the thinking of the Secretary of State for Justice, Jack Straw, and those who have worked with him on its preparation (including Michael Wills MP). For this reason, this essay refers to "the authors" of RR. This locution points up the fact that we are dealing with a distinct contribution to the contested New Labour project. See also P Wintour, "Straw hails new rights to end the 'me' society", *The Guardian*, 24 March 2009, p. 6.

8 The phrase "philosophy of government" is taken from H L A Hart, *Essays in Jurisprudence and Philosophy* (Oxford: OUP 1983), p. 198.

9 RR, p. 3 (associating "turbulent times" with "a . . . crisis in the world's financial system") and p. 17. See also P Eleftheriadis, "On rights and responsibilities" (2010) *Public Law* 33, at 33–8 (identifying the "core argument" in *Rights and Responsibilities* as comprising three steps: by encouraging selfish individualism, rights exhibit a "moral flaw"; for this reason, they "threaten[ ] social cohesion and community"; hence, "rights ought to be publicly linked to responsibilities").

10 RR, p. 3.

11 RR, p. 3.

This agenda, as the "Foreword" to *Rights and Responsibilities* makes plain, has many elements. They include the Equality Bill, the Welfare Reform Bill and the pledge to eradicate child poverty by 2020.[12] Alongside these measures, the government wishes to explore the possibility as to whether "responsibilities can be given greater resonance" alongside the rights protected by the Human Rights Act.[13] On this topic, the authors take the view that a Bill of Rights and Responsibilities would have "great symbolic and cultural importance" and could (along with, inter alia, the welfare state) become a landmark of the constitution.[14] While sounding this ambitious note, they also state that the government's aim is not to "draw[ ] up blueprints for new [social] models" or to meet the requirements of "an abstract system of ideals".[15] Rather, it is to explore the possibility of cautious constitutional change (on a model that has long been a feature of politico-legal life in Britain).[16]

Before turning to the topic that is their central concern (responsibilities), the authors dedicate a chapter to bills of rights. They seek, among other things, to place New Labour's human rights-related agenda in historical and global context. They find in, inter alia, the Magna Carta 1215 and the Declaration of Arbroath 1320 "proud traditions of liberty".[17] Moreover, they set New Labour's innovations and plans in the context of the human rights revolution that has been unfolding since the end of World War Two.[18] To this end, they situate the Human Rights Act in the context of a process of politico-legal development embracing the Universal Declaration of Human Rights and regional and municipal human rights instruments.[19] They also identify New Labour's human rights-related agenda as part of a process of development that embraces the US Constitution and Bill of Rights and the French Declaration of the Rights of Man and of the Citizen.[20]

Rights and Responsibilities does not, however, focus narrowly on human rights. The authors also seek to point up the practical significance of welfare provision in Britain in the twentieth and twenty-first centuries. Thus, we find them discussing, among other things, the National Health Service.[21] Moreover, they dwell on the relationship between human rights and welfare as components in an egalitarian politico-legal project. They illustrate this relationship by reference to South Africa's Bill of Rights 1996. This instrument guarantees "not only . . . traditional civil and political rights, but also social and economic [entitlements]".[22] In fastening on this feature of South African law, the authors alert us to a theme that features in their thinking. This is the desirability of seeing human rights, welfare provision and "the delivery of key public services" (e.g. the protection provided by the criminal justice system) as components in a progressive political agenda.[23]

Even before they have reached the end of their chapter on bills of rights, the authors have turned to the topic that is their central concern: whether "the articulation of

12 RR, p. 3.
13 RR, p. 8.
14 RR, p. 8.
15 RR, p. 7.
16 RR, p. 7.
17 RR, p. 12 (1.11).
18 RR, p. 12 (1.9). See also M Ignatieff, "Human rights as politics" in A Gutmann (ed.), *Human Rights as Politics and Idolatry* (Princeton: Princeton UP 2001), pp. 5–6 (on the post-World War Two human rights revolution).
19 RR, pp. 11–12.
20 RR, p. 11 (1.3–4).
21 RR, p. 12 (1.11).
22 RR, p. 11 (1.6).
23 RR, pp. 10, 11 (1.6) and 32–7 (3.15–31).

responsibilities" would enhance Britain's "constitutional arrangements".[24] This leads (in their chapter on responsibilities) to a rather breathless account of the notion of "individual responsibility". They tell us that individual responsibility is "a time-honoured concept for healthy and vibrant societies".[25] The authors find support for this claim in ancient Greece and Rome where "philosophers . . . stressed that individual responsibility is an essential ingredient for the well-being and flourishing of a community and its members".[26] This appeal to the classical world betrays no sensitivity to the point that contemporary understandings of individuality, personal responsibility and community differ from those in Greece and Rome.[27] The upshot is an anachronistic analysis that would not win plaudits from those (e.g. Quentin Skinner) who dwell on the evolution of politically significant ideas.[28]

The obvious explanation for this feature of *Rights and Responsibilities* is that the authors are using the past as grist to their argumentative mill. A further feature of their brisk journey through Western history lends force to this explanation. They find not just in ancient Greece and Rome but also in the philosophy that inspired the American and French revolutions support for the proposition that "responsibilities" play a "critical role" in "fostering a peaceful and harmonious society".[29] They also find support for this proposition in the communitarian political philosophy of Amitai Etzioni and Mary Ann Glendon.[30] Moreover, the authors forge a link between this body of political philosophy (within which they identify a strong commitment to "civic virtue") and socialism.[31] For socialism is, they tell us, associated with "co-operative action".[32] The authors make clear what they mean by "co-operative action" by adding that it has to do with balancing "the individual and community interest".[33] The importance they attach to this point becomes clear when they turn to the context in which they are writing. They state that this context is "more atomised" than in the past.[34] The authors also draw on comment running on the theme that "an over-emphasis on rights, to the exclusion of notions of responsibility, can lead to a 'me' society rather than a 'we' society".[35] This, they add, threatens to harm the "philosophical basis of inalienable, fundamental human rights and public support for them".[36]

Having sought to point up the practical significance of responsibilities, the authors consider how government might give them suitable emphasis in a rights-respecting constitutional order. They state that "[t]he Government is clear" on the point that

24 RR, pp. 13 (1.16) and 5 (xv).

25 RR, p. 15.

26 RR, p. 14 (2.2).

27 See M Schofield, *Plato* (Oxford: OUP 2006), pp. 219–20 (on the "organic" conception of social life in the classical world), and A MacIntyre, *A Short History of Ethics* (London: Routledge 2002), p. 192 (on communities, from the eighteenth century onwards, as "collections of individuals").

28 K Palonen, *Quentin Skinner: History, politics, rhetoric* (Cambridge: Polity Press 2003), pp. 20, 39 and 52 (on constant conceptual change as a feature of politically significant ideas).

29 RR, p. 14 (2.5).

30 RR, p. 15 (2.7 and note 6).

31 RR, p. 15 (2.7–8).

32 RR, p. 15 (2.8).

33 RR, p. 15 (2.10).

34 RR, p. 17 (2.15).

35 RR, p. 17 (2.17).

36 RR, p. 17 (2.18).

"fundamental rights cannot be legally contingent on the exercise of responsibilities".[37] But what follows in *Rights and Responsibilities* is less clear. The authors state that it may be possible to give responsibilities "greater resonance in a manner which does not necessarily link them to the adjudication of particular rights".[38] They follow this with an examination of international and national instruments that recognise the importance of responsibility in social contexts informed by a strong commitment to justice[39] These instruments include the Universal Declaration of Human Rights, the preamble to the Australian Capital Territory's Human Rights Act 2004 and the Polish Constitution.[40] The authors identify these instruments as sharing two closely related themes: those who enjoy the protection of rights should seek to "foster . . . shared values" and act in ways that show "concern for the common good".[41] Moreover, the authors link this practical outlook with ideas of duty, citizenship and community.[42] *Rights and Responsibilities* does not explore the relationship between these ideas with any degree of precision. But they each clearly have to do with the pursuit of a goal that bulks large in the minds of the authors: this is to continue "build[ing] a secure and flourishing society".[43]

The authors follow this examination of responsibilities with a chapter on rights that begins unpromisingly. For they sound another anachronistic note when they claim that "[t]hroughout history, philosophers have articulated theories of a society governed by law and . . . the rights which individuals consequently possess".[44] This claim appears to give expression to the assumption that individual rights have been a constant feature of the historical contexts that the authors survey. If they do make this assumption, they are wrong. The term "right" has not been a permanent feature of the Western politico-legal landscape.[45] Before rights talk gained currency, the notion of *ius* did broadly similar but less individualistic work (by focusing on the question as to what is "fair" between the members of a community).[46] Moreover, since the emergence of the notion of a human right in a naïve form, political, moral and legal commentators have refined our understanding of it.[47] The breezy insensitivity to these points on display in *Rights and Responsibilities* reveals the

37 RR, p. 18 (2.22). Cf. A Giddens, *The Third Way: The renewal of social democracy* (Cambridge: Polity Press 1998), p. 65 (arguing that "*no rights without responsibilities*" could be "a prime motto" of the "third way" political agenda embraced by New Labour). While Giddens may be correct on this point, Neil Kinnock forged the same sort of link between rights and responsibilities when he declared (while addressing the Welsh Labour Party in 1987): "we co-ordinate so that everyone can contribute and everyone can benefit, everyone has responsibilities, everyone has rights". See P Kellner, *Democracy: 1,000 years in pursuit of British liberty* (Edinburgh: Mainstream Publishing 2009), p. 481.

38 RR, p. 18 (2.22).

39 RR, p. 22ff.

40 RR, p. 22 (2.40–3) and 26 (2.57 and 2.60). See also p. 24 (2.47–8) (on the duties to serve the community enunciated in the American Declaration of the Rights and Duties of Man (1948)).

41 RR, pp. 26 (2.60) (quoting from the Polish constitution) and 28 (2.66).

42 RR, pp. 24 (2.48) and 27 (2.62).

43 RR, p. 19 (2.27).

44 RR, p. 29 (3.1).

45 M Freeden, *Rights* (Milton Keynes: Open UP 1991), p. 26 (noting that "historically the concepts of law and duty . . . preceded that of rights"). See also J M Finnis, *Natural Law and Natural Rights* (Oxford: Clarendon Press 1980), p. 210.

46 Finnis, *Natural Law*, n. 45 above, p. 206, contrasting individual rights with *ius*. On Finnis's (Aquinas-influenced) account, *ius* is captured by the noun "arights": i.e. fair arrangements between the members of a community. See also J Griffin, *On Human Rights* (Oxford: OUP 2008), pp. 1 and 31.

47 See, for example, R Dworkin, *Taking Rights Seriously* (London: Duckworth 1977), pp. 190–1 (on the right to free expression as a "trump" vis-à-vis a wide range of arguments having to do with the public interest). See also Griffin, *On Human Rights*, n. 46 above, pp. 1 and 30–2 (tracing the emergence of the idea of a human right to the late Middle Ages).

same lack of subtlety when dealing with relevant history that we found in the authors' references to the classical world.

Rights and Responsibilities also exhibits a strong tendency to elide human rights (a distinct form of "strong protection") with other goods that serve to underwrite a just (or, at least, well governed) social order.[48] This tendency is plain to see when the authors turn to the emergence of the British welfare state. They note that "[s]ome 20th-century theorists . . . began to take an increasingly comprehensive view of rights".[49] This, they tell us, is true of T H Marshall who identified three types of rights (civil, political and social) as associated with "full membership in the community" (or citizenship).[50] The authors endorse this view. This is anything but surprising, for their central concern is to establish a framework that defensibly accommodates the interests of all those who live within it.[51] On this view, human rights are part of a larger whole (including welfare provision and public goods such as an ordered and respectful environment) that serves the end of distributive justice.[52] In light of this point, we have a basis on which to explain why responsibilities have become a pressing concern. Fearful that some rightsholders are attaching undue importance to their own interests, government now wishes to establish "a link between rights and responsibilities".[53] This "link" is the idea of balancing interests and, at a foundational level, the ideal of distributive justice.

The government's commitment to balancing interests is a point to which the authors return on many occasions.[54] In their chapter on rights, they refer to the "balancing provisions" of the Human Rights Act and the European Convention on Human Rights.[55] Here, they are referring to the proportionality principle (which affords a means by which to address the problems that arise when "individual and societal interests collide").[56] This principle specifies that government and public bodies should only override the interests of individuals where doing so is necessary in order to pursue an outcome that serves the public interest.[57] While the authors (in common with many judges and commentators) refer to proportionality as a "balancing" principle, it is far from obvious that it does the sort of work suggested by this term. For "balancing" suggests that those using the principle are able to weigh all relevant concerns on the same set of scales. This is a point to which we will return below.

While confident that government can balance interests justly, the authors are less sure-footed in their penultimate chapter, which concerns a crucial question of institutional design. This is how to make responsibilities a more prominent feature of the politico-legal landscape. The authors state that "[t]he possible range of approaches to a Bill of Rights and

48 RR, pp. 42 (3.51) (on employment-related training and "minimum standards in public services") and 44 (3.56) (on housing). On human rights as a distinct form of "strong protection", see J Griffin, *On Human Rights*, n. 46 above, p. 90.

49 RR, p. 30 (3.5).

50 RR, p. 30 (3.5), referring to T H Marshall, *Citizenship and Social Class* (Cambridge: CUP 1950), p. 6.

51 See, for example, RR, p. 57 (4.25) (on "fair provision for society as a whole").

52 Distributive justice has to do with establishing a fair allocation of benefits and burdens in society (or within some socially significant institutions). See J Rawls, *A Theory of Justice* (Oxford: OUP 1971), p. 4. See also J Raz, *The Morality of Freedom* (Oxford: Clarendon Press 1986), p. 199 (on the public good of an environment "infused with a sense of respect for human beings").

53 RR, p. 8.

54 RR, pp. 4 (vi), 5 (xi), 9, 15 (2.10), 25 (2.53), 29 (3.4), 30 (3.7), 49 (3.78) and 55 (4.19).

55 RR, p. 30 (3.7).

56 RR, pp. 55 (4.19) (where the authors identify the proportionality principle as the balancing provision to which they are making reference) and 31 (3.9).

57 D Pannick, "Principles of interpretation and Convention rights under the Human Rights Act and the discretionary area of judgment" (1998) *Public Law* 545, at 547–8.

Responsibilities represents a continuum".[58] At one end of this continuum lies "a declaratory or symbolic statement" while, at the other, we find "a set of rights and responsibilities directly enforceable by the individual in the courts".[59] The authors are clearly uneasy about the second of these approaches. This is because it would, on their account, increase the likelihood that the courts would assume "a more important role in protecting individual freedoms".[60] For this reason, they dwell on an approach that lies in the middle of the spectrum they describe. This is a general interpretative provision.[61] According to the authors, such a provision would provide legislators and courts with guidance on the question as to how they should weave a suitably strong commitment to responsibilities into the fabric of the law.[62]

While considering how to develop Britain's constitutional framework in a way that will give greater prominence to responsibilities, the authors consider two further matters. They recognise that a process of development of the sort they contemplate will raise controversial questions concerning resource allocation. On this point, they state that such questions are a matter for Parliament.[63] Moreover, they tell us that "it is the Government's clear view that Parliamentary sovereignty must remain as the cornerstone of the UK constitution".[64] The authors also recognise that government will have to make clear the relationship between a Bill of Rights and Responsibilities and other human rights-related provisions. Before drawing this chapter to a close, they also introduce a further (egalitarian) rationale for reform. By placing greater emphasis on responsibilities, the government will take a step towards ensuring that "everyone has a fair chance to participate in society".[65] In their brief concluding chapter, the authors add only one point of significance. This is that a Bill of Rights and Responsibilities should reflect a "broad consensus" on values.[66] The government might find a basis on which to establish this consensus in the philosophy of government to which we now turn.

The egalitarian philosophy of government

We can trace the roots of this philosophy of government back to Europe in the late Middle Ages. At this time, the view that "important powers and privileges . . . were simply to be derived from one's human status" began to gain currency.[67] By the seventeenth century, we find Hobbes, while arguing for the Leviathan state, identifying all men as having an equal interest in peace.[68] This egalitarian strand in Hobbes's thinking made a great impression on Kant who, in the eighteenth century, offered a more robust variation on the same theme. According to Kant, a state only deserved the description "good" if it established a body of law that defensibly accommodated the interests of all its citizens.[69] Where states met this requirement, they acted, on Kant's account, in conformity with the universal principle of

58 RR, p. 52 (4.2).
59 RR, p. 52 (4.2).
60 RR, p. 51 (4.3).
61 RR, pp. 55–6 (4.18–23).
62 RR, p. 55 (4.18–20).
63 RR, p. 57 (4.27).
64 RR, p. 57 (4.27).
65 RR, p. 60 (4.39).
66 RR, p. 62 (5.1). The government recognised the need for a broad consensus in its earlier Green Paper, *The Governance of Britain* Cm 1770 (Norwich: HMSO 2007), p. 63, para. 213.
67 Griffin, *On Human Rights*, n. 46 above, p. 40.
68 T Hobbes, *Leviathan*, R Tuck (ed.) (Cambridge: CUP 1991), p. 92.
69 R J Sullivan, *An Introduction to Kant's Ethics* (Cambridge: CUP 1994), pp. 11–12.

justice. This principle is highly relevant to this discussion. This is because it points up a relationship (in the egalitarian philosophy of government) between the state, law and the citizen that Britons and Westerners more generally now take for granted. This relationship is one in which law and the state underwrite a conception of the individual as a source of intrinsic value.

While this conception of the individual runs like a connecting thread through the history of the egalitarian philosophy of government, this body of thought has developed constantly since its emergence. The philosopher Charles Taylor has traced this process of development. He identifies Hobbes and Kant, along with, inter alios, Grotius, Pufendorf, Locke, Rousseau and Hegel, as having played prominent roles in establishing a new "moral order".[70] Moreover, this "moral order" (or, as we have styled it here, "philosophy of government") has gone through a number of "redactions".[71] Taylor also claims that each of these redactions has been "more demanding" than the previous one.[72] There is something in this. In Hobbes, we find an emphasis on freedom from interference (or negative liberty) as an interest that people have in common. But some later contributors to the egalitarian philosophy of government (e.g. Jean-Jacques Rousseau) place emphasis on a more complex notion of freedom. This notion embraces a range of interests (over and above non-interference) that make it possible for people to live freely (e.g. by leading a life of authentic self-direction).[73] Proponents of this view also argue that people grasp these interests more or less adequately. In light of these points, they conclude that the state should act in ways that enable (or perhaps even force) individuals to live lives that more adequately approximate the ideal of freedom. This view of freedom, like that propounded by Hobbes, is intensely controversial. Critics of the Hobbesian view may argue that it underwrites a night-watchman state that will be unable to deliver the goods necessary in order for those who live within it to flourish.[74] By contrast, those who criticise the more ambitious (Rousseauian) view argue that it entails a state that tends in an authoritarian direction.[75]

Disagreement concerning the state's proper role is only one of many areas in which those who embrace either modest or more ambitious versions of the egalitarian philosophy of government disagree with one another. A related source of disagreement concerns rights. Those who cleave to the modest view associate rights with protection from other individuals and government. Thus, they might characterise the human right to free expression as a "protective capsule" that insulates individuals from the claims of those around them.[76] Matters are significantly different when we turn to more ambitious understandings of the egalitarian philosophy of government. Those who make contributions to this body of thought place emphasis on positive claim rights: for example, entitlements to goods that facilitate the pursuit of a fulfilling life.[77] To stake out positions of this sort is to argue for or presuppose an extensive state apparatus that proponents of the more modest view typically regard as posing a threat to the freedom of individuals. While disagreements of this type rumble on interminably, those who participate in them agree on one point concerning rights: they are a particularly powerful symbol of the egalitarian philosophy to which they give expression. This is a point that Ronald Dworkin has repeatedly driven home. He argues

70 C Taylor, *A Secular Age* (Cambridge, Mass: Harvard UP 2007), ch. 4.

71 Ibid., p. 160.

72 Ibid.

73 G Crowder, *Isaiah Berlin: Liberty and pluralism* (Cambridge: Polity Press 2004), p. 67.

74 Rawls, *A Theory*, n. 52 above, p. 205.

75 Crowder, *Isaiah Berlin*, n. 73 above, ch. 3.

76 Freeden, *Rights*, n. 45 above, p. 7.

77 Raz, *Morality*, n. 52 above, p. 415.

that the rights-based protections enjoyed by individuals in the United States and Britain give expression to an abstract egalitarian principle. This principle specifies that the state must treat its citizens with equal concern and respect.[78]

While rights have bulked large in the egalitarian philosophy of government, other considerations (such as the provision of welfare) also occupy a place of prominence within it.[79] Moreover, the precise idiom in which proponents of this philosophy talk typically reflects the culture and historical epoch in which they seek to have a practical impact. We can illustrate this point by reference to Britain between the second half of the nineteenth century and the middle of the twentieth century. During this period, the Fabians and New Liberals identified state intervention (in spheres such as education) as a means by which to secure the interests of society's poorer members.[80] In the course of advancing their arguments, they placed emphasis not on rights but, rather, on welfare. For they saw in this broad notion a means by which to pursue a just end-state (characterised as, among other things, New Jerusalem). But, by the middle of the twentieth century, we can detect an increasing emphasis on rights as a means to the same end.

Shifts of this sort are (as Charles Taylor notes) a prominent feature of the body of thought we are surveying. However, some of its features have remained stable over time. It has, at all times, been progressive. Those who have embraced this philosophy have seen in it a basis on which to establish increasingly adequate sets of practical arrangements. Thus, they have regarded themselves as probing the limits of practicable political possibility. This point merits emphasis. For, on the analysis offered by John Rawls, those who take this view express a commitment to the pursuit of a "realistic utopia".[81] Moreover, Rawls has identified the idea of a realistic Utopia (as it applies "[i]n the domestic [or municipal] case") as "importantly institutional".[82] By this he means that "it connects with the way citizens conduct themselves under the practices and institutions" that order their lives.[83] But while his account of a realistic Utopia has this institutional focus, Rawls is at pains to point out that it takes people as they are.[84] These points have, as we will see, great relevance to *Rights and Responsibilities* (and New Labour's agenda more generally).

New Labour and the pursuit of a realistic Utopia

Rawls's notion of a realistic Utopia is relevant not just to New Labour but to the political tradition (British and more generally Western) of which it is a part. We can find in British political history a readiness (sustained over many centuries) to probe the bounds of political

78 R Dworkin, *Law's Empire* (London: Fontana Press 1986), pp. 222 and 296. See also Dworkin, *Taking Rights Seriously*, n. 47 above, pp. 272–8.

79 See T H Marshall, *Social Policy in the 20th Century* 4th edn (London: Hutchinson 1975) (tracing the development of welfare policy in Britain from 1890).

80 M Loughlin, *Public Law and Political Theory* (Oxford: Clarendon Press 1992), pp. 116–23, and B Wilson, *What Price Liberty? How freedom was won and is being lost* (London: Faber & Faber 2009), ch. 8.

81 J Rawls, *Lectures on the History of Political Philosophy* (Cambridge, Mass: Harvard UP 2007), pp. 10–11. In talking of a "realistic utopia", Rawls makes it plain that he has in mind something significantly different from a Utopia. But Charles Taylor provides grounds for thinking that the (Rawlsian) realistic Utopia/Utopia distinction may be too sharp. He argues that the notion of Utopia gives expression to the belief that "these things are really possible in the sense that they lie in the bent of human nature". See C Taylor, *A Secular Age*, n. 70 above, p. 785, note 15.

82 J Rawls, *The Law of Peoples* (Cambridge, Mass: Harvard UP 2001), p. 16.

83 Ibid.

84 Ibid., pp. 12–13.

possibility.[85] We see it in the emergence and extension of the democratic principle.[86] Likewise, we see it in the increasing emphasis given to freedom of expression and the associated ideal of toleration.[87] But when we focus on British political history in the latter part of the nineteenth century, talk of utopianism (as Rawls employs that term) becomes particularly relevant. For we find in the writings of the Fabians and the New Liberals a common theme: the desirability of pursuing (by welfarist means) an end-state in which all Britons would live secure, dignified lives.[88] Moreover, when we survey the history of the welfare state in twentieth-century Britain, we find that those who followed in the footsteps of these thinkers sought to make the end-state that they argued for a reality. It is in this context (oriented towards the pursuit of a welfarist New Jerusalem) that we find T H Marshall setting out his account of civil, political and social rights.[89] Marshall is a pivotal figure in this process of development.[90] For one of his contributions to the body of thought we are surveying was to encourage a shift in the idiom of its proponents. He did this by giving emphasis to "rights" rather than to "welfare".[91] Marshall was not alone in encouraging this change. Those who spent the war years arguing for human rights played a significant part in bringing this change about.[92]

We might see the shift (from welfare to rights) encouraged by, inter alios, Marshall as an instance of modest progress in the direction of a more attractive model of human association. However, within the body of welfarist thought that Marshall played a part in elaborating, progress is associated with an ambitious (or progressive) state that plans for a better future and designs institutions that will make it a reality. This view of the state gives expression to a large assumption: those who wield the levers of power can fashion institutions that accommodate all relevant interests harmoniously. We find this assumption in *Rights and Responsibilities* and the New Labour agenda more generally.[93] However, this assumption is, for reasons explored below, highly questionable.

85 Kellner, *Democracy*, n. 37 above, pp. 24–33. See also R Mullender, "Democracy in the Land of Good Things (Britain)" (2010) 81 *Political Quarterly* 146.

86 C Turpin and A Tomkins, *British Government and Constitution* 6th edn (Cambridge: CUP 2007), pp. 34–40.

87 See E Barendt, *Freedom of Speech* 2nd edn (Oxford: OUP 2005), pp. 39–48; Wilson, *What Price Liberty?*, n. 80 above, p. 158, and N Ferguson, *The War of the World: History's age of hatred* (London: Allen Lane 2006), p. 626.

88 Loughlin, *Public Law*, n. 80 above, pp. 116–23, and M Oakeshott, *The Vocabulary of the Modern European State*, L O'Sullivan (ed.) (Exeter: Imprint-Academic 2008), ch. 39.

89 See A Vincent and R Plant, *Philosophy, Politics and Citizenship: The life and thought of the British idealists* (Oxford: Basil Blackwell 1984); C Barnett, *The Lost Victory: British dreams, British realities 1945–50* (London: Macmillan 1995), p. 123; and P Hennessey, *Never Again: Britain 1945–51* (London: Penguin Books 2006), ch. 4, pp. 180 and 324.

90 On Marshall's "seminal" contribution to the body of thought we are considering, see S Fredman, *Human Rights Transformed: Positive rights and positive duties* (Oxford: OUP 2008), p. 227.

91 D Marquand, *The Unprincipled Society: New demands and old politics* (London: Fontana Press 1988), pp. 28–9 (noting that social rights on the model argued for by Marshall became part of the welfare "strand" of Keynesian social democracy after World War Two: the change in idiom noted in the text was, on Marshall's analysis, due to improved material circumstances (T H Marshall, *Class, Citizenship and Social Development* (Westport, Connecticut: Greenwood Press 1973), p. 104)).

92 Griffin, *On Human Rights*, n. 46 above, pp. 176–7.

93 See *Discrimination Law Review: A framework for fairness: proposals for a single equality bill for Great Britain* (London: Department for Communities and Local Government 2007), p. 9 (on "joined up action across government" with the aim of promoting "fairness and social justice" in, inter alia, the fields of equality for ethnic minorities, disability, and domestic violence). See also T Clark, "New Labour's big idea: joined-up government" (2002) 1 *Social Policy and Society* 107.

Hubris and the "grand march"

If the analysis in the last section is correct, the authors of *Rights and Responsibilities* are seeking to offer a solution to problems associated with the protection of fundamental rights that is utopian in thrust. In following others in the progressive British tradition of which the Labour Party is a part in adopting this approach, they expose themselves to some criticisms that Friedrich Hayek levelled at some of their predecessors. Hayek identified the welfarist agenda that gained currency in Britain as the Second World War neared its end as a threat to the liberty of individuals.[94] He also drew attention to an assumption that, on his analysis, informed the thinking of ministers and officials at this time. This is the assumption that they had sufficient knowledge to draw up a "comprehensive plan" for the effective pursuit of "social justice".[95] Hayek regarded those who made this assumption as exhibiting hubris (and an associated tendency towards authoritarianism).[96]

In the 1980s, these features of Hayekian political philosophy found an echo in the work of the novelist Milan Kundera. In *The Unbearable Lightness of Being*, Kundera argued that those who embrace the cause of progressive, egalitarian politics see themselves as participating in a "grand march . . . on the road to brotherhood, equality, [and] justice".[97] On Kundera's account, this march, while giving expression to noble aspirations, has malign effects.[98] This is because those who lead the march are apt to treat (or, at least, regard) those who follow them as mere means to an egalitarian end (rather than as ends in themselves).[99] Kundera adds that those who behave in this way often seek to deny that they are doing so. To this end, they present the society in which they wield the levers of power as a "smiling brotherhood".[100] This is a model of human association that is harmonious since all those who live within it focus on and find fulfillment in the pursuit of justice. On Kundera's analysis, this representation of the situation he describes is bogus. He seeks to capture its dishonesty by categorising it as an example of kitsch. By this he means that it is a representation that offers a sanitised account of life: that is an account that does not acknowledge the practical difficulties with which people must wrestle.[101]

Both Hayek and Kundera make points that are relevant to *Rights and Responsibilities*. The authors of this Green Paper use a metaphor that tells of their self-understanding as social architects. For they state that their aim is to reconfigure the nation's "constitutional architecture".[102] This looks very much like the mindset that drew criticism from Hayek.[103]

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94 F A Hayek, *The Road to Serfdom* (London: Routledge 1944). Hayek pursued the same theme in F A Hayek, *The Constitution of Liberty* (London: Routledge 2006), pp. 225–6. See also R Colls, *Identity of England* (Oxford: OUP 2002), pp. 84, 130 (on progressive political opinion in the 1940s) and 373 (on Hayek).

95 Hayek, *The Constitution*, n. 94 above, p. 222.

96 Ibid., pp. 37 and 226–7. The themes pursued by Hayek were also present in mainstream political discourse in the 1940s. See D Kynaston, *Austerity Britain* (London: Bloomsbury 2007), pp. 58, 201, 227–8, 431 and 525.

97 M Kundera, *The Unbearable Lightness of Being* (London: Faber & Faber 1985), p. 250. Charles Taylor offers a broader variation on Kundera's theme of the grand march. He describes egalitarian thought from the seventeenth century onwards as "the long march". See C Taylor, *Modern Social Imaginaries* (Durham: Duke UP 2004), p. 30.

98 Kundera, *Unbearable Lightness*, n. 97 above, pp. 239–50.

99 Ibid., pp. 244–5.

100 Ibid., p. 250.

101 Ibid., p. 241ff. See also P Roth, *The Human Stain* (London: Vintage 2001), p. 242 (on "the quest to purify" social relations as "*more* impurity").

102 RR, p. 17 (2.16). See also p. 58 (where the authors identify themselves as concerned with "governance arrangements").

103 See Hayek, *The Road*, n. 94 above, p. 20 (associating the "habits of thought" of those who pursue the welfarist (and more generally statist) agenda, he criticises with "the engineer" and "the natural scientist").

Moreover, the authors' emphasis on community and consensus conveys the impression that harmony (if not a smiling brotherhood) is a live possibility.[104] These are points that we can develop by drawing on the writings of Michael Oakeshott and Isaiah Berlin.

The anti-utopianism of Isaiah Berlin and Michael Oakeshott

(A) OAKESHOTT

Oakeshott draws a distinction between two models of human association each of which has relevance to this discussion. He labels the first of these models "enterprise association" and tells us that it is highly instrumental.[105] Those who govern an enterprise association organise it with the aim of pursuing a desired goal or end-state. This may be, for example, a set of social relations that is distributively just.[106] While the pursuit of such an end-state may lend an enterprise association moral appeal, Oakeshott is critical of this approach to governance since, on his analysis, it compromises individualism.[107] This is because those who govern an enterprise association treat the end-state they pursue as their primary concern and are apt to regard the individuals over whom they wield power as means to its pursuit.[108]

This is not, on Oakeshott's account, a problem in the second model of human association he describes: "civil association". He tells us that a civil association, unlike an enterprise association, is not concerned with "plans for imposing substantive activities".[109] Rather, it constitutes a modest, rule-governed, politico-legal framework. Oakeshott describes this framework (with some awkwardness) as non-instrumental. By this he means that those who live within a civil association may "pursue the activities of their own choice with the minimum of frustration".[110] The "minimum" to which Oakeshott refers is a readiness on the part of individuals to act in accordance with the "general rules of conduct" that constitute and sustain the framework.[111] While exhibiting a clear preference for civil association, Oakeshott recognises that the Western political tradition is informed by commitments to both of the models that he describes.[112] Consequently, the "modern European state" exhibits, on Oakeshott's analysis, an equivocal character.[113]

Oakeshott's distinction between enterprise and civil association enables us to gain analytic purchase on *Rights and Responsibilities* and New Labour's human rights-related agenda

104 While New Labour politicians do not invoke the idea of "brotherhood", it was invoked in the early 1950s by Michael Young (who bore primary responsibility for drafting Labour's manifesto for the 1945 general election). See Kynaston, *Austerity*, n. 96 above, pp. 539–40.

105 M Oakeshott, *On History and Other Essays* (Oxford: Basil Blackwell 1983), p. 153, and M Oakeshott, *On Human Conduct* (Oxford: Clarendon Press 1975), pp. 289 and 315.

106 There is no necessary relationship between enterprise association and egalitarianism. See R Mullender, "Nazi law and the concept of community" (2008) 58 *University of Toronto LJ* 377, at 381–2.

107 Oakeshott, *On Human Conduct*, n. 105 above, pp. 115, 119, 157–8, 206, 264, 298, 315–17 and 319. See also P Franco, *Michael Oakeshott: An introduction* (New Haven: Yale UP 2004), p. 170.

108 Oakeshott, *On Human Conduct*, n. 105 above, p. 273. See also J-J Rousseau, *The Social Contract and Discourses*, G D H Cole (trans.) (London: Everyman's Library 1973), bk II, ch. 4.

109 M Oakeshott, "On being Conservative", in *Rationalism in Politics and Other Essays* (London: Methuen, 1977), p. 183.

110 Ibid. See also M Oakeshott, *On Human Conduct*, n. 105 above, p. 243 (describing a civil association as "the *civitas peregrina*: an association, not of pilgrims travelling to a common destination, but of adventurers each responding as best he can to the ordeal of consciousness in a world composed of others of his kind").

111 Oakeshott, "On being Conservative", n. 109 above, p. 183. See also Franco, *Michael Oakeshott*, n. 107 above, p. 161, on "standards of civility".

112 On Oakeshott's preference for civil association, see Franco, *Michael Oakeshott*, n. 107 above, pp. 164–70.

113 Oakeshott, *On Human Conduct*, n 105 above, ch. 4. See also Franco, *Michael Oakeshott*, n. 107 above, pp. 164ff.

more generally. Some passages in *Rights and Responsibilities* make glancing references to ideas that Oakeshott associates with civil association (e.g. negative freedom).[114] But the authors' central concern reveals them to be proponents of enterprise association. They dwell on the means by which to pursue an end-state in which all the law's addressees enjoy access to the goods necessary in order to flourish. Moreover, *Rights and Responsibilities* emphasises the role played by the law's addressees in the pursuit of this end-state. By behaving responsibly, they will secure the interests of others and facilitate pursuit of the government's distributive justice-related plans.[115] We can present human association on this model in a very attractive light. We might, for example, describe those who conduct themselves in the way outlined here as acting in accordance with a personal virtue of justice (by playing their part in a co-operative scheme).[116] Moreover, we might describe this approach to practical life as giving content to the idea of "community" as it features in *Rights and Responsibilities* and New Labour's thinking more generally. But Oakeshott would, doubtless, tell a different story. He would describe the model of human association we are contemplating not as a community but, rather, as an enterprise association in which people begin to take on the appearance of pieces in a social jigsaw. Moreover, he would find support for this view in the emphasis that *Rights and Responsibilities* places on "a 'we' society rather than a 'me' society".[117] For, on Oakeshott's analysis, language of this sort portends a threat to the idea of individualism.[118]

(b) Berlin

While Oakeshott encourages us to think about the shape that egalitarian models of human association might assume, Berlin prompts us to consider a number of concepts that have relevance to them. Prominent among these concepts is "liberty" or "freedom".[119] Berlin famously distinguished between two "senses" of liberty or freedom – one "negative" and the other "positive".[120] Negative liberty features in the writings of many prominent contributors to the egalitarian philosophy of government, including Thomas Hobbes.[121] Liberty on this model is the absence of coercive interference. On Berlin's account, it is "simply the area within which a [person] can act unobstructed by others".[122] While this is a simple idea, Berlin's notion of positive freedom is more complex. In order to enjoy positive freedom, we must have the capacities and the goods necessary in order to live a fulfilling (e.g. autonomous) life.[123] This means that we are free when we are not deflected from the pursuit of a fulfilling life by irrational impulses and when we have, among other things, access to adequate education and health care. But positive freedom, on Berlin's

114 RR, p. 30 (3.6) (on Hobbes's conception of freedom). See also RR, p. 12 (1.11) (on Britain's "proud traditions of liberty").

115 See nn. 41–3, above, and associated text. See also *Discrimination Law Review*, n. 93 above, p. 8 (on "[o]ur vision of a society in which there is opportunity for all and responsibility from all").

116 See G J Postema, *Bentham and the Common Law Tradition* (Oxford: Clarendon Press 1986), p. 42 (discussing the idea of a personal virtue of justice as elaborated by Aquinas).

117 See n. 35 above and associated text.

118 Oakeshott, *On History*, n. 105 above, p. 182.

119 I Berlin, *Four Essays on Liberty* (Oxford: OUP 1969), ch. 3, especially p. 121 (where Berlin states that he uses the words "liberty" and "freedom" interchangeably).

120 Ibid., pp. 121–34.

121 Ibid., p. 123, note 2.

122 Ibid., p. 122.

123 Ibid., pp. liii–lix and 131–4. On the account offered by James Griffin, the value central to positive freedom is "*being* a normative agent, a self-creator". This means that "value resides not simply in one's having the undeveloped, unused capacities for autonomy . . . but also in exercising them". Moreover, it entails that we have a human right to minimum provision (including health care and education). See Griffin, *On Human Rights*, n. 46 above, p. 181.

account, discloses a further dimension about which he is deeply uneasy. This is the doctrine of the "true" self. This doctrine draws a distinction between the empirical self and a true or ideal self.[124] The empirical self may be a benighted individual who pursues a course through life that does not serve his or her interests.[125] By contrast, the true self makes sound choices and flourishes.[126] Having introduced us to the idea of the true self, Berlin argues that, in those states where it informs the thinking of government, it encourages authoritarianism.[127] For government seeks to implement plans that will close the gap between (more or less) misguided empirical selves and the ideal self that it posits.[128]

Berlin's two conceptions of liberty or freedom clearly have relevance to the agenda that *Rights and Responsibilities* is supposed to play a part in advancing. Both negative liberty (e.g. freedom from interference with expressive activity) and positive freedom (claim-rights to educational and health care-related goods) feature in the body of thought that New Labour is seeking to refine. But the latter occupies a more prominent place in the minds of those who seek to shape the New Labour project.[129] In *Rights and Responsibilities*, we see this in the emphasis the authors place on establishing conditions in which people can "thrive", "flourish", "develop", and enjoy "wellbeing".[130] Moreover, we can find in *Rights and Responsibilities* intimations of the doctrine of the true self that Berlin associates with governmental authoritarianism. As we have noted, the authors identify the perceived problem of "selfish individualism" (associated with the assertion of rights) as one of their primary concerns.[131] They also state that one of their aims is to identify ways in which to foster a more "harmonious" society.[132] When we set these points alongside one another, the picture emerges of rather self-absorbed individuals who act in ways that compromise their relations with others and (as a consequence) damage the wider social environment. This hardly sounds like a fulfilling basis on which to journey through life. But *Rights and Responsibilities* points the way to a more adequate set of practical relations. It does this by arguing that those who see rights through "a prism of selfish individualism" would benefit from having "a better understanding" of their entitlements.[133] For they would, on acquiring this understanding, be able to enter into "peaceful and harmonious" relations with those around them.[134] We might see this feature of *Rights and Responsibilities* as having to do with closing the gap between a self-subverting empirical self and an ideal self who, in taking proper account of others' interests, secures his or her own. If this analysis is broadly correct, then we can ascribe to the authors of *Rights and Responsibilities* a perfectionist agenda. This is because they want to establish a body of law that will prompt those

124 Berlin, *Four Essays*, n. 119 above, pp. 132–3.

125 Ibid., p. 133.

126 Ibid., p. 132.

127 Ibid., pp. 132–3.

128 Ibid. See also I Berlin, *Freedom and its Betrayal: Six enemies of human liberty*, H Hardy (ed.) (London: Pimlico 2003), p. 47.

129 See A Giddens, *Third Way*, n. 37 above, pp. 44 and 66. See also J Purnell, "New Labour became too much of a sect", *The Guardian*, 20 July 2009, p. 26 (arguing for "equality of capability", which involves "giving everyone the power to pursue their goals"), and S Driver and L Martell, *New Labour: Politics after Thatcherism* (Cambridge: Polity Press 1998), p. 105 (on New Labour's commitment to the more equal distribution of "life chances" in pursuit of "endowment egalitarianism"). Cf. J Daley, "You can 'aspire', but don't you dare achieve", *The Sunday Telegraph*, 3 January 2010, p. 18.

130 RR, p. 21 (2.35).

131 RR, p. 17 (2.18).

132 RR, p. 14 (2.5).

133 RR, p. 17 (2.18).

134 RR, p. 18 (2.23).

regulated by it to conduct themselves in ways that government considers good.[135] This would not come as a surprise to Berlin. For he argues that, when government embraces the idea of positive freedom and the associated doctrine of the true self, the usual upshot is a reduction in individual freedom of action.[136]

Just as Berlin's distinction between negative and positive freedom is relevant to our concerns, so too is his account of values. He tells us that prominent strands of Western political philosophy have long given expression to the "dream" of "a perfect society".[137] He adds that those who seek to make this dream a reality assume that wise rulers can harmonise all sources of positive value. Berlin regards this was of thinking as utopian and has no truck with it.[138] This is because sources of positive value may be incommensurable and/or uncombinable.[139] The problem of incommensurability arises in circumstances where we cannot rank two or more values on a common scale.[140] Uncombinability afflicts us in situations where we can only accommodate one value (e.g. security) by excluding another (e.g. freedom of action).[141] In light of these points, Berlin draws some conclusions that should bring up short those who harbour hopes of Utopia. Because of the problem of incommensurability, those who govern a society necessarily have to make choices that they cannot identify as optimal. They will also have to pay for some good things in the coin of other good things. This is because they cannot escape the choices that uncombinability forces upon them.

Part of Berlin's purpose in offering this analysis of values is deflationary.[142] He seeks to discourage the large ambitions that we associate with utopianism.[143] But other strands of his analysis are more upbeat. Berlin argues that societies can respond to the problems thrown up by uncombinability and/or incommensurability by accommodating the relevant values in ways that give expression to "the general pattern of life" in which their members believe.[144] He also emphasises that the choices that concern him have to do with

135 Perfectionism gives expression to the view that we should organise practical life in ways that foster human potentialities and excellences. See W Kymlicka, *Contemporary Political Philosophy: An introduction* 2nd edn (Oxford: OUP 2002), p. 190. See also Eleftheriadis, "On rights", n. 9 above, p. 34 (arguing that *Rights and Responsibilities* is "very ambitious" since "[i]t is about what is the right thing to do"), and D Lawson, "Look out – Harriet's on a crazy crusade", *The Sunday Times*, 7 February 2010, p. 20 (arguing that "some of [New Labour's] leading figures have held firm to the view that it is possible through the enforcement powers of the state to improve society's moral character").

136 Crowder, *Isaiah Berlin*, n. 73 above, ch. 3.

137 I Berlin, *The Crooked Timber of Humanity: Chapters in the history of ideas* (London: Pimlico 2003), p. 20.

138 Ibid., p. 65. On this point, Berlin's thinking bears obvious similarities to that of Lev Shestov, a philosopher he greatly admired. According to Shestov, "[t]he idea of total unity", in practical matters, "is an absolutely false idea". See L Shestov, *Athens and Jerusalem* (New York: Simon & Schuster 1968), p. 431.

139 Berlin, *Crooked Timber*, n. 137 above, pp. 55 (on incommensurability) and 57 (on "irreducible incompatibility"). See also M Ignatieff, *Isaiah Berlin: A life* (New York: Metropolitan Books 1998), pp. 227–9.

140 Raz, *Morality*, n. 52 above, p. 329.

141 J Gray, *Post-Liberalism: Studies in political thought* (London: Routledge 1993), p. 301. See also I Berlin, *The Proper Study of Mankind: An anthology of essays*, H Hardy and R Hausheer (eds) (London: Pimlico 1998), p. 11 (noting that "[s]ome among the Great Goods cannot live together").

142 On occasion, Berlin described his (deflationary) ambition rather differently. He saw himself as giving "dreary" advice and as offering a "dull solution" to the practical problems with which humankind must wrestle. See Gray, *Gray's Anatomy*, n. 5 above, p. 104.

143 Crowder, *Isaiah Berlin*, n. 73 above, p. 4.

144 Berlin, *Four Essays*, n. 119 above, p. lv. See also Berlin, *Crooked Timber*, n. 137 above, p. 18 (identifying "the forms of life of the society to which one belongs" as a typically eligible starting point for practical reflection and activity).

"objective" values: that is values that serve genuine human interests.[145] In light of these points, Berlin emerges as a pluralist who accepts that we can pursue ends that serve abiding human interests in a range of defensible ways.[146]

Berlin's analysis of values provides a basis on which to bring out a source of tension in *Rights and Responsibilities*. The authors tell us that government seeks to foster "a peaceful and harmonious society".[147] But they also recognise that tensions arise when individuals exercise their rights in ways that have an adverse impact on others. We see this when, for example, the authors tell us that "an unbridled focus on our own . . . rights . . . risks overtaking . . . respect for others".[148] Berlin focuses on tensions of this sort to point up the difficulties faced by those who seek to establish a just accommodation of interests.[149] Thus, we find him contemplating "the human world as a battle of . . . ceaselessly conflicting wills".[150] Berlin adds that, if we take this view, we must accept that it is "incompatible" with "the very concept of Utopia" (understood as "the notion of a harmonious solution to the problems of mankind").[151]

We find very little like this in *Rights and Responsibilities*; rather, the authors (as we have noted) refer repeatedly to the possibility of "balancing" competing considerations and contemplate the possibility of a "harmonious" society.[152] Moreover, they identify a means by which to balance interests where they collide. This is the proportionality principle.[153] But when we consider the sort of uses to which decision-makers can put this principle, it quickly becomes apparent that it is not an instrument for use in a literal balancing exercise. Those who use the proportionality principle do not weigh competing interests on a set of scales. Instead, they use it as a means by which to sharpen their awareness of a number of considerations that they address in a sequential order (rights, countervailing considerations and the proportionality principle's requirements).[154] In going about their business in this way they are able to reflect on the question as to how they might (so far as they can) accommodate values that are uncombinable and often incommensurable. Consider freedom of expression and the threats that it may pose to the interests of others. When free expression clashes with the interests of those who live in a particular community, we cannot simultaneously prioritise both concerns. Thus, we find ourselves confronted with the problem of uncombinability. Suppose further that we attach priority to the qualified right to free expression protected by Article 10 of the ECHR. We can override the expression-related interests protected by this right where countervailing considerations are suitably significant. This response to the problem of uncombinability may give rise to a clash

145 Berlin, *Crooked Timber*, n. 137 above, pp. 11 and 80.

146 Crowder, *Isaiah Berlin*, n. 73 above, pp. 190–1.

147 RR, p. 14 (2.5).

148 RR, p. 17 (2.17).

149 Berlin, *Four Essays*, n. 119 above, pp. 123–4.

150 Berlin, *Crooked Timber*, n. 137 above, p. 44.

151 Ibid.

152 See ns 29 and 54 above and associated text. On two occasions the authors fleetingly sound a note reminiscent of Berlin: the first when they recognise that "individual and societal interests collide" (RR, p. 31 (3.9)) and the second when they mention "trade-offs" between principles relevant to "[l]iving within environmental limits" (RR, p. 50 (3.82)).

153 RR, p. 9, stating that "a balancing framework" involves proportionality.

154 See *R* v *Butler* (1992) 89 DLR (4th) 449 (Supreme Court of Canada), 498–9, per Gonthier J (noting that judges must sharpen their awareness of arguments in the field when deciding whether matters of pressing and substantial concern meet the proportionality principle's requirements and provide a basis on which to override fundamental rights). See also B Chapman, "Law, incommensurability, and conceptually sequenced argument" (1998) 146 *University of Pennsylvania Law Review* 1487, at 1507 (on the "ordered relevance" of "rights and welfare").

between incommensurable values. Certainly, this is the case if we assume that free expression is intrinsically valuable and that the countervailing concerns we are considering have to do with the harmful effects of expressive activity. For this is a clash between two types of moral impulse: deontological impulses (that ascribe intrinsic value to certain interests, goods and states of affairs) and consequentialist impulses (that ascribe value on the basis of outcomes).[155] When these two types of impulse clash, it is far from obvious as to how we should rank them. Thus, the problem of incommensurability arises.[156] In such circumstances, the term "balancing" obscures rather than explains the nature of the task judges and other public officials undertake.

While being vulnerable to this sort of criticism, *Rights and Responsibilities* exhibits a feature that intersects with Berlin's thinking. As we have noted, Berlin argues that societies can respond to the problems thrown up by uncombinability and/or incommensurability by accommodating the relevant values in ways that give expression to "the general pattern of life" in which their members believe.[157] The authors of *Rights and Responsibilities* do not address the problems of uncombinability and incommensurability in terms. However, they do state that the government seeks (when advancing its responsibilities-related agenda) to capture and give more adequate expression to the form of life that would be affected by the reform it contemplates.[158] Moreover, the authors place emphasis on the government's wish (when giving greater "resonance" to responsibilities) to make a "symbolic statement" that would reflect "broad aspirations" in the culture of which it would be a part.[159] This suggests a commitment to elaborating "the general pattern of life in which we believe" (to use Berlin's phrase).

If we place this interpretation on *Rights and Responsibilities*, we can view it in a charitable light. It constitutes an effort to elaborate or refine an existing and long-standing commitment to the egalitarian philosophy of government. Likewise, it bespeaks a commitment on the government's part to the pursuit of a realistic Utopia. But the form of life in which these aspirations have grown up exhibits a richness that the authors of *Rights and Responsibilities* fail to capture adequately. When we scrutinise it carefully, we find that commitments to both enterprise and civil association (as described by Oakeshott) are features of this form of life.[160] Given the different levels of emphasis these models of human association place on the individual, they stand in a relationship of tension. The authors of *Rights and Responsibilities* do not bring out this source of tension. This is because they conceive of the society they describe as an enterprise association.[161] The government's insensitivity to the source of tension that we are considering would not come as a surprise to Oakeshott. He argued that those who seek to capture the main elements of a form of life can only hope to offer an abridgement.[162] He also described abridgements of this sort

155 On deontology and consequentialism, see S Blackburn, *The Oxford Dictionary of Philosophy* (Oxford: OUP 1994), pp. 67, 100 and 206.

156 T Nagel, *Mortal Questions* (Cambridge: CUP 1979), p. 129.

157 See n. 144 above and associated text.

158 RR, p. 32 (3.13) (on the relationship between *Rights and Responsibilities*, New Labour's other human rights-related initiatives and "national culture"). See also RR, p. 28 (2.66) (on the agenda set out in *Rights and Responsibilities* as a means by which to "foster our sense of shared values").

159 RR, pp. 51 (4.3) and 53 (4.11).

160 See Oakeshott, *On History*, n. 105 above, chs 2 and 3. See also Wilson, *What Price Liberty?*, n. 80 above, p. 227.

161 See *Governance of Britain*, n 66 above, p. 5, "Foreword" (where Gordon Brown and Jack Straw identify the reform agenda they are contemplating as having to do with the pursuit of a "shared national purpose").

162 Franco, *Michael Oakeshott*, n. 107 above, pp. 13 and 82–97.

as amounting to an "ideology".[163] But this sinister sounding word (which refers, inter alia, to "systematically distorted communication") may not capture the weaknesses that *Rights and Responsibilities* exhibits.[164] While the authors fail to recognise that two models of human association inform the cultural context that they aim to shape while also reading relevant history anachronistically, we should not assume that this makes them ideologists. It seems equally plausible to suggest that they have raked over the recent and more distant past in a way that calls to mind a clumsily executed but well-intentioned school project.

Conclusions

On the charitable interpretation offered in this essay, *Rights and Responsibilities* gives expression to a commitment, on the part of government, to the pursuit of a realistic Utopia in Rawls's sense. New Labour's aim, on this analysis, is to probe the bounds of political possibility. Thus, we find the authors of *Rights and Responsibilities* identifying a greater emphasis on responsibilities (as a counterweight to rights) as a means by which to establish a more harmonious accommodation of interests. As used here, the term "harmonious" has to do with distributive justice. This becomes clear when we recognise that the agenda of which *Rights and Responsibilities* is a part encompasses a wider range of goods than human rights and responsibilities. Among other things, it embraces welfare provision and public goods (e.g. security as promoted by the operation of the criminal justice system). Government regards these goods (as an ensemble) as means by which to approximate a just end-state more adequately.[165]

In this ambitious agenda, we might detect governmental hubris of the sort that drew criticism from Hayek. For government assumes that it has sufficient knowledge and capacity to pursue an end-state in which human rights, responsibilities, welfare provision and the public goods it seeks to foster form a harmonious whole. This is an outlook that suggests the pursuit not of a realistic Utopia but, rather, of Utopia in the strong (or optimal) sense. This would not be altogether surprising. The New Labour administrations of Tony Blair and Gordon Brown have gestured in the direction of practical arrangements that secure the interests of all relevant persons and resolve enduring sources of practical difficulty. We see this in the Third Way as propounded by Blair (which promised to resolve long-standing conflict between the left and the right in politics).[166] Likewise, we see it in a recent White Paper that bears the imprint of Gordon Brown. In *Building Britain's Future,* the Prime Minister declares that "strong, active government" can establish a "fair balance" of interests by drawing on "the *best* British values".[167]

While we can use the term "Utopia" to suggest *naïveté* on the part of those who engage in progressive politics, it has (when used as Rawls uses it) some plausibility in the British context. For Britain's history (over many centuries) discloses a commitment on the part of those who have engaged in politico-legal life to explore the bounds of possibility

163 A Sullivan, *Intimations Pursued: The voice of practice in the conversation of Michael Oakeshott* (Exeter: Imprint-Academic 2007), pp. 63–7.

164 On ideology, see T Eagelton, *Ideology* (London: Verso 1991), ch. 1.

165 The New Labour administration is far from alone in identifying human rights as part of a wider (justice-oriented) ensemble of goods. On the analysis offered by James Griffin, we can trace this view back at least as far as the Universal Declaration on Human Rights. See Griffin, *On Human Rights*, n. 46 above, pp. 186–7.

166 A. Giddens, *Third Way*, n. 37 above, pp. 37–46. See also R Mullender, "Theorizing the third way: qualified consequentialism, the proportionality principle, and the new social democracy" (2000) 27 *Journal of Law and Society* 493, 495–500.

167 *Building Britain's Future* Cm 7654 (Kew: Office of Public Sector Information 2009), p. 7, "Foreword" (emphasis added). In using "best" the Prime Minister gives expression to the assumption that all relevant values are commensurable.

(with the aim of bringing about reforms that have been egalitarian in thrust). We see this in, for example, the development of the democratic principle and more particularly in the extension of the franchise. Likewise, we see it in the development of the welfare state and in New Labour's commitment to the protection of human rights. Moreover, we can situate these (and many other such developments) in a context that extends beyond Britain. For these developments are expressions of commitment to the egalitarian philosophy of government.

Given the many successes this philosophy has enjoyed over an extended period of time, it seems entirely appropriate that contemporary politicians should ponder the question as to how they might refine existing institutions and practices. The great success of the egalitarian philosophy of government goes some way towards explaining why those who embrace it may, on occasion, be tempted to pursue not a realistic Utopia but, rather, an optimal end-state. To the extent that this ambition informs *Rights and Responsibilities*, the contributions to political philosophy made by Michael Oakeshott and Isaiah Berlin provide grounds on which to subject it to critique. Oakeshott enables us to gain analytic purchase on the model of human association that informs New Labour's thinking and that finds expression in its policy agenda. It is an enterprise association within which the members of society strive to pursue (and ultimately maintain) a just end-state. While this model has many attractions (e.g. a strong commitment to distributive justice), it poses, on Oakeshott's analysis, a threat to the notion of individualism. Berlin enables us to press the analysis further by giving us, inter alia, concepts (e.g. uncombinability and incommensurability) that throw light on the difficulties involved in justly accommodating the interests of all members of society.

Finally, we have grounds for thinking that the authors of *Rights and Responsibilities* offer an analysis that, if used as a guide to action, would abridge the tradition of which it is a part. While we have used Oakeshott to bring this point out, Kundera has reflected on it in uncommonly powerful terms. He tells us that those who pursue an egalitarian political agenda are apt to conceive of themselves as engaged in a "grand march".[168] He adds that they see themselves as leading the way to a harmonious end-state that he describes as a "smiling brotherhood".[169] To the extent that Kundera captures the view that those who lead this march have of those they seek to benefit, we have reason to be uneasy. They assume that the people for whom they write a social script will happily read their lines on cue. But the tradition out of which the egalitarian philosophy of government has grown also recognises that people are apt to be awkward and that their interests clash.[170] While Kundera and the other writers on whom we have drawn dwell on some or all of these points, the authors of *Rights and Responsibilities* do not. Instead, they invoke "responsibilities" as a basis on which to establish harmony. They seem to have in mind something more than the mutual consistency (or compossibility) of rights.[171] Instead, they appear to contemplate a state of affairs in which people cultivate dispositions that will make the end-state envisioned by ministers an enduring reality. If this is the case, *Rights and Responsibilities* seems to go beyond the compossibility of rights and to contemplate the compossibility of

168 See *Governance of Britain*, n. 66 above, p. 5, "Foreword" (where Gordon Brown and Jack Straw state that "we need to begin the journey towards a new constitutional settlement"). Cf. *Building Britain's Future*, n. 167 above, where the Prime Minister identifies the government as "driven" by "the best of British values".

169 See also Oakeshott, *On Human Conduct*, n. 105 above (identifying the leaders of an enterprise association as holding out "the promise of salvation" to their "followers").

170 Wilson, *What Price Liberty?*, n. 80 above, p. 52, and Berlin, *Four Essays*, n. 119 above, p. 124.

171 On the compossibility of rights, see H Steiner, *An Essay on Rights* (Oxford: Blackwell 1994), pp. 2–3.

persons.[172] Assuming that this is broadly correct, we have a basis on which to conclude that New Labour is pursuing something more ambitious than a realistic Utopia. For (as Rawls tells us) those who probe the limits of practicable political possibility should take people as they are: complex creatures who make unlikely candidates for inclusion in a smiling brotherhood.[173]

172 We might see Berlin as having the compossibility of persons in mind when he observes that the "anti-Utopias" of Huxley, Orwell and Zamyatin "paint a horrifying picture of a frictionless society in which differences between human beings are, as far as possible, eliminated". See Berlin, *Crooked Timber*, n. 137 above, p. 45. See also Oakeshott, *On Human Conduct*, n. 105 above, p. 278 (on "a state from which the last vestiges of civil association had been removed, a *solidarité commune* in which there was no distinction of persons and from which no one was exempt") and Eleftheriadis, "On rights", n. 9 above, p. 41 (arguing that the authors of *Rights and Responsibilities* identify a new Bill of Rights and Responsibilities as necessary in order properly to "calibrate our practice of human rights" by treating "[t]he *motives* and *personal attitudes* of the persons exercising them" as relevant to the "scope" of their entitlements (emphasis added)). While the point cannot be pursued in detail here, to regard people as compossible may be to make a category mistake. Rights are artefacts. Hence, we may specify them in mutually consistent ways. But people are (sometimes refractory) agents who may be disinclined to act in accordance with our plans (even when those plans have to do with establishing a distributively just model of human association). Hence, talk of the compossibility of persons leads on to the tricky topic of human nature. Here, New Labour's use, among other things, of the locution "ordinary people" does not suggest a particularly flattering view of those whose interests it seeks to secure and/or promote. See, for example, *Review of the Implementation of the Human Rights Act: Myths and misconceptions* (London: Department of Constitutional Affairs 2006), p. 42 (on "the benefits which the Human Rights Act has given ordinary people"). Cf. D Kennedy, "The international human rights movement: part of the problem?" (2002) 15 *Harvard Human Rights Journal* 101, pp. 113 and 116–17 (arguing that the post-World War Two human rights movement has encouraged an approach to governance that places the state at "the center of [its] emancipatory promise" and that may stultify those whose interests it seeks to secure), and R M Unger, *What Should Legal Analysis Become?* (London: Verso 1996), p. 185 (arguing that "there is more in us . . . than there is in the institutional . . . worlds we make and inhabit").

173 Rawls, *The Law of Peoples*, n. 82, above, pp. 12–13.

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Protection of minority shareholders in Hong Kong and China: do culture and institutional design make any difference?

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Abstract

The corporate governance system in Hong Kong and mainland China was transplanted from Western countries. However, the latest ranking in corporate governance in Asia shows that Hong Kong moved to the top of the 2007 ranking above 11 other Asian countries while China was not even included.[2] *How can such a huge difference be explained? This article compares and discusses the reasons for the difference in corporate governance in Hong Kong and China. In particular, it focuses on discussing local cultural influences and institutional design on the implementation of the system of protection of minority shareholders in Hong Kong and China.*

Introduction

Corporate governance is promoted by many people[3] as an all-embracing concept to fix corporate ills and failures because it establishes a system of checks and balances to ensure that decision makers are accountable to various stakeholders.[4] Protection of minority shareholders (PMS) is one of the important elements of corporate governance. Each country has its own PMS mechanism embedded in its company law.[5] The effects of PMS rules that appear similar may not be the same due to different cultural environments. The fact that a system of PMS works well in certain countries does not ensure that it will work successfully in other countries or regions.

1 I would like to express deep appreciation to Professor Christopher L Ryan from City University London for his guidance and invaluable comments.

2 According to the news reported by Dow Jones International News, "Hong Kong's corporate governance is ranked as the strongest out of 11 major Asian economies, the first time Hong Kong has held the top position since the study began in 2000. Singapore slipped to second." The ranking was conducted by the Asian Corporate Governance Association in 2007. For details, see http://www.acga-asia.org/public/files/HK%20Has%20Asia%27s%20Best%20Corporate%20GovernanceSingapore%20Slips-Study%20DJ%2026%20Sep%2007.pdf (last accessed July 2009).

3 S S M Ho, *Corporate Governance in Hong Kong: Key problems and prospects* (Hong Kong: Centre for Accounting Disclosure and Corporate Governance, School of Accountancy, Chinese University of Hong Kong 2003), p. 3.

4 C Xi, "In search of an effective monitoring board model: board reforms and the political economy of corporate law in China" (2006) 22 *Connecticut Journal of International Law* 1.

5 H Cai, "Bonding, law enforcement and corporate governance in China" (2007) 13 *Stanford Journal of Law, Business and Finance* 18. At common law, initial protection was provided by the judiciary but in recent years the protections have become statutory. See the UK Company Act 2006, ss 260 and 994, for example.

There is a large amount of literature on corporate governance and PMS worldwide. La Porta et al.[6] for example, hold the opinion that "common law countries afford the best legal protections to shareholders and French civil law countries afford the worst" after examining legal rules covering protection of corporate shareholders and creditors, the origin of these rules and the quality of their enforcement in 49 countries. They also argue that highly concentrated ownership has a close connection with poor investor protection. The conclusion they draw is "good accounting standards, rule of law, and shareholder protection measures are highly negatively correlated with the concentration of ownership".[7]

Stijn Claessens and his co-authors have drawn a similar conclusion after analysing the relevant data of 1301 publicly traded corporations in eight East Asian countries.[8] They point out that more than two-thirds of East Asian firms are controlled by a single shareholder and separation of management from ownership control is rare.[9] They also argue "as ownership gets beyond a certain point, large owners gain nearly full control of the company and are wealthy enough to prefer to use firms to generate private benefits of control that are not shared by minority shareholders".[10]

When comparing corporate structures in Hong Kong with those in China based on the above scholars' arguments, it is easy to conclude that PMS in the two places should be more or less the same because a majority of private companies in Hong Kong and a large number of limited liability companies in China are controlled by a single or a few majority shareholders. Therefore, shareholders' interests may not be as well protected as their counterparts in common law countries.

But the latest ranking in corporate governance in Asian countries shows that Hong Kong moved to the top of the 2007 ranking above 11 other Asian countries while China was not included.[11] Despite so much resemblance in ownership structure, culture and management of companies, what causes such divergence in corporate governance and PMS between Hong Kong and China? Does culture and institutional design make the difference?

Both Hong Kong and China are Chinese-dominated societies with the same Confucius-influenced cultural background which affects people's way of thinking, behaviour and doing business. To understand the interrelationship between these three characteristics, it is necessary to see how scholars discuss the interconnection. There is a large body of literature examining the relationship between philosophy, culture and law. Hahm says that the law is a reflection of the culture's norms and values and, in order for law to be effective or valid, it must accurately reflect those norms and values.[12] Kim and Markus examined the values of uniqueness or conformity among people in different countries and found that Americans preferred uniqueness while Chinese and other East Asians preferred

6 The four authors are Rafael La Porta, Florencio Lopex-de-Silances, Andrei Shleifer and Robert W Vishny and the title of their article is "Law and finance", Working Paper 5661 (Cambridge, Mass: National Bureau of Economic Research, July 1996).

7 Ibid.

8 The eight East Asian economies are Hong Kong, Indonesia, South Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand.

9 S Claessens, S Djankov, J Fan and L Lang, "Expropriation of minority shareholders in East Asia" Working Paper 2000-4 (Tokyo: Center for Economic Institutions, Institute of Economic Research, Hitotsubashi University 2000), downloadable from http://ideas.repec.org/p/hit/hitcei/2000-4.html (last accessed July 2009).

10 Ibid.

11 The ranking was conducted by the Asian Corporate Governance Association in 2007. See n. 2 above.

12 C Hahm, "Law, culture, and the politics of Confucianism" (2003) 16(2) *Columbia Journal of Asian Law* 254–301.

conformity.[13] Amir Licht further discusses the possibilities of neatly "plugging-in" foreign legal elements to an existing corporate governance system. He says that, to ensure foreign legal elements are workable, one must assess the difference or distance between the source and target system.[14]

In order to find out the reasons for Hong Kong's placement at the top of corporate governance ranking in Asia and China's non-appearance, this article intends to compare PMS in Hong Kong and China from four aspects: first, cultural influence on company management in Hong Kong and China; second, the property ownership structures of private companies in Hong Kong and limited liability companies in China (because a company's property ownership structure, to a large extent, decides the company's management style); third, the relevant laws and regulations guiding PMS and the corporate governance systems in the two places; and, fourth, the differences in institutional design and culture between Hong Kong and China.

1 Cultural influence on company management

Cultural differences exist between Western and Asian countries. In Western countries, in America, in particular, cultural values such as freedom and individual rights are strongly emphasised. By the American Constitution and especially the Bill of Rights, people repeatedly hear messages about their responsibility for their own fate. They should follow their own conscience, be true to themselves and make their own choices. It is also believed that individual persons' attitudes, feelings and behaviours should be determined by the self without being controlled by any external cause.[15] On the other hand, the East Asian cultural context emphasises harmony and conformity.[16] One of the most important virtues stressed throughout Chinese history is the notion of centeredness and harmony which refers to keeping balance and harmony within the group.[17] Individuals' interests are subordinate to those of a group.[18] Keeping balance and harmony among extremes without being skewed or biased has been respected as one of the highest virtues in Chinese culture.[19]

Property Ownership Structure

(a) the role of the paternalistic figure in a Hong Kong company

Because individuals are required to put the group interests ahead of their own (based on Confucian teaching), a paternalistic figure within the group therefore plays a very important role. Chinese believe a country is like an extended family with the emperor or monarch at the top.[20] Within a Chinese family, the relationships between father and son and husband and wife are superior–inferior in character with a general duty of obedience owed by the inferior to the superior and a reciprocal duty of caring, support and guidance owed by the superior to the inferior.[21] A private company in Hong Kong is like an extended family with

13 H Kim and H R Markus, "Deviance or uniqueness, harmony or conformity? A cultural analysis" (1999) 77(4) *Journal of Personality and Social Psychology* 785–800.

14 A N Licht, "Legal plug-ins: cultural distance, cross-listing, and corporate governance reform" (2004) 22 *Berkeley Journal of International Law* 195.

15 D A Jopling and U Neisser, *The Conceptual Self in Context: Culture, experience, self-understanding* (New York: Cambridge UP 1997), vol. 7.

16 Kim and Markus, "Deviance", n. 13 above.

17 Hahm, "Law, culture, and politics", n. 12 above.

18 Kim and Markus, "Deviance", n. 13 above.

19 Ibid.

20 S B Lubman, *Bird in a Cage: Legal reform in China after Mao* (Palo Alto, CA: Stanford UP 1999), pp. 3–8.

21 D C K Chow, *The Legal System of the People's Republic of China in a Nutshell* (St Paul, MN: Thomson/West 2003).

an enterprise founder (EF) acting as a paternalistic figure in control of the company. Its employees show their utmost respect and loyalty to their EF, despite the fact that professional company managers are being widely employed nowadays. The vertical management structure used has the features of paternalism, hierarchy, responsibility, mutual obligation, family atmosphere, personalism and protectionism.[22] Conformity and harmony are much emphasised.

People in Asia are taught from their childhood to be obedient to elders, tradition and social norms. Employees should have the virtue of being responsive to standards of proper behaviour without emphasising their personal interests. Thus, it is not easy for employees and minority shareholders to stand up and express their objection to decisions which are not in their favour. In particular, employees must understand that even if their patriarch is wrong, confronting the patriarch directly in public will cause loss of "face", and losing face could seriously undermine the legitimacy of the patriarch's position in the company. In addition even if one person is brave enough to stand up and speak frankly, a cherished quality in Western countries, that person may not receive positive support from his or her colleagues, instead, the employee might be punished for disloyalty. The other employees and colleagues may even consider that the person making the complaint or allegation has become disconnected from the group. A person's desire for independence is believed to be a sign of immaturity.[23]

Apart from the extremely rare superior and inferior confrontation between a patriarch and an employee, serious face-to-face confrontation between two directors, in general, will not happen in a boardroom in Hong Kong, China or any other Asian country. As Child describes,[24] the chair of the board of directors (BOD) at a board meeting aims to establish a climate of consensus around general principles or the direction of policy rather than to raise specific issues. A compromise will be reached or a decision made prior to the meeting in order to avoid an open loss of face. Disagreements are normally voiced only in private. In Chinese eyes, expressing an objection against a BOD chair may label that person as a personal rival of the chair or chief executive officer (CEO). If people declare their position and even if their view proves correct, it does not mean they come out on top, indeed, it may actually put them in a difficult position in the company. That explains why fewer minority shareholders in China, Hong Kong and other Asian countries file cases against their majority shareholders or the company compared to similar situations in Western countries.[25]

The advantage of this vertical management structure is to have fewer transaction and agency costs. When an important decision is to be made by a BOD of a company in a Western country, it is often necessary to consult with advisors and receive the approval of the board and shareholders. All these procedures will inevitably cause delay.[26] In Hong Kong and China, when the same important decision needs to be made by a BOD, such a decision could possibly be made at a cocktail party or a dinner. If a paternalistic figure is wise, experienced in management and well-connected, the company may benefit. If the patriarch is not as smart as people expected, the one-person decision-making process could

22 P Lawton. "Berle and Means, corporate governance and the Chinese family firm." (1996) 6 *Australian Journal of Corporate Law* 348.

23 R D Friedman and J F Yates, "The triangle of culture, inference, and litigation system" (2003) 2(6) *Law, Probability and Risk* 137–50.

24 J Child, *Management in China during the Age of Reform* (Cambridge: CUP 1994), vol. 23, p. 333.

25 P Lawton, "Modeling the Chinese family firm and minority shareholder protection – the Hong Kong experience 1980–1995" (2007) 49(5/6) *Managerial Law* 249–71.

26 Ibid.

lead to a decision being made either improperly or based on inadequate information so as to destroy the company's competitive quality or damage its finances and its reputation.

(b) The number one person (*yi bashou*) of a company in China

Due to the political climate in China, in addition to these common cultural features of conformity and loyalty to a company "ruler" and the hierarchical management structure described above, the number one person's (NOP) power is reinforced. During the second half of the twentieth century, people in China were constantly taught that the Communist Party headed by Chairman Mao Zedong embodied absolute leadership and authority. Nobody dared to challenge his authority during his lifetime.[27] This culture of worshipping the "emperor" was deeply rooted in China for many thousands of years,[28] so when a former state owned enterprise (SOE) director is reappointed as a CEO or a BOD chair of a corporatised enterprise, that director also aspires to build up a private empire and be worshiped as a leader by the company employees. Hofstede describes now in such cultures the powerful are entitled to privileges and are expected to use their power to increase their wealth. Their status is enhanced by symbolic behaviour which makes them look as powerful as possible.[29] Unlike the EF in a private Hong Kong company, a BOD chair or CEO in a Chinese company is only an agent (due to the property ownership structure of Chinese companies which will be discussed later). These agents expect obedience from people below them (more so than would a Hong Kong EF) because they know an agent's fortune is in the hands of his or her principal. Everyone could lose their jobs and powers if the principal (i.e. the government) decides to remove the agent. So power/money exchange is significant.[30] In order to strengthen their power, these agents are expected to be appointed as both chair of a BOD and CEO[31] so that they can make and execute their decisions without delay. From the government's point of view, it is easier to control the company; from an agent's point of view, it is perhaps an opportunity to make a fortune occurring only once in his or her lifetime. In July 2009, Chen Tonghai (Communist Party of China (CPC) secretary and chair of the BOD and managing director of SinoPec)[32] was sentenced to death with a two-year suspension for bribery and corruption. The money Chen received in the previous nine years (1999–2007) reached RMB200m (*renminbi* (people's money), equivalent to US$29m).[33] People say Chen was destroyed by the "culture of *yi bashou*". He considered himself king of SinoPec and would not allow anyone in SinoPec to challenge his authority. He made a unilateral decision to invest RMB200m on behalf of the company after talking to someone for only 40 minutes. To him, the board of directors and the shareholders' meeting were for ornamental purposes only.[34]

Chen Tonghai's case has highlighted the difference between an EF of a Hong Kong company and a *yi bashou* in a Chinese company in so far as decision making is concerned. It is almost impossible for an EF in Hong Kong to make such a hasty decision without careful

27 In the 1950s and 1960s many intellectuals were labelled rightists or counter-revolutionaries and were sent for exile because they criticised the CPC when Mao encouraged them to give suggestions and advice to the government on economic development.

28 Chow, *The Legal System*, n. 21 above.

29 G Hofstede, *Cultures and Organizations – Software of the mind* (London: McGraw Hill 1991), p. 38.

30 Cai, "Bonding", n. 5 above.

31 In some Western systems of corporate governance this is unacceptable, for example, in the UK, the City's Combined Code requires the offices of chair and of CEO to be held by different people.

32 SinoPec is the second largest corporate group in China.

33 For details, see, http://hk.news.yahoo.com/article/090715/4/d7av.html (last accessed 15 July 2009).

34 For details, see, http://news.xinhuanet.com/comments/2008-01/30/content_7524535.htm (last accessed 15 July 2009).

consideration and consultation. Only an agent of a Chinese company would make such a "courageous" decision to invest that amount of money without getting permission from the principal. The reasons for the difference lie in the cultural anomalies discussed below.

(c) *Guanxi* network

When discussing differences in culture, Hofstede remarks that in the collectivist society personal relationships prevail over the task and should be established first; while in the individualist society the task is supposed to prevail over any personal relationships.[35] In a collectivist society, such as Hong Kong or China, company managers or CEOs prefer to manage their business by relying on "*guanxi*" networks. The interpretation of the concept of "wealth" in Western and oriental culture is different. People consider a successful person "wealthy" in the Western tradition while the equivalent in China is "well connected".[36] *Guanxi* in Chinese society refers to a set of interpersonal connections that facilitate exchange of favours between people.[37] *Guanxi* brings people together and encourages the the exchange of valued materials or ideas. *Guanxi* also means trustworthiness. Two persons having *guanxi* mean they have long-time interactions and the opportunity to develop future relationships. *Guanxi* also means mutual obligation. In a corporation, a boss has an obligation to look after the company's employees and employees have the duty to be loyal and dedicate themselves to the corporation. If an employee, at whatever level, denies his or her obligations, the ultimate price might be the loss of connections.[38]

Guanxi culture also influences a company's style of dealing with its partners or outside affiliates. People believe *guanxi* has the function of "glue" that holds Chinese society together[39] Company managers both in Hong Kong and China therefore tend to personalise communications and relationships when doing business. BOD chairs and CEOs need to build up their personal *guanxi* networks for exchanging informal favours and maintaining harmony in order to be successful in their own business or their company's business. After all, in Chinese society, *guanxi* is deemed as a dominant mechanism for establishing trust. Unlike CEOs in Western countries, Chinese managers prefer to solve daily management-related problems not through formal meetings but through informal personal contacts.[40] So, a considerable amount of Chinese managers' time is spent on informal personal connections.[41] When a person does someone a favour because of *guanxi*, that person wins "face" from others and also puts the beneficiary in debt. The beneficiary is then obligated to return a favour when it is requested. So, a Chinese manager believes that, provided a strong *guanxi* network has been established, should a problem arise, a helping hand will easily be found somewhere.

This is particularly true in China where laws and regulations are not well implemented, so people rely on *guanxi* to solve their problems. If there is a problem or a disagreement between a government department and a company or between two companies which needs to be solved through a legal or administrative procedure, paperwork needs to be completed and an agenda of a scheduled meeting needs to be communicated to the relevant personnel.

35 Hofstede, *Cultures*, n. 29 above, p. 67.

36 J E Garten, "Opening the doors for business in China" (1998)76 *Harvard Business Review* 167.

37 K-K Hwang, "Face and favor: the Chinese power game" (1987) 92 *American Journal of Sociology* 944–74.

38 T W Dunfee and D E Warren, "Is guanxi ethical? A normative analysis of doing business in China" (2001) 32 *Journal of Business Ethics* 191–204.

39 L-F Chou, B-S Cheng, M-P Huang and H-Y Cheng, "Guanxi networks and members' effectiveness in Chinese work teams: mediating effects of trust networks" (2006) 9 *Asian Journal of Social Psychology* 79–95.

40 Lawton, "Berle and Means", n. 22 above.

41 Ibid.

When a solution is reached, the execution of the solution needs to be checked and the feedback needs to be reported to the relevant government department. To avoid all this bureaucracy, people believe it is better to solve the problem through an informal channel by using a manager's *guanxi* (personal contacts) or influence.

Apart from the common features of *guanxi* in Hong Kong and China, *guanxi* can also be established more blatantly in China. Stuffing a large amount of money into a "red envelope" (*hongbao*) by an entrepreneur to give to a government official without explicit demand for a return is the most popular way of establishing *guanxi*. The official having received the money certainly knows he or she is obliged to reciprocate by using status, power or position.

The second method of establishing *guanxi* in China is called "*renqing*" meaning an entrepreneur tries to make a connection to a government official as a "brother", "cousin" or a "godfather". This kind of connection can be claimed to be non-material or non-commercial, therefore, it can avoid being classified as the offering or receiving of bribes. Unlike giving a red envelope, which is regarded as an entrepreneur's response to a cadre's hinted demands, *renqing* depends on the entrepreneur's shrewd observation of a cadre's unarticulated needs.[42] For example, one entrepreneur may introduce his relative, a famous surgeon, to perform an operation on and take special care of a cadre's sick mother. In return, the cadre introduces colleagues and friends to the entrepreneur to enhance connectivity. Such investment may not receive an immediate return but will be really helpful when assistance is needed.

The third method of establishing *guanxi* is to provide the sexual equivalent of the red envelope, with the added possible leverage of bribery. Important business proposals and contracts nowadays are often completed with what those involved see as ideal results in karaoke bars, dance halls, nightclubs, saunas, karaoke TV suites, restaurants, hotels and massage parlours. This form of *guanxi* is preferred by some businesspeople and government officials. There is a common saying that "giving women's bodies and sexual services as gifts will cement *guanxi* better".[43]

Another observation is that small and medium-sized companies in China are more keen on establishing *guanxi* networks than large companies. Those companies located at a lower position on the administrative ladder may not easily obtain necessary resources like loans and tax concessions. According to Fan et al.'s empirical studies of corruption cases in China, a firm's access to debt finance, in particular, long-term debt provided by corrupt bureaucrats, is vital to many firms' competitiveness.[44] Local leading companies, especially those converted from SOEs, have already experienced the upper levels of the administrative hierarchy. This is because of their natural connections with administrative organs in urban industry and leads to their receiving generous support from the local government. As a result, they have less need to go out of their way to pull strings through connections. While small and medium-sized companies, on the other hand, in order to survive in the market economy, have to use all possible means to build up a *guanxi* network.[45]

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42 D L Wank, "The institutional process of market clientelism: guanxi and private business in a South China City" (1996) *The China Quarterly* 830–38.

43 M M Yang, "The resilience of guanxi and its new developments: a critique of some new guanxi scholarship" 2002 *The China Quarterly* 459–76.

44 J P H Fan, O M Rui and M Zhao, "Rent seeking and corporate finance: evidence from corruption cases" (2008) 36(3) *Journal of Comparative Economics*, available from the Social Science Research Network http://papers.ssrn.com/sol3/papers.cfm?abstract_id=877627 (accessed in July 2009).

45 Yang, "Resilience", n. 43 above.

It is interesting to look at the reasons why Chinese businesspeople are more enthusiastic than their counterparts in Hong Kong in establishing *guanxi* networks. Unlike Hong Kong, where the rule of law is well established, laws written on a piece of paper and laws implemented are sometimes two different matters in China. In other words, "unspoken rules" are still popular in China. Local protectionism, departmental protectionism and difficulties in law enforcement occur from time to time. Some government officials take bribes and bend the law, abuse their power when executing the law, and may even substitute their own word for the law. Therefore, businesspeople can anticipate potential problems they may face such as sudden policy changes or administrative harassment.[46] If they know someone in the government who has more discretionary control over a wider range of public resources and most importantly is willing to protect them, entrepreneurs are happy to invest in the *guanxi* network and treat that government official as *kaushan* (supporter). From the perspective of the government official, having *guanxi* with local entrepreneurs may institutionalise new sources of revenue to cope with decline in state-allocated resources.[47] In fact, a *guanxi* network may benefit both sides. Therefore, people perceive *guanxi* as a double-edged sword, it can be beneficial but it can easily be interpreted as bribery and corruption. *Guanxi* is also considered as fertile soil for corruption to flourish.[48] Many Chinese government officials, company directors and CEOs have been punished for corruption or bribery by misusing their *guanxi* networks.[49]

2 Different ownership structures

(a) Ownership structure of Hong Kong private companies

Why is the *yi bashou* management style so popular both in Hong Kong and China? More than 50 per cent of Hong Kong private companies are controlled by a few majority shareholders so the EF is able to play a crucial role in a private company. According to Doe's research, "fifty-three per cent . . . of all listed companies had one shareholder or a family shareholder group owning 50 per cent or more of the voting shares . . . Eighty-eight per cent . . . had one shareholder or family shareholder group owning 25 per cent or more."[50]

Hong Kong private companies or family firms normally undergo four stages: emergent, centralised, segmented and disintegrative.[51] At the emergent stage, the EF together with other business partners work hard to start their business. In order to survive in the market, they have to show their ultimate mutual trust and confidence. Ownership and management of a firm is normally not separated. At the second stage, the firm has established its business well and the EF may have also have reached retirement. But it is not easy for EFs to hand over the power that they have fought for almost all of their lives to the next generation so succession becomes a major issue. At the third stage, the second generation

46 For example, if a bureaucrat from an environment protection bureau wanted a local company to reimburse his or her personal expenses but the request was turned down, the bureaucrat could harass the company by finding an excuse to order the company to pay an extra penalty for not reaching certain environmental protection standards. In China, it is not surprising that some local companies have to pay extra money to a local environmental protection bureau in order to allow them to continue their production without spending money on purchasing proper equipment to purify their wasted water or polluted air. As the company has not done the right thing, it is easy to blackmail it.

47 Yang, "Resilience", n. 43 above.

48 Chou et al., "Guanxi networks", n. 39 above.

49 U C Braendle, T Gasser and J Noll, "Corporate governance in China – is economic growth potential hindered by guanxi?" (2005) 110(4) *Business and Society Review* 389–405.

50 J Doe, "Corporate governance in Hong Kong" (1998) 9(10) *International Company and Commercial Law Review* 281–90.

51 Lawton, "Modeling the Chinese family firm", n. 25 above.

may have control of the family business but equal inheritance of the family business and assets becomes a problem among siblings which may put the business in danger and vulnerable to outside market competition. So it is wise to move the family firm back to the centralised stage in order to pull all the strength and resources together to survive in the market with one sibling controlling the business and helping the other siblings to establish their own firms.[52] The capability and experience of a paternalistic figure in a company is crucial to the success of a family business. Since most Chinese family firms or private companies have undergone this lifecycle, the strengths and problems are all linked to the structure of ownership and control. As far as minority shareholders' interests in these companies are concerned, Ho and Chueng both point out that the main problem is not the agency problem but the problems between the majority and minority shareholders.[53]

(b) Ownership structure of Chinese limited liability companies

An NOP in a Chinese limited liability company (LLC) expects everyone in the company to understand that he or she is the only person who can make decisions for the company. To explain the reasons why these NOPs are so reluctant to give up any managerial power, it is necessary to examine the ownership structure of the LLC in China. Most LLCs were converted from SOEs and many former SOE directors were reappointed by the government as BOD chairs and CEOs. SOEs had a long history of misusing or wasting state assets due to the public ownership structure and lack of supervision mechanisms, so, when a former SOE director is reappointed as a BOD chair or CEO of an LLC, the post is changed but the bad habit of misusing state assets cannot be corrected overnight. Besides, converted companies have a split share structure with more than half of the shares belonging to the state and legal person companies. These shares are non-transferable. Only the remaining (minority) shares can be traded on the stock market.

State shareholders in Table 1 are mainly local state assets bureaux responsible for investing and managing state assets in companies. Legal person shareholders include state-owned companies, private companies, state institutions (*shiye danwei*) or social organisations (*shehui tuanti*).[54] If a company happens to be a listed company, more than half of its shares are not allowed to be traded on the stock exchange for the reason that state shares should remain in the hands of the government according to the regulations promulgated at that

Table: 1 Ownership and control[55]

Shareholders	**Ownership**	**Control (in board of directors)**
State shareholders	24%	21%
Legal person shareholders	44%	48%
Staff shareholders	2%	3%
Individual shareholders	30%	4%
Total	**100%**	**76%**

52 Lawton, "Modeling the Chinese family firm", n. 25 above.

53 R Cheung, "The statutory minority remedies of unfair prejudice and just and equitable winding up: the English Law Commission's recommendations as models for reform in Hong Kong" (2008) 19(5) *International Company and Commercial Law Review* 156–64; Ho, *Corporate Governance*, n. 3 above.

54 Legal person shareholders are mainly those LLCs converted from SOEs. In order to expand their production, these companies may invest in another company and become a legal person shareholder. So, technically speaking, a large amount of assets of these companies invested in by legal persons are also state assets.

55 The table is copied from Z Guanghua and C Guofu, *The Government and Enterprises – Their interrelationship in the transitional period* (in Chinese) (Beijing: Beijing University Publisher 2005), p. 109.

time.[56] It was believed that if a large amount of state shares or legal person shares became tradable, the stock market could open up a channel for misappropriation or depreciation of state assets.[57] The immediate problem of such an unbalanced share structure is that the price of a listed company does not reflect its performance and the problem of "insider control" is serious. Controlling shareholders of these companies, either representatives from the State Assets Management Bureau (SAMB)[58] or a legal person company, have less motivation to care about changes in the values of share prices of the listed companies in the market. They are more interested in raising funds from the stock market. Therefore, they are frequently engaging in benefit transfer through misappropriation of funds or related-party transactions to expropriate listed companies and infringe upon the interest of minority shareholders.[59] That explains why so many minority shareholders in China complain that they were misled by companies' fabricated annual reports and have suffered great loss by purchasing shares in those companies.

The combination of all the above factors indicates that the interests of minority shareholders both in Hong Kong private companies and in Chinese LLCs will not be effectively protected. Scholars in Hong Kong have pointed out that the concentrated Chinese ownership structure can lower agency costs between the managers (agent) and shareholders (principal) but they give rise to a second dimension of the agency problem – the one between controlling and minority shareholders.[60] In Chinese LLCs, the problem of expropriating minority shareholders' interests is even worse. But it would be premature or hasty to conclude that the law and methods of PMS in Hong Kong and China are more or less identical in providing inadequate protection. The legal and regulatory framework and cultural factors affect how PMS operates in each jurisdiction.

3 Relevant legislation on PMS in Hong Kong and China

Hong Kong was a colony of the UK for over 150 years, so its company law (the Company Ordinance)[61] is largely based on the UK's Company Act 1948 and its amendments. China, on the other hand, is still a socialist country implementing a civil law system and its Company Law has characteristics of civil law countries, such as Germany and Japan.

56 For example, the Ministry of Finance published "Circular on Issues Relating to Reduction of State-owned Shares held by Financial Assets Management Companies and State-owned Banks" in 2004. The circular clarifies that: "when companies go public, the shares held by the wholly state-owned banks and financial assets management companies which are converted from credit assets may not be reduced, and the contribution to the social security fund corresponding to such shares shall be exempted".

57 By April 2005, as many as 1102 listed companies started issuing A shares on the stock exchanges. Among these companies, 890 companies had unbalanced share structures with one majority shareholder holding more than 50 per cent of the total. Sixty-three companies had powerful majority shareholders holding 75 per cent of a company's shares. W Junhui, "Some thoughts about accumulative voting rights" (in Chinese) (2007) 19(3) *Journal of Henan Textile College* 37–40.

58 In order to manage state assets in corporatised SOEs efficiently, the state-owned SASAC was established at the central government level in 2003 and SAMBs at local government level in 2003 or 2004. Their major responsibilities include supervision of the preservation and increment of the value of state-owned assets in enterprises under their supervision and enhancement of the management of state-owned assets and to advance the establishment of modern enterprise systems in SOEs. For details of their rights and liabilities, see http://www.sasac.gov.cn/n2963340/n2963393/2965120.html (accessed December 2008)

59 Z J Lin, L M Liu, X Zhang. "The development of corporate governance in China" (2007) 28(7) *Company Lawyer* 195–203.

60 Cheung "Statutory minority remedies", n. 53 above; H Goo and R H Weber, "The expropriation game: minority shareholders' protection" (2003) *Hong Kong Law Journal* 71–98.

61 The latest amendment to Hong Kong Company Ordinance was made on 14 December 2007.

(a) Hong Kong legal and regulatory framework

Hong Kong has an effective legal system to protect minority shareholders. For example, s. 168A of the Hong Kong Company Ordinance allows any shareholder to petition the court for an appropriate order if the affairs of the company have been conducted in a manner which is unfairly prejudicial to the interests of that shareholder or shareholders generally. Section 177(1)(f) permits shareholders to apply for a just and equitable winding up if they feel that they have been unfairly treated. Shareholders in Hong Kong can also claim their interests in the court based on an exception to the rule in *Foss* v *Harbottle*.[62] A recent amendment (ss 168BA–BK) to the Company Ordinance[63] has strengthened the position of minority shareholders in companies. It establishes a procedure allowing a member of a company to bring a derivative action or intervene in any proceedings in the event of misfeasance.[64] In fact, the Hong Kong legislation permits coexistence of the common law and statutory derivative actions. Judge Rogers VP confirmed in the case of *Waddington Ltd* v *Chan Chun Hoo* & *others* (2006) that the creation of a new statutory procedure would not affect the common law right to bring a derivative action.[65]

Apart from the Company Ordinance, there are several other laws regulating companies in Hong Kong:

- The Securities Disclosure of Interests Ordinance (Cap 396) which requires substantial shareholders to disclose interests in shares of listed companies. Directors and chief executives of a listed company are also required to disclose interests in shares and debentures of the listed company and its associated companies.[66]
- The Hong Kong Code on Takeovers and Mergers requires companies to disclose timely and adequate information to enable shareholders to make an informed decision as to the merits of the offer and to ensure that there is a fair and informed market in the shares of companies affected by takeover and merger transactions.[67]
- The Listing Rules require a listed company to keep the market informed of all sensitive information, such as connected transactions, with its subsidiary or a connected person (including a director, chief executive, or substantial shareholder of the company or its subsidiaries, or associate of any of these). These transactions are subject to disclosure to the stock exchange and shareholder approval in the general meeting. Interested parties are prevented from voting.[68]

62 V Stott, *Hong Kong Company Law* 12th edn (Hong Kong: Pearson Longman 2008), p. 186.

63 The amended Company Ordinance came into effect on 15 July 2005.

64 Stott, *Hong Kong Company Law*, n. 62 above, p. 188.

65 This is a double derivative action in which minority shareholders sue majority shareholders and other relevant parties in relation to certain steps taken by majority shareholders in a number of complex commercial transactions which are alleged to be to the ultimate disadvantage of the company, and consequently the minority shareholders, and the ultimate benefit of the majority shareholders, the first and second defendants. For details, see http://legalref.judiciary.gov.hk/lrs/common/ju/ju_body.jsp?DIS=56913&AH=&QS=&FN=&currpage= (last accessed August 2009). See also Stott, *Hong Kong Company Law*, n. 62 above, p. 189, and *Waddington Ltd* v *Chan Chun Hoo & others* in Court of Appeal, Civil Appeal No. 220 of 2005 Hong Kong, p. 905.

66 For details, see http://sdinotice.hkex.com.hk/di/NSSrchMethod.aspx?src=MAIN&lang=EN&in=1 (last accessed December 2008).

67 For details, see http://www.mallesons.com/publications/Corporate_Finance_Briefing/6630265W.htm (last accessed December 2008).

68 For details, see http://www.hkex.com.hk/rule/mbrule/mb_ruleupdate.htm. See also Ho, *Corporate Governance*, n. 3 above, p. 13.

With the exception of the relevant ordinances and regulations to control companies in Hong Kong, a three-tier market regulatory system is also well established by the Hong Kong government. The Securities and Futures Commission (SFC) and the stock exchange (HKEx) work together to monitor listed companies and the securities and futures market in Hong Kong. Among the regulatory institutions, the Hong Kong government is the overall policymaker. The SFC as the statutory regulator of listed companies enforces the new Securities Futures Ordinance and the Takeover Code. HKEx, as the non-statutory frontline regulator of listed companies, enforces the Listing Rules.[69] Except for commercial secrets, SFC encourages all firms to increase transparency by more voluntary disclosure.[70]

(b) China's legal and regulatory framework

China's system for regulating companies, although started in the 1990s, has been greatly improved in the past 10 years. Its first Company Law, promulgated in 1994, was a hybrid produced by copying company laws from both common law countries and civil law countries (including Hong Kong's Company Ordinance), plus local elements.[71] China's Company Law was further amended in 2006. In order better to protect minority shareholders' interests in companies, the amended Company Law provides shareholders with cumulative voting rights,[72] the right of requesting the company to repurchase their shares at a reasonable price[73] and the right of viewing important company documents.[74] Most importantly, considering the weakness of 1994 Company Law with no relevant article permitting shareholders to initiate derivative actions, the amended Company Law has inserted one article (Article 152) which provides details on how shareholders may bring proceedings against company wrongdoers.

China's Securities Law was proclaimed in 1998 and amended in 2005. It has strict and detailed rules on issuance of securities, trading of securities, guidelines for stock exchanges and clear legal liabilities that companies and the relevant personnel shall carry if they violate it. In addition to these laws, and specifically to counter the serious problem of making

69 Ho, *Corporate Governance*, n. 3 above.

70 See http://www.sfc.hk/sfc/html/EN/aboutsfc/disclosure/policy.html (last accessed December 2008).

71 Local elements here refer to some provisions in the 1994 Company Law which emphasised the importance of the CPC and the state. For example, Article 17 highlighted that "the grass-root organization of the Communist Party of China in a company shall carry out its activities in accordance with the Charter of the Communist Party of China". As the 1994 Company Law failed to clarify the relationship between the CPC organisation, a shareholders' meeting and a board of directors in a company, when the 1994 Company Law was implemented, it was difficult to avoid problems between the CPC organisation, the shareholders' meeting and the board of directors in the company. Article 4(3) emphasised that "the state assets of a company belong to the State". This provision has received many criticisms because an LLC is an independent legal person. When a company is required to consider "the state assets of a company belong to the State", it is difficult for the company to be truly independent and be responsible for its own profits and losses.

72 Article 106 of 2006 Company Law states "when shareholders elect directors or supervisors, each share has the voting rights equal to the number of the directors or supervisors to be elected, and concentrated use of the voting rights held by a shareholder is permitted". It means shareholders may bundle their shares up with other minority shareholders in order to reach a minimum amount of ownership that may give them enough power to express their views at a shareholders' meeting. Buckley et al. further describe how the cumulative voting system operates: "A shareholder may allocate all of the votes that he would be entitled to cast for the election of all directors (the number of shares owned times number of directors to be elected, assuming one vote per share) among the different candidates in any manner he wishes." For details, see F H Buckley, M Gillen and R Robert, *Corporations, Principles and Policies* 3rd edn (Toronto: Emond Montgomery 1995), p. 427.

73 For details of how shareholders can request the company to repurchase their shares and the relevant conditions, see Article 75 of 2006 Company Law.

74 Article 34 of 2006 Company Law states "shareholders shall have the right to check and make copies of the articles of association, minutes of shareholders' meetings, resolutions of the board of directors and board of supervisors and financial reports of the company".

fraudulent misrepresentations by listed companies to trap unsophisticated investors, the Supreme People's Court in 2002 issued a Notice on the Relevant Issues Concerning the Acceptance of Civil Tort Dispute Cases Caused by False Statements in the Securities Market.[75]

Apart from a series of laws and regulations which apply to companies and the securities market, China has also set up a supervision system with two major institutions playing important roles. One is the China Securities Regulatory Commission (CSRC) responsible for the supervision of securities and futures business; stock and futures exchange markets; listed companies; and other securities-related business.[76] The other is the state-owned Assets Supervision and Administration Commission of the State Council: SASAC at the central government level and SAMBs at local government level. Their major responsibility, as state investor, is to supervise the preservation and increment of the value of state assets in SOE-converted companies under their supervision.[77]

(c) Protection of minority shareholders: practice in Hong Kong

How comparable is the enforcement of the relevant laws and regulations in these two places? Data relating to cases filed by minority shareholders against companies and majority shareholders in Hong Kong is not readily available, so discussion of the practice of PMS in Hong Kong is mainly based on different scholars' research and in particular the data (1980–1995) collected by Lawton.[78]

Doe stated that "fifty-three per cent . . . of all listed companies in Hong Kong had one shareholder or a family shareholder group owning 50 per cent or more of the voting shares".[79] As a result of such shareholding, the interests of minority shareholders in these companies will inevitably be affected. First, when a private company becomes a listed company with its shares floated on the stock exchange, the EF of that company may still consider the company as family property. Minority shareholders, having contributed their capital, are seen as merely fund providers, not as shareholders or co-owners deserving of equal treatment.[80] Secondly, when directors of the company need to be appointed, as the management of the company is in the hands of the EF and controlling shareholders, the procedure of nominating and appointing directors is ultimately controlled by them. Minority shareholders have almost no chance to vote for a director who could represent them on the board.[81] Thirdly, when a company enters into a contract with a related party, as a general rule, controlling shareholders who are also directors must not approve a contract in which they are interested.[82] But, in reality, as shareholders do not owe any fiduciary duty to each other, it is perfectly acceptable for them to put their personal interests before those of the company when they vote at the general meeting.[83] The

75 For details, see http://www.lawinfochina.com/law/displayModeTwo.asp?id=4699&keyword= (last accessed 30 October 2008).

76 For details of the functions of the CSRC, see http://www.csrc.gov.cn/n575458/n4001948/n4004898/n4026463/index.html (last accessed November 2008).

77 For details of the SASAC, see http://www.sasac.gov.cn/n2963340/n2963393/2965120.html (last accessed November 2008).

78 The data relating to minority shareholder petitions in Hong Kong (1980–1995) is collected by Lawton "Modeling", n. 25 above.

79 Doe, "Corporate governance", n. 50 above.

80 Goo and Weber "The expropriation game", n. 60 above.

81 Ibid.

82 Lord Greene MR said in *Regal (Hastings) Ltd* v *Gulliver* [1942] 1 ALL ER 378: "The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect."

83 *Northwest Transportation Co. Ltd* v *Beatty* [1887] 12 App Cas 589.

consequence of controlling shareholders' misconduct through related party transactions is that minority shareholders' interests are compromised. Therefore, minority shareholders' complaints (according to Lawton's research on 275 minority shareholder petitions in the High Court of Hong Kong from 1980 to 1995 inclusive) are mainly in the following categories: exclusion from management 73.1 per cent; loss of confidence 58.9 per cent; failure to follow regulations 51.3 per cent; diversion of funds/assets 30.1 per cent; no dividend paid 12.7 per cent; and dilution of shareholding 12.7 per cent. The grounds of petition may vary depending on the cause of action used. In some cases, the grounds of petition overlap, for example, exclusion from management and loss of confidence might be the grounds of the same petition.[84]

(D) Protection of minority shareholders: practice in China

Collecting the relevant data relating to PMS in China is even more difficult because China is a civil law country: legal cases do not carry the force of precedent compared to the practice in a common law country. It is not a mandatory requirement for all courts in China to report cases. A court may select and publish some important cases if it wishes. Before the amended Company Law became effective, only a few high-profile and influential cases were reported. I have managed to collect 26 (26=100%) PMS-related cases from different sources.[85] Of these, 11 cases (42%) were decided in accordance with the 2006 Company Law and another 11 (42 %) were decided on the basis of the 1994 Company Law. Four cases (16%) were first turned down by the court due to lack of guidance in the 1994 Company Law but reopened for trial after the amended Company Law became effective and minority shareholders filed the cases again.[86] Although 26 cases are insufficient to make meaningful comments on whether the relevant PMS provisions in the new Company Law are proper and effective, at least, through these cases, we have a better view of how minority shareholders fight for their interests in companies and how courts in China handle these cases.

In general, minority shareholders' status in Chinese companies is comparatively similar to their counterparts in Hong Kong. Due to the split shareholding structure, minority shareholders in China are mainly excluded from management. Therefore, the grounds of complaint by minority shareholders in China are similar to the complaints by minority shareholders in Hong Kong.

First, minority shareholders complain that they are not consulted when the company's articles of association are altered (three cases (12%)).[87] Secondly, directors or controlling shareholders of a listed company transfer the company property to a third party or use the company property to provide a guarantee for a third party without either a decision reached by the BOD or informing minority shareholders. They also treat a listed company within a corporate group as a cash machine (11 cases = 43%). Thirdly, company directors and

84 The grounds of complaint listed by Lawton were based on analysis of 275 minority shareholder petitions in the High Court of Hong Kong between the years 1980 and 1995 inclusive. Although the data (1980–1995) collected by Lawton is outdated, the grounds of complaint listed are still applicable because these grounds match other scholars' findings. Also see, A Lau, J Nowland and A Young, "In search of good governance for Asian family listed companies: a case study on Hong Kong" (2007) 28(10) *Company Lawyer* 306–11. Doe, "Corporate governance", n. 50 above.

85 Different sources here refer to Chinalawinfo.com; Infobank; Isinolaw; LawinfoChina; Lawyee.net; Lexis.com and also relevant websites of local courts.

86 As 1994 Company Law had no provision guiding derivative action, when minority shareholders initiated a lawsuit on behalf of the company, the court had no choice but to turn down their request. When the Company Law was amended, a new article (Article 152) guiding derivative action was included. The former shareholders are therefore permitted to file their case again.

87 The calculation is based on 26 cases collected. Note that all percentages are rounded up.

controlling shareholders release untrue information in prospectuses and annual reports to mislead/cheat investors (nine cases = 35%). Fourth, minority shareholders are not given dividends (one case = 4%). Fifth, company directors or controlling shareholders sell state assets at an undervalue (two cases = 8%) which results in a drop in the minority shareholders' share value.

Close examination of the grounds of complaint by minority shareholders in Hong Kong and China reveal differences. First, although the minority shareholders in both places complain that controlling shareholders and directors exclude them from the decision-making process, at least in Hong Kong company directors cannot carry out notifiable transactions or connected transactions without timely disclosure in accordance with the Listing Rules.[88] If the stock exchange and the SFC discover that they are not accurately informed of any price-sensitive information that may have an effect on the market, the stock exchange may use its powers to suspend trading in the shares of the company until such information enters the public domain.[89] Because of effective supervision and accounting systems, company directors or controlling shareholders find it difficult to diversify company assets without proper disclosure. In China, minority shareholders (nine cases (35%)) complain that controlling shareholders or company directors transfer the company assets to its parent company or use the company assets to provide guarantee a for a third party without a decision made by the BOD or informing minority shareholders. The difference here is that assets of a private company in Hong Kong belong to either the EF or the shareholders. It is unlikely that they will transfer or use their own property as a guarantee to save another company without any benefit. In China, majority shareholders in many companies are agents from the SAMBs. Their personal interests may conflict with that of the company and, therefore, they might generously transfer the company assets to save another company.[90] Even if these shareholders and directors do not benefit directly from the transfer, they will benefit later from an enhanced *guanxi* network that has been established through the transaction.

Secondly, there is also a difference in the issuing of company prospectuses and annual reports. The practice in Hong Kong in this respect is very strict. When a company plans to issue a prospectus, the requirement of the Company Ordinance is that, if the prospectus contains an untrue statement, the persons who subscribe for any shares or debentures on the faith of the prospectus and who suffer loss or damage by reason of that statement will be entitled to be compensated.[91] The requirement to make an annual report[92] by company directors states that failure to take all reasonable steps to secure compliance is an offence.[93] So it is more difficult for company directors in Hong Kong to make fraudulent misrepresentation through either their annual report or their company prospectus. In nine cases (34%) out of the 26 Chinese cases, minority shareholders complained that the company directors and majority shareholders fabricated their monthly or annual reports.

88 Modifiable transactions refer to details of significant acquisitions or dispositions of assets that have to be disclosed when the value of the transaction relative to the value of the issued share capital of the company exceeds a specified percentage. See Ho, *Corporate Governance*, n. 3 above, p. 13.

89 Ibid.

90 For details of how company directors use the company assets as a guarantee to save another company without a decision reached by the BOD, see http://www.people.com.cn/GB/jinji/20021127/875535.html (last accessed December 2008).

91 Stott, *Hong Kong Company Law*, n. 62 above, pp. 7 and 9.

92 An annual report made by the directors normally deals with the profit or loss of the company for the financial year. The report must be approved by the BOD and signed on its behalf either by the chair of the meeting at which it was approved or by the secretary of the company: Hong Kong Company Ordinance, s. 129D(2).

93 Hong Kong Company Ordinance, s. 129F.

Although both the 2006 Company Law and the Securities Law in China emphasise directors' duties and the severe punishment that they may receive if they make misrepresentations,[94] in reality, it is difficult for minority shareholders who are not professionals with knowledge of accountancy and law to collect crucial evidence to prove that the statements issued by the company are fictitious.[95] It also indicates that the supervision and accounting systems in China are not as efficient as their counterparts in Hong Kong. In addition, it means agency problems are still serious although the new Company Law has set up stricter rules to punish those who breach directors' fiduciary duties and duties of care and skill.[96]

4 Institutional design differences

(a) Do culture and institutional design make any difference?

Cultural influence produces some differences in corporate governance and PMS between Hong Kong and China, but the difference is not huge. So, why is Hong Kong at the top of the corporate governance ranking of Asian countries but China is not? Is there any other reason that causes such huge difference? Does it lie in a difference in culture and institutional design?

(b) Institutional design in Hong Kong

Although Chinese-dominated societies emphasise harmony and conformity, Chinese culture is an evolutionary process developing from a pluralist platform to include subcultures and hybrids.[97] This is particularly true in Hong Kong. Apart from the influence of Confucianism, Hong Kong is an international business hub with a modern outlook, free

94 Regarding issuing new shares in China, Article 137(3) of the 2006 Company Law requires a company not to have "false reporting in the financial and accounting documents of the company during the last three years". Article 152(5) allows a company to issue new shares with the condition that "the company has not committed any significant illegal acts and there are no false records in the financial accounting statements for the last three years". With regards to the liabilities of misrepresentation, Article 212 states "if a company is found to have provided false financial and accounting reports or to have concealed important facts in reports to shareholders or the public, the principal personnel directly responsible and other personnel directly responsible shall have a fine imposed of RMB10,000 to RMB100,000 Yuan. If a case is serious enough to constitute a crime, criminal liability shall be pursued in accordance with the law." The Securities Law also has similar requirements, such as Articles 20, 31, 69, 151 and 192.

95 In one case, 476 minority shareholders sued Ying Guanxia (YGX), a gigantic listed company. YGX fabricated its annual report to impress potential investors and many minority shareholders living in different provinces. Because of the report, these shareholders suffered a great loss. The disputable capital reached RMB181m. As many as 476 investors registered as plaintiffs to claim for compensation. As the minority shareholders filed the case in 2001, the case was turned down for a reason that no judgment could be made without proper guidance. After the amended Company Law became effective in 2006, the shareholders filed the case again. The case dragged on until, eventually, shareholders were offered 2.2 shares for each RMB10 Yuan by YGX. Considering the losses minority shareholders had suffered, the offer was very unfair. For details, see http://0-www.chinainfobank.com.lib.cityu.edy.hk/IrisBin/Test.dll?db=hk (last accessed September 2008).

96 For example, Article 148(2) states "Directors, supervisors and senior management personnel shall not abuse their duties and rights to receive bribes or other illegal income and shall not convert company assets." Article 203 states "where a company made false records or concealed important facts on financial accounting reports etc provided to the relevant authorities as required by the law, the person-in-charge and other personnel who are directly responsible shall be imposed a fine ranging from RMB30,000 to RMB300,000 by the relevant authorities". For details of how this law punishes those who breach a director's fiduciary duties and duties of care and skill, see China Company Law Chapter XII: Legal Liability.

97 A Young, "Rethinking the fundamentals of corporate governance: the relevance of culture in the global age" (2008) 29(6) *Company Lawyer* 168–74.

markets and technological innovation and a culture which is increasingly a mix of traditional and Western influences.

The sovereignty of Hong Kong was handed over to China in 1997. Since then separation of power has been adhered to based upon the principle of "one country and two systems" and the Basic Law of the Hong Kong Special Administrative Region (HKSAR).[98] A three-tier system is exercised with the Chief Executive holding the power of the executive and the powers of judiciary and legislature being exercised by the courts and legislative council. The three-tier system aims to provide a check and balance function with each element monitoring the performance of the others.

In addition to the implementation of this check and balance system, one Hong Kong institution that plays an irreplaceable role in keeping Hong Kong clean, fair and transparent is the Independent Commission Against Corruption (ICAC) which is considered the community watchdog.[99] The Hong Kong ICAC does not confine its activities to enforcement. It is responsible directly to the Chief Executive of the HKSAR. The ICAC's strategy of fighting corruption is three-pronged, namely investigation,[100] prevention[101] and education.[102] Because of its outstanding performance, the ICAC has significantly changed the business cultural climate in Hong Kong. Previously, corruption was widespread and now it is largely rejected,[103] According to the Transparency International 2008 Corruption Perceptions Index, Hong Kong is ranked 12th with Austria and the UK 16th and the USA 18th worldwide.[104]

Media supervision is another powerful weapon that watches over government and helps to maintain a clean Hong Kong. Under the notions of press freedom and social responsibility, government intervention with the press in Hong Kong is minimal. As no government censorship of news is allowed, people are free to criticise the administration. For example, Antony Leung Kam-chung, the former Financial Secretary of the HKSAR, resigned after the media disclosed that he had bought a car for HK$790,000 (US$101,282) just weeks before he raised the tax on new vehicles in his March budget. In view of the public outcry, he tried to

98 Article 2 of the Basic Law.

99 The ICAC was established on 15 February 1974 with the enactment of the Independent Commission Against Corruption Ordinance. Being a statutory body, it was given an independent status in that the commissioner has the statutory responsibility to fight corruption through investigation, prevention and education. R Wong Sai-chiu, "The Hong Kong anti-corruption model" (paper presented at Opening Ceremony of the Centre of Anti-Corruption Studies and seminar, 3 April 2009).

100 Investigation here includes compelling a suspect or a third person to provide information under certain conditions. In recognition of the difficulty in bringing the corrupt to justice and to ensure public confidence in the ICAC, there are provisions which include legal presumptions and protection of confidentiality including the identity of a subject of investigation and the details of the investigation. Ibid.

101 Prevention here means the Corruption Prevention Department within the ICAC which seeks to tackle corruption at source by proactively engaging government departments and the commercial sector to review procedures and practices conductive to corruption. They make recommendations, in the form of corruption prevention assignment reports, to plug corruption loopholes which are usually identified during the course of corruption investigation. Ibid.

102 Education here means the Community Relations Department within the ICAC which is tasked with the promoting of the image of ICAC as an independent and determined anti-corruption body and to ostracise the corrupt by instilling a culture of integrity in the community. They achieve this through various programmes that educate the public against the evils of corruption and by fostering the enlisting of their support in reporting corruption. Ibid.

103 M J Skidmore "The future of Hong Kong: Hong Kong institutions: promise and peril in combating corruption: Hong Kong's ICAC" (1996) 547(118) *The Annals of the American Academy of Political and Social Science* 24–36.

104 Lord Martin Thomas of Gresford, "The rule of law v the national interest" (paper presented at Opening Ceremony of the Centre of Anti-Corruption Studies and seminar, 2 April 2009).

defuse the controversy by donating the money to the Community Chest, a local charity,[105] but the Hong Kong people were not satisfied till he announced his resignation. A search of several influential newspapers in Hong Kong in the past few years discloses other such reports. For example, in 2003, the media reported that a judge was investigated for claiming reimbursement for an air ticket after receiving the same ticket from his daughter as a gift. Such indiscretions, however, are minor if compared with what corrupt government officials have done in mainland China.[106] Because of powerful media supervision and the Hong Kong people's high expectations of their government, Hong Kong retained its top ranking together with Singapore as the region's least corrupt economies in 2009.[107]

(c) Legal culture in Hong Kong

In Hong Kong, due to Western cultural influence, rules and systems are well respected and operated impartially. The concept of the rule of law is deeply rooted in Hong Kong. A law professor[108] from mainland China once described the legal culture difference between Hong Kong and China. He said that wherever he went in Hong Kong people, including police, salespeople, government officials and almost everyone he contacted behaved according to "written rules". These rules can be easily learnt through the government's websites or from different pamphlets available at government departments and offices. Therefore, these rules are transparent, comprehensive and easy to follow.[109] Because people can predict the results of following the written rules, it is easy for them to make a decision either to follow the rules or to reject them and risk the consequences. They also know that Hong Kong enforcement mechanisms are efficient and effective.

Therefore, minority shareholders in Hong Kong feel less restraint about filing cases in court against the company and its directors if they discover that their interests in companies have been unfairly treated. Shareholders normally feel confident of winning the case if they have enough evidence to prove their claim because of the judicial system of Hong Kong. According to Lawton's research, there were 286 actions issued in the High Court of Hong Kong during the period of 1990–1995 alone.[110] Of course, minority shareholders in Hong

105 For details, see http://www.knowledgerush.com/kr/encyclopedia/Antony_Leung_Kam-chung/ (last accessed 8 February 2010).

106 Chen Tonghai, former chair of the BOD of China Petrochemical Corporation, was sentenced to the death penalty with a two-year suspension for corruption and bribery on 15 July 2009. The amount of money he received over 10 years reached RMB200m. For details, see http://news.ifeng.com/opinion/200803/0309_23_432067.shtml (last accessed July 2009).

107 For details, see http://business.inquirer.net/money/breakingnews/view/20090408-198573/RP-no-longer-most-corrupt-in-ranking (last accessed July 2009).

108 The law professor is from the Law School, Yunnan University, China. He wrote his impression of Hong Kong in June 2007 under the pen name Fa Dou after he completed his work as a visiting fellow at the Law School, City University of Hong Kong. For details, see http://www.jcrb.com/n1/jcrb1340/ca615721.htm (last accessed July 2009).

109 Y Fan, "Chong Wen Hua Jiaodu Lijie XiangGang" ("To understand Hong Kong from a cultural perspective"), see http://www.lunwenda.com/fangan200804/31775-2/ (accessed in July 2009).

110 Lawton "Berle and Means", n. 22 above.

Kong face similar problems of paying huge litigation fees as shareholders do in other countries[111] but, that aside, they have confidence in the legal system.

(D) Institutional design in China

China has been absorbing Western traditions since the policy of economic reform and opening to the outside world started in 1979. Legislative, administrative and judicial functions in China have made great advances. If looking at corporate governance-related legislation, China's Company Law and Securities Law regulating the stock exchange and corporate governance have been amended and implemented. Two powerful supervision systems (CSRC and SASAC)[112] have also been established. Its judicial system has undergone tremendous reform to try to combat long-standing problems, such as its close relationship with local government.[113] Higher courts, instead of local government or party officials, now have more decisive power in court appointments and promotion. In order to prevent judges being involved in corruption, an internal monitoring system has been set up in all courts, especially those located in provincial capital cities. Judges' salary adjustment and promotion are closely linked with the quality of cases they have handled. Directors of lower-level courts and division directors of higher courts are required to rotate from time to time.[114] This may give an impression that there is now not much difference between Hong Kong and China in terms of legislation and the role of the judiciary.

But careful study of China's constitution shows that there are differences in institutional design. Article 3 of the constitution states: "All administrative, judicial, and procuratorial bodies of the state are created by the National People's Congress (NPC) and they are

111 Minority shareholders in Hong Kong also have problems paying huge litigation fees. In Hong Kong, there is no strict rule on how much a solicitor should charge his/her client. In practice, a partner in a city firm charges approximately HK$8000 per hour. An associate charges roughly HK$6000 per hour. If a barrister is needed for a case, the client needs to pay the barrister's fee on top of the fee which has to be paid to the solicitor based on the agreement. Fortunately, according to s. 168BI of the Hong Kong Company Ordinance, "the court may, at any time (including on granting leave under section 168BC(3)), make any order it considers appropriate about the costs incurred or to be incurred by the following persons in relation to an application for leave made under section 168BC(3) or any proceedings brought or intervened in, or to be brought or intervened in, under section 168C (1) a) the member; b) the specified corporation; and c) any other parties to the application or proceedings". In the case of *Chung Sau Ling & others* v *Asia Women's League Ltd & others* [2001] 3 HKC 410, the court of first instance adjudicated the test for the exercise of discretion as to costs in a minority shareholder's derivative action on behalf of a company. It was held that the court had the discretion to make a prospective pre-emptive costs order in favour of minority shareholders in terms of ordering the company to indemnify the plaintiffs against the costs incurred in the action. For details, see *Butterworths Hong Kong Company Law Handbook* 8th edn (Hong Kong: Butterworths Asia 1999), pp. 724–5.

112 CSRC refers to the China Securities Regulatory Commission. It is the main securities regulator of the PRC. The CSRC oversees China's nationwide centralised securities supervisory system, with the power to regulate and supervise securities issuers, as well as to investigate, and impose penalties for, "illegal activities related to securities and futures". The CSRC is empowered to issue Opinions or Guideline Opinions, non-legally binding guidance for publicly traded corporations. SASAC refers to the State-owned Assets Supervision and Administration Commission of the State Council. Its main responsibilities are to supervise state assets management nationwide.

113 Chinese courts have a close relationship with local governments because courts are financed by local governments. This sponsorship system has caused a lot of problems. Before the reform of the judiciary system, local government officials or the local CPC party members would send notes or phone a judge handling a high profile or a politically sensitive case for certain confidential information which greatly affected the judge's ability to make a fair judgment. For details, see X He "Routinization of divorce law practice in China: how institutional constraints influence judicial behavior" (2009) *International Journal of Law, Policy and the Family* 83–109.

114 See news article. "A reshuffle of provincial-level court directors" at http://www.jcrb.com/gssfgg/ (last accessed 28 August 2008).

responsible to and supervised by the respective congresses."[115] The pyramid structure with the NPC at the top and the judicial and procuratorial institutions at the bottom indicates that the degree of judicial independence in China is different from the real judicial independence in Hong Kong. In addition, in the preamble to the constitution, the leadership of the CPC and the guidance of Marxism–Leninism, Mao Zedong thought, and Deng Xiaoping theory are all emphasised in building China into a prosperous socialist state.[116] So, when the rule of law and the party's leadership are in conflict, it becomes unavoidable that the rule of law, to a certain degree, will be compromised. Wu Bangguo, chair of the NPC Standing Committee, emphatically declared at the annual session of the NPC in March 2009, China "would definitely not adopt a Western-style political system, and would definitely not practise multi-party policies, 'separation of three powers' or bicameralism".[117]

Potter argues that the role of law in China today remains conflicted. On the one hand, the Chinese government and society at large have accorded significant importance to the role of law in socio-economic relations. But herein lies the rub – fealty to socialism unavoidably qualifies and diminishes the capacity for law to serve as an independent source of restraint on government behaviour.[118] Lubman further portrays the systemic and ideological limitations of Communist Party rule as a cage confining the bird of Chinese legal reform.[119] So, based on Lubman's description, China is attempting to build the rule of law within its own boundary which means the rule of law is not unconditional. If it contradicts the party's leadership or state sovereignty, which one shall prevail? The rule of law or the party's leadership? The answer is "unspoken". So the rule of law in China should be understood as "the rule of law with Chinese characteristics" or better, "the rule of law within the political/constitutional context of China".

In terms of institutional design in anti-corruption, China has similar institutions to the ICAC in Hong Kong, such as an internal anti-corruption bureau within each procuratorate, the National Bureau of Corruption Prevention (NBCP) of the People's Republic of China[120] and the Central Commission for Discipline Inspection (CCDI) of the CPC.[121] They are all responsible for punishing corrupt government officials. An advantage of having multiple anti-corruption agencies is to create competition among these institutions. Therefore, from an institutional design point of view, China's anti-corruption network should be more comprehensive, however, its functions have not reached the ICAC's standard. The reason for the inefficiency is that these institutions owe their duties only to their own superiors. For example, the CCDI is an internal disciplinary inspection agency of the CPC so it is responsible only to the CPC. The anti-corruption bureau within the

115 Article 3 of China's Constitution (the Fourth Constitution) amended in 2004.

116 See para. 7 of the Preamble to China's Constitution.

117 The National People's Congress Standing Committee's report to the National People's Congress in March 2009. See, http://www.npc.gov.cn/npc/xinwen/syxw/2009-03/16/content_1493462_5.htm (last accessed 26 July 2009).

118 P B Potter, "Review essay: legal reform in China: institutions, culture, and selective adaptation" (2004) 29 *Law and Social Inquiry* 465.

119 S B Lubman, *Bird in a Cage*, n. 20 above, pp. 3–8.

120 The NBCP was established in September 2007. The new bureau will report directly to the State Council, or China's cabinet. The main task of the NBCP is to push forward transparency of government information at various levels, in other words, to "prevent corruption at its root". The NBCP will not step into the investigation of individual cases because it does not have the power. See http://www.chinadaily.com.cn/china/2007-09/13/content_6104202.htm (last accessed July 2009).

121 For details, see http://www.sourcejuice.com/1295331/2010/01/13/17th-session-Communist-Party-China-Central-Commission-Discipline-Inspection/ (last accessed 8 February 2010). This website publishes an article discussing the CCDI of the CPC and its Fifth Plenary Session, held 11–13 January 2010 in Beijing.

People's Procuratorate is naturally responsible to the People's Procuratorate. While the NBCP, an anti-corruption institution at the national level, is responsible to the State Council or to the NPC. So lack of mutual communication and co-operation among these institutions is an urgent problem. The consequence of such insufficient teamwork is lack of adequate protection for whistleblowers. The reports against corrupt officials are often transferred back and forth among several relevant institutions, causing leakage of the reporters' identification. Sometimes, certain reports have even been sent to the target government officials. Retaliation against reporters is not uncommon in China.[122] Most reporters are too scared to put their names to reports. Therefore, many company directors and majority shareholders in China are not afraid of the NBCP, CCDI or the anti-corruption bureau in each procuratorate, although a great number of high profile government officials, company directors and majority shareholders have been punished for corruption because of the excellent work of these agencies.[123] It is often said that it is easy for these institutions to kill "flies" but difficult to catch "tigers".[124]

Media supervision is also less effective in China. Journalists are not as lucky as their counterparts in Hong Kong. In China, media is under the tight supervision of the CPC and the government. Some local government officials deliberately make it difficult for journalists to interview local people in order to expose scandals. From time to time, news emerges of journalists being beaten up for disclosing conspiracy between corrupt government officials and businesspeople, violating local people's interests.[125] For example, in Zhenzhou City, when a journalist was told that several luxurious residential buildings had been erected on a piece of land initially designated by the local government to build flats for people on low incomes, he wanted to interview the government officials responsible for urban land planning. But his requests were repeatedly turned down. Eventually, he got a chance to encounter Mr LuJun, a government official in charge of Zhenzhou Urban Planning and ask for an explanation. To his surprise, LuJun told the journalist not to be a busybody. When the journalist insisted, LuJun gave an explanation, asking the journalist whether the journalist represented the CPC or the ordinary citizens.[126] To government officials like LuJun, the unspoken rule is that the CPC's and people's interests are different. If the journalist supported the CPC represented by LuJun, he should keep his mouth shut without asking for trouble. Unfortunately, LuJun was unlucky this time. After the journalist exposed the scandal through the internet, millions of people accused LuJun of putting the interests of the CPC above those of the people. LuJun was therefore removed from his urban planning post.[127] Although the media in China has been playing a more and more important role in monitoring the government, it

122 G Yong, "Historical evolvement and future reform of China's Communist Party Discipline Inspection Commission" (paper presented at Opening Ceremony of the Centre of Anti-Corruption Studies and seminar, 3 April 2009).

123 For details, see an anti-corruption website: http://www.china-fantan.net/?vkxxbqb=40406 (last accessed December 2008).

124 For details, see http://news.sina.com.cn/c/2004-03-02/14032985447.shtml (accessed July 2009).

125 For example, in June 2009, the news reported that in Shanghai, a newly completed residential building had collapsed. People are questioning whether there is a conspiracy between corrupt officials and the land developer. Also, when a journalist tried to interview the relevant people, the local government officials asked the journalist to shut up. For details, see http://shengbuzhang.cctv.com/20090723/102651.shtml (last accessed July 2009).

126 For details, see http://news.ifeng.com/opinion/politics/200907/0714_6438_1247924_7.shtml (last accessed July 2009).

127 After the journalist exposed the scandal, LuJun was removed from the position and the construction of the luxurious buildings was suspended. Ibid.

is interesting to examine why the unspoken rules are so popular with the likes of Lujun and the many corrupt government officials in China.

(E) Unspoken rules and legal culture in China

Compared with Hong Kong, China has a similar cultural background but emphasises more centeredness and harmony. The difference between the two places is that rules and principles are implemented impartially in Hong Kong while in China rules can be interpreted and implemented in various ways.[128] In other words, there is another set of unspoken rules, so-called "implied rules" working effectively parallel to the officially published rules. The popularity of implied rules can also be considered a kind of cultural phenomenon since culture involves learned patterns of behaviour.[129] For example, in August 2008, incidents of poisonous dried milk had been widely reported. Some thousands of babies had developed kidney problems from drinking melamine – found in the contaminated dried milk. Surprisingly, lawyers were told by the Heibei provincial government not to take such cases: if such cases are accepted, the details must be reported to the government.[130] A court in Lanzhou Gansu Province even announced that it would not accept lawsuits over the Sanlu infant dried milk scandal until a guideline for dealing with such cases was issued by the authority (i.e. the CPC).[131] In fact, the Heibei provincial government had noticed the milk powder problem long before the media reported the incident. What the government did was to quietly remove all problematic milk power products from the shelves of all supermarkets within the province, hoping that the problem would quietly go away without being noticed by the people and the media.[132] The implied rule here is that the local government must control the situation in order not to lose "face" and local companies must not be bankrupted by huge compensation payments. An unspoken rule that local courts follow is that they should not come into conflict with the local government by deciding cases in favour of the complainants. If a local profitable company is bankrupted because of such an incident, the government may lose tax revenue and, most importantly, the relevant officials in the government will have to be removed. The chain reaction is that local courts may therefore not obtain sufficient financial support from the local government and, thus, have to find fiscal sources somewhere else.[133] All of these factors may result in a certain degree of compromise in justice and fairness.

Potter's arguments can be used to explain the reasons why unspoken rules are exercised by the local government and company directors. He says the patrimonialism of Confucianised, Marxism–Lenimism, Mao Zedong thought combines with the sovereign

128 For example, according to the relevant rules, children should go to a primary or secondary school close to the residential area where they live. But if the parents of a pupil or student are willing to pay extra money to the best school in that district or the city, the student can go to that particular school without any problem. If someone needing an operation prefers a top surgeon, all the patient needs to do is to pay extra money to that particular doctor. Such things happen all the time in the author's hometown, Hangzhou, China.

129 J Scott and G Marshall, *Oxford Dictionary of Sociology* (Oxford: OUP 2005), p. 133.

130 According to the report, about 5770 babies in Hebei province have developed kidney problems because of drinking poisonous dried milk. For details, see the news report at http://www.usqiaobao.com (last accessed 22 September 2008).

131 News report, "Judge refuses to accept lawsuit until guidelines" and "Sanlu court action put on hold", *South China Morning Post*, 16 October 2008.

132 See www.takungpao.com/news/09/01/23/sanlu_discuss-1022979.htm (last accessed 23 January 2010).

133 Due to lack of sufficient funding, some local courts encouraged judges to fine more people for violating certain administrative regulations. The extra fines collected by these local courts were considered their additional income should therefore be distributed among all staff in the courts as a kind of welfare. For details, see, Z Wenji, "Chang Sha Kaifu local people's court collects fees and fines without proper guidelines" (in Chinese) http://people.rednet.cn/PeopleShow.asp?ID=322796, 22 April 2009 (last accessed 8 February 2010).

party-state supremacy to establish a powerful modality of governance in the People's Republic of China (PRC). Patrimonial sovereignty is thus a typology by which regulators are accountable only to their bureaucratic and political superiors. Under the dynamic of patrimonial sovereignty, political leaders and administrative agencies have responsibility for society but are not responsible to it.[134] Potter has pinpointed the core of the problems. As the Chinese government considers the sovereign party-state as supreme, the rule of law has, to a certain degree, been treated as a vehicle by the government to exercise power when convenient or necessary. But such practice is non-spoken, it therefore creates a grey area for unspoken rules to be practised among party members, government officials, entrepreneurs and ordinary citizens. That explains why LuJun, a government official, felt able to use the CPC as a weapon to silence the journalist. In LuJun's mind, the CPC had supreme power and he, as a local representative of the CPC, was entitled to enjoy material satisfaction originated from that supreme power. The "unspoken rule" can also be used to interpret the Hebei provincial government's response to the milk powder scandal. As the local government was accountable only to its bureaucratic and political superior, all it wanted to do was to conceal the scandal so that the local government's image would not be ruined. Once the contaminated milk scandal received international media coverage, the local government changed its attitude. The Ministry of Health has discussed with the relevant departments and companies various proposals for compensating the sick babies.[135] In the case of the milk powder scandal, it was predictable that the local government would instruct lawyers not to get involved in the sick babies cases. It is likely that the same government would support local important companies at the expense of minority shareholders' interests.

Another reason to explain the popularity of unspoken rules is the imbalance between economic and political reform, with the wheel of economic reform going faster and the wheel of political reform slowing down.[136] Chinese leaders witnessed the Soviet leader Mikhail Gorbachev's political reforms which caused the collapse of the former Soviet Union. Most Chinese leaders therefore believe that Gorbachev had his priorities wrong – by pursuing political reform before economic reform, he courted disaster and failure.[137] Chinese leaders are convinced that political reform should be carried out more slowly than economic reform in China. But economic growth will inevitably lead to democratic opening. Intentionally holding back political reform results in the current institutional design becoming incompatible with economic development, which unavoidably forces people to use unspoken rules to solve their problems. In addition, the Chinese economy is in a transition period, from a closed economy to an opening-up economy. Political power becomes much more valuable because political power can now allocate economic resources. That explains why the exchange of "power and money" has become so popular and why the government, in charge of political power, is much less willing to give it up or even allow political reform.

Unspoken rules also apply to companies. Most of the successful companies in China have ambitions of becoming world top-500 companies. Company directors have dreams of

134 Potter "Review essay", n. 118, above.

135 For details, see http://news.bbc.co.uk/chinese/trad/hi/newsid_7770000/newsid_7776300/7776333.stm (last accessed 12 December 2008).

136 L Rui, "A proposal for our country's political reform" (paper presented at 16th National Congress of the CPC and published in Yan Huang Chun Qiu 2003). For details, see http://personal.nbnet.nb.ca/stao/lirui003.htm (last accessed December 2008).

137 M Pei, "Political reform in China: leadership difference and convergence", see http://www.carnegieendowment.org/files/Pei_Revised.pdf, 2 November 2005 (last accessed July 2009).

becoming "global champions". Once this dream comes true, it would not only bring with it the pride of the Chinese people and the government, but, most importantly, the company wins "face" and the directors become national heroes. To reach this goal, some Chinese companies prefer a short cut instead of working hard. For example, Lenovo Group Limited (LGL), mainland China's largest and the world's fourth largest personal computer manufacturer,[138] merged with IBM in 2004. LGL's plan was to make Lenovo an international brand with the help of IBM's reputation. But LGL was not well prepared for possible and potential problems, therefore, the merge did not bring LGL the ideal result, instead, its profits dropped 78 per cent two years of the merger.[139] Another case that demonstrates the "global champion" culture is that of TCL[140] merging with Thomson. In 2003, TCL, the largest TV manufacturer in China, merged with Thomson, a French company, in order to create a TV–DVD giant. Li Dongshen, the CEO of TCL, boldly pledged in 2003 to make profit within two years after the merger. Again, TCL failed to do its homework properly before the merger, all it wanted was to become a world famous company by using Thomson as a ladder. Instead of bringing TCL profit, it brought a nightmare. TCL's loss in 2006 reached RMB1840m and TTE, a joint venture of TCL and Thomson, also suffered a great loss due to this aggressive strategy. Eventually, TCL had to break up with Thomson to avoid further loss.[141]

The two gigantic companies' painful merger experiences demonstrate that when companies make hasty and aggressive decisions under the influence of a "global champion" mentality, they will inevitably ignore necessary measures to improve corporate governance and to protect minority shareholders' interests in the companies. In addition, from the majority shareholders' point of view (in particular, where the majority consists of state shareholders), protection of state assets in the company is also their priority. So the unspoken rule here is that if there is a conflict of interest between becoming a "global champion" and the minority shareholders' benefits (that is between the state and minority shareholders' interests in the company), then sacrificing the minority shareholders' interests for the dream of "global champion" or the interests of the state should be considered a patriotic decision. Otherwise, the intention of the decision makers will be questioned. In Chinese culture, an individual's interests never have an equal status with those of the state or collectives. This was true in ancient times and was also true at the time of the implementation of the planned economic system (1949–1979). The motto "be dedicated to serving the public without any thought of oneself" was used as a standard for choosing a

138 Lenovo produces desktops, laptops, servers, handheld computers, imaging equipment and mobile phone handsets. Lenovo also provides information technology integration and support services, and its QDI unit offers contract manufacturing. It is the world's fourth largest personal computer manufacturer after Hewlett-Packard and Dell of the USA and Acer of Taiwan. See www.businessweek.com/magazine/content/05_19/b3932113_mz063.htm, 9 May 2005 (last accessed 8 February 2010).

139 For details, see http://hi.baidu.com/havis2008/blog/item/ad6a772dd7c644e48a1399b9.html (last accessed July 2009).

140 TCL is China's largest television manufacturer. TCL teamed with French company Thomson to form the world's largest television production joint venture in 2003. Li Dongsheng, chair of TCL International, and Charles Dehelly, CEO of Thomson, said at a signature ceremony that the TCL–Thomson company was planning to produce 18 million television sets annually, replacing Sony as the leading global television maker. The two companies planned to combine their TV and DVD businesses, according to the cooperation memorandum. Total assets of the joint venture amounted to €450m, with TCL International holding 67 per cent and Thomson 33 per cent of the shares. For details, see http://www.chinadaily.com.cn/en/doc/2003-11/04/content_278455.htm (last accessed July 2009).

141 For details, see http://www.shangdog.com/weburl/96938.htm (last accessed July 2009).

model worker or a national hero for several decades. A government official[142] in Shenzhen expressed a majority shareholder's standpoint when he was interviewed recently.[143] He stated that:

> about 75% of listed companies have one dominant shareholder. This results in the dominant shareholder appointing directors to look after its interests. In terms of shareholder return, if there is a conflict of interest between the dominant shareholder and the minority shareholders, the interests of the dominant shareholder will be looked after first.[144]

From the point of view of minority shareholders, due to traditional Confucian influence, sacrificing personal interests for the collective or for society's best interests is considered good virtue and should be well praised. Besides, owing to the long Chinese tradition of mediation and the Confucian preference for mediation and harmony, before minority shareholders manage to enter into a court room, they may have to go through a mediation process. Even after litigation has commenced, mediation will still be conducted by the court according to China's Civil Procedure Law.[145] Considering the exhausting, time and energy-consuming process of mediation which may not result in a favourable outcome for them, minority shareholders may not want to be start a fight with the majority unless absolutely necessary even though they have know that their interests in a company have been compromised. Instead, they may prefer someone else to litigate for them. The Chinese have another expression for such a situation "the nail that sticks up most gets hammered down". In addition, minority shareholders also have problems collecting crucial evidence to support their arguments and are hampered by lack of professional knowledge and experience. They are also subject to expensive litigation fees, in particular, if it is a derivative action, the benefit goes to the company even if minority shareholders win the case. So, minority shareholders in China have little motivation and many disincentives to sue the company and the majority.

Conclusion

Mainland China and Hong Kong are both dominated by rich cultural heritages and both have good legal and regulatory frameworks and comprehensive supervision systems to protect minority shareholders. But Hong Kong was ranked number one in corporate governance in Asia in 2007 and China was not included. Culture and institutional design arguably explain the difference. Hong Kong, due to its British colonial history and the fact that it is now an international business centre, has developed its unique cultural mixture of both Chinese and Western tradition. In addition, the rule of law, separation of power and impartiality of administration are strongly emphasised. Minority shareholders not only have less restraint to sue the majority shareholder or company directors in court but also have confidence in Hong Kong's judicial system because it is independent, predictable, consistent and not arbitrary.

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142 In China, when a government official is interviewed by a foreign journalist or a researcher, if possible, that official would prefer his or her name not to be released in the published report in order to avoid unnecessary troubles. In particular, if the report criticises the local government, that government official will be in trouble. It is therefore not easy to find out the name of the government official who was interviewed by the Australian researchers.

143 The interview was carried out by the research team led by Roman Tomasic and Neil Andrews from Victoria University and Jane Fu from Deakin University. The project was sponsored by the Australian Research Council (ARC) under an ARC Discovery Grant. The report they wrote is "Minority shareholder protection in China's top 100 listed companies" 2007 9(1) *Australian Journal of Asian law* 88–119.

144 Ibid.

145 See PRC Civil Procedure Law, Chapter Eight.

In China, the constitution confirms the CPC's position of supreme power. Separation of power is not exercised. Fast economic development should naturally lead to democratic opening but intentionally slowing down political reform makes current institutional design not compatible with economic development which results in the popularity of unspoken rules. The rule of law cannot be fully implemented. Sometimes, unspoken rules prevail against written rules. People pay more attention to unspoken rules because such implied rules can sometimes help get the job done better, more quickly and cheaply.

China can point to the many laws regulating companies and company finances and an apparently comprehensive supervision system as part of its good corporate governance agenda which includes the protection of minority shareholders. But, without a more fundamental culture change, minority protection is only an aspiration. In reality, the unspoken rules (the nepotism, the bribes, the conflicts of interests, the system of reciprocal favours) will have to be eliminated and the culture of willingly subordinating individual interests to those of the state needs to be adjusted. Otherwise China will not reach the standard of corporate governance that has been achieved in Hong Kong. One of the most important prerequisites of good corporate governance in China is the elimination of unspoken rules so that companies are transparently managed. Without improvements in the reality of corporate governance, foreign investment in Chinese companies will not be forthcoming and the development of private equity financing internally will not happen if the potential providers of private equity have a poorly protected minority status.

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The "Europeanisation" of labour law: can comparative labour law solve the problem?

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The debate surrounding the nature of "Europeanisation" has been raging in the EU for a number of years. It raises a variety of issues regarding the impact of the EU and its effects on the domestic politics and institutions of member states. In terms of labour law, the EU has, over the years, attempted to Europeanise national labour law systems directly and indirectly by introducing measures under the banner of "European labour law". However, there has always been a debate on the success of such measures as well as on the existence of a category of European labour law.

This paper examines the debate surrounding the Europeanisation of the German and UK labour law systems. Germany and the UK have been chosen as focal points as their different labour law systems illustrate the wide spectrum of national systems of regulation that European labour law must take into account in order to achieve some measure of harmonisation. The paper therefore suggests criteria for testing the success which measures of European labour law have attained in attempting to Europeanise the national labour law systems. These criteria are borrowed from the sphere of comparative labour law. In doing so, firstly, the debate on the Europeanisation of national legal systems is expounded, with specific attention being paid to the sphere of labour law. Secondly, in order to illustrate the problems surrounding Europeanisation, a number of examples are set out. These examples demonstrate circumstances in which the Europeanisation of labour law has been successful or, as the case may be, unsuccessful. Finally, a framework is set out within which to test the success of a measure of European labour law and criteria are also suggested which measures of European labour law need to fulfil in order to successfully Europeanise national systems of labour law.

Europeanisation and European labour law

The European Community has been attempting to Europeanise national legal systems in a range of ways and for a number of years. Europeanisation has been defined broadly in the academic literature by various writers. One of the earliest conceptualisations of the term was given by Ladrech who defined Europeanisation as:

> an incremental process of re-orienting the direction and shape of politics to the extent that EC political and economic dynamics become part of the organisational logic of national politics and policy making.[1]

1 R Ladrech, "Europeanisation of domestic politics and institutions: the case of France" (1994) *Journal of Common Market Studies* 69, at 69.

A number of authors elaborated upon Ladrech's definition thereby widening it to include the development of political networks at a European level[2] as well as "transnational influences that affect national systems"[3] within the concept of Europeanisation. Following on from these definitions, "EC political and economic dynamics"[4] can be integrated into a member state's organisational structure through either a top-down or a bottom-up approach. In certain areas of law, the Europeanisation of national legal systems has been very successful. A typical example often given is that of competition law where the European Community has achieved a near-complete convergence of member states' legal systems. However, within the sphere of labour law, and, particularly, collective relations, a more nuanced analysis is necessary. Due to the socio-cultural context within which the labour laws of the individual member states have developed, a top-down approach has often resulted in fruitless attempts of approximation of laws and practices. Alternatively, a bottom-up approach is sometimes attempted in order to approximate labour standards across the EU. However, for similar reasons to those mentioned in the context of the top-down approach, a bottom-up approach is equally difficult to implement across the EU as a whole because transnational influences are often difficult to reconcile with the socio-cultural context of labour relations systems. As Weiss points out, "at best there is a chance to approximate the systems in a functional sense, thereby eliminating distortions of competition arising from existing differences".[5] Other attempts, like the social dialogue, avail themselves of a mixed approach. It combines a top-down approach, with the European umbrella organisations negotiating framework agreements, while the national affiliates, in a bottom-up approach, should ideally have a strong input into those negotiations. However, despite the lack of success of the top-down and bottom-up approaches, any definition of Europeanisation must take into account the two-way process that takes place in the Europeanisation of national labour law systems. As Börzel points out, "approaching Europeanisation exclusively from a top-down rather than bottom-up perspective may in the end fail to recognise the more complex two-way causality of European integration".[6] For the purposes of this paper, the following definition of Europeanisation is therefore employed. Europeanisation is, very broadly, a process of domestic change that can be attributed to European integration. This process of change can originate from the European and the national level. Europeanisation is, therefore, a two-way process.

2 T Börzel and T Risse, "When Europe hits home: Europeanisation and domestic change" (2000) *European Integration Online Papers* 4.

3 B Kohler-Koch, "Europäisierung: Plädoyer für eine Horizonterweiterung" in M Knodt and B Kohler-Koch (eds), *Deutschland zwischen Europäisierung und Selbstbehauptung* (Frankfurt: Campus 2000): Kohler-Koch includes "auf die nationalen Systeme einwirkende trans-nationale Einflüsse" within the definition of Europeanisation.

4 R Ladrech, "Europeanization and political parties", Working Paper 7 (Keele: Keele European Parties Research Unit (KEPRU) 2001), at p. 5

5 M Weiss, "Workers' participation: its development in the European Union' (2000) *Industrial Law Journal* 737, at 738.

6 T Börzel, "Towards convergence in Europe? Institutional adaptation to Europeanisation in Germany and Spain" (1999) 37 *Journal of Common Market Studies* 573, at 574.

In the area of labour law, the Europeanisation of national systems has largely been attempted under the banner of a so-called European social model[7] since the early 1990s.[8] The current EU Commissioner for Employment, Social Affairs and Equal Opportunities, Vladimir Špidla, describes the European social model as "an integrated strategy where social politics are perceived as an investment in human capital and therefore contribute to productivity". Its objective is, therefore, to "reconcile economic performance with worker well-being".[9] This description of the European social model as an arbitrator between economic interests and social protection is, however, not unproblematic. There has been a long-standing debate as to whether the European social model exists and, if so, what its role is. It is often stated, for example, that the European social model "is not really a model, it is not only social, and it is not particularly European".[10] In contrast, Vaughan-Whitehead recognises the existence of a European social model but lists myriad criteria that it must fulfil in order to count as such.[11] A number of more general arguments are frequently proffered when discussing the existence or lack of a European social model. First, it is impossible to define a Europe-wide social model. Every member state has its own system which has developed varying standards, institutions and structures.[12] It is thus difficult to define a European norm and social model. Second, even where European standards exist, these are often implemented to varying degrees and in different ways in the member states. It is therefore difficult to speak of a clearly defined European social model. Pontussen, for example, borrows Esping-Andersen's terminology[13] and argues:

> The concept of a "social Europe" is by no means clearly defined. For political and analytical reasons, it is better to differentiate between two "social models" or even between two different visions of "social Europe": the Northern European model on the one hand, and the Continental model on the other. There are no clear lines of division between these two categories, however, there are differences in emphasis. Both models protect the individual against the risks of a free market economy but whereas the Northern European model emphasises social equality, the Continental model emphasises social stability.[14]

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7 This is the collective name given to the EU's involvement in social policy which was seen as a necessary component in the economic integration project. For more information, see J Shaw, J Hunt and C Wallace, *Economic and Social Law of the European Union* (Basingstoke: Palgrave 2007), pp. 341–67.

8 J Bischoff and R Detje, "Das Europäische Sozialmodell und die Gewerkschaften" (2007) (Supplement) *Zeitschrift Sozialismus* 1ff.

9 V Špidla, "Une nouvelle Europe sociale", speech 05/598, at PES Conference "A New Social Europe", Brussels, 11 October 2005, at p. 5: He describes the European social model as "une stratégie intégrée où la politique sociale est conçue comme un investissement dans le capital humain et donc un facteur productif". The objective is, therefore, to "concilier performance économique et solidarité".

10 A Diamantopolou, "The European social model – myth or reality?," address at the fringe meeting organised by the European Commission's Representation in the UK within the framework of the Labour Party Conference, 29 September 2003.

11 D Vaughan-Whitehead, *EU Enlargement versus Social Europe?* (London: Elgar 2003).

12 J Alber, "Das 'europäische Sozialmodell' und die USA" (2006) (2) *Leviathan* 208–41.

13 G Esping-Andersen, *The Three Worlds of Welfare Capitalism* (New Jersey: Princeton UP 1990).

14 J Pontusson, "Wohin steuert das soziale Europa" (2006) 10 *WSI Mitteilungen* 532: Pontusson argues "dass das Konzept eines 'sozialen Europas' unklar ist. Aus politischen wie auch aus analytischen Gründen ist es vielmehr sinnvoll, zwischen zwei verschiedenen 'Sozialmodellen' bzw. zwischen zwei verschiedenen Visionen eines 'sozialen Europas' zu unterscheiden: das nordeuropäische Modell einerseits und das kontinentale Modell andererseits. Die Unterscheidung zwischen diesen Modellen erzeugt zwar keine absolut trennscharfen Kategorien, jedoch legt sie unterschiedliche Schwerpunktsetzungen offen: Beide Modelle schützen den Einzelnen vor den Risiken des Markts, dock während das nordeuropäische Modell die soziale Gleichheit betont, stellt das kontinentale Modell die soziale Stabilität in den Vordergrund."

All of the above-mentioned arguments illustrate the difficulty encountered in trying to pin down the idea of a European social model. However, the problem may not only lie with the availability of EU norms which may or may not make up a European social model. Rather, the difficulty in definition may be due to the criteria used. It is often argued, that the European social model cannot be compared to national social models which regulate a vast array of social matters.[15] Instead, the European social model should be seen as a political tool which enables the EU to create minimum standards in those areas that fall within its competence. These minimum standards are meant to reduce competition between member states which should lead to further European integration. The hope of the EU is that, by combining economic and social welfare, the EU will achieve "stronger, lasting growth and the creation of more and better jobs".[16] By accepting that a European social model can only set minimum standards in certain areas, one recognises the existence of a so-called European social model which can complement rather than replace national structures and institutions. As Giddens points out, the European social model is "a mix of values, achievements and hopes which differ in their form and in the extent of their development in the individual Member States".[17] While this recognises the existence of a European social model it does not create expectations of a model akin to national social welfare systems.

Within the European social model, the EC has enjoyed a limited amount of competence in the field of labour law since the adoption of the Single European Act in 1986. Apart from the provisions contained in the EC Treaty, which enable the community to act in order to facilitate the free movement of workers, Article 137 EC allows for the introduction of directives on working conditions, information and consultation of workers, and equality at work between men and women. Limitations on legislative competence operate in other areas of labour law and, as an alternative, soft law techniques must be used. This has been most visible with the increased reliance on the Open Method of Coordination (OMC) in the sphere of labour law since 2003. The method originated under the EU's Employment Strategy and is essentially a coordinated and Commission-facilitated inter-governmental process.[18] As Scott and Trubek explain:

> the OMC aims to coordinate the actions of several Member States in a given policy domain and to create conditions for mutual learning that hopefully will induce some degree of voluntary policy convergence. Under the OMC, the Member States agree on a set of policy objectives but remain free to pursue these objectives in ways that make sense within their national contexts and at differing tempos.[19]

However, there are conflicting views on the effectiveness of the OMC which, due to space constraints, cannot be examined in this paper.[20]

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15 Špidla, "Une nouvelle Europe sociale", n. 9 above.

16 European Commission Communication to the Spring European Council, *Working Together for Growth and Jobs: A new start for the Lisbon Strategy* COM (2005)24.

17 A Giddens, *Zukunft des europäischen Sozialmodells* (Bonn: Friedrich Ebert Stiftung Politikanalyse 2006), at p. 1: As Giddens points out, the European social model is "ein Gemisch aus Werten, Errungenschaften und Hoffnungen, die hinsichtlich ihrer Form und des Grades ihrer Verwirklichung in der einzelnen europäischen Staaten unterschiedlich ausfallen".

18 P Marginson, "Europeanisation and regime competition: industrial relations and EU enlargement" (2006) 13(2) *Industrielle Beziehungen* 103.

19 J Scott and D Trubek, "Mind the gap: law and new approaches to governance in the European Union" (2002) *European Law Journal* 1, at pp. 4–5.

20 For an overview of different opinions on the OMC, see, for example, C de la Porte, "Is the open method of coordination appropriate for organising activities at European level in sensitive policy areas?" (2002) *European Law Journal* 38 and V Hatzopoulos, "Why the open method of coordination is bad for you: a letter to the EU" (2007) *European Law Journal* 309.

There is also the option to make rules on matters related to employment law through the social dialogue mentioned above. Introduced by the Treaty of Maastricht, the social dialogue consists of representatives of the two sides of industry: management and labour. The agreements concluded between the two sides may be given force of law through a European Council decision under Article 139 EC, thereby turning the agreements into a directive. National trade unions are thus afforded a direct role in the legislative process through their membership in the European trade union confederations. At a national level, the negotiated directives can either be implemented through legislation or by the social partners. As a result, collective agreements at a national level have been accorded a role in legislation implementing EU standards. However, recent caselaw of the European Court of Justice (ECJ)[21] illustrates the difficulties encountered when national social partners acting in their specific social context are accorded a role in implementing EU legislation. As a whole, the legislative initiatives taken at a European level, ranging from directives to soft law techniques such as the OMC, as well as rulemaking under the social dialogue, are often seen as comprising the category of European labour law. However, there has been a long-standing debate as to whether such an overarching category of laws has actually developed. Many academics in both Germany and the UK are sceptical as to the existence of a European labour law. Schmidt, for example, writes:

> In reality, there is not really such a thing as a set of "European Labour Laws". This is due to the absence, at a European level, of the usual division prevalent in Germany and other Member States between labour law as a form of private law and social security law as a form of public law. At a European level both categories fall under the umbrella of "European social policy".[22]

This rejection of the idea of a category of European labour laws is based on an understanding of labour law in a national context with its inherent divisions into public and private law, collective and individual labour law. This categorisation is nigh impossible at a European level which leads to the conclusion drawn by Schmidt above.

In contrast, Schiek argues that European labour law is the "counterweight to national labour law. European labour law describes those labour law norms that originate at a European rather than a national level".[23] This allows for a much broader interpretation of the term European labour law. It permits the recognition of such a category of laws as long as one limits the ambit of the subject matter to those rules emanating from a European level, rather than requiring a complete system of labour law at a European level. This view

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21 C-341/05 *Laval un Partneri Ltd* v *Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avd. 1, Byggettan, Svenska Elektrikerförbundet* ECR [2007] I-11767; and Case C-346/06 *Dirk Rüffert* v *Land Niedersachsen* ECR [2008] I-01989. In both cases, provisions of Directive 96/71/EC on the posting of workers were implemented by collective agreement in Sweden and Germany respectively. The ECJ held that the collective agreements in these cases did not adequately implement the provisions to the directive as they had not been declared universally applicable. This then caused further problems for the social partners beyond the realm of this paper.

22 G Haverkate, M Weiss, S Huster and M Schmidt (eds), *Casebook zum Arbeits- und Sozialrecht der EU* (Baden-Baden: Nomos 1999), p. 15: "Ein 'europäisches Arbeitsrecht' gibt es, genau genommen, eigentlich nicht. Denn auf Gemeinschaftsebene ist die im deutschen Recht übliche Trennung zwischen dem dem bürgerlichen Recht zugeordeneten Arbeitsrecht und dem öffentlichen Recht zugerechneten Sozialrecht – ebenso wie in den meisten anderen Mitgliedsstaaten der Gemeinschaft – unbekannt. Beide Materien unterfallen vielmehr gleichermaßen dem Begriff der "europäischen Sozialpolitik".

23 D Schiek, *Europäisches Arbeitsrecht* 2nd edn (Baden-Baden: Nomos 2005). European labour law is the "Gegenbegriff zum nationalen Arbeitsrecht . . . [es bezeichnet] arbeitsrechtliche Normen, die keinen nationalen sondern einen europäischen Ursprung haben".

is shared by other writers[24] who recognise the presence of labour law norms originating from a European level and who therefore classify these norms as European labour law. For the purposes of this paper the expression European labour law will be used (with caution) to refer to those hard and soft law mechanisms originating from a European level which aim to approximate national labour law systems. It is recognised that these rules of European labour law are by no means comparable to the systems of labour law prevalent at a national level, for example, in the UK or Germany. Moreover, to a large extent, these rules (especially in the case of directives) must be implemented within national systems in order to take effect. However, as Schiek writes:

> European Labour Law is part of a supranational legal order which has direct effect in the Member States of the EU. It is, therefore, EU law which can lead to a complete system of European Labour Law.[25]

The EU has legislated in a range of areas in recent years in order to achieve a certain degree of harmonisation in the area of labour law across the member states. A number of directives were issued between 1994 and 2002[26] in the area of labour law[27] with a large proportion of these having been negotiated by the social partners through the social dialogue. Due to the relatively large amount of directives and the limited scope for discussing them in this paper, two particular directives[28] are analysed briefly below, by way of example, in order to demonstrate a case in which the Europeanisation of national labour laws was successful, as well as a case in which it was not successful. It is argued that successful implementation also indicates a successful Europeanisation of national labour law systems in this case. Europeanisation has been defined in this paper as a process of domestic change that can be attributed to European integration. Directives aim to bring about domestic change. Therefore, successful implementation implies successful Europeanisation.

The two directives have been chosen for a variety of reasons. On the one hand, the first directive – Directive 94/45 on the establishment of a European Works Council (EWC) – is frequently cited as an example of a very successful attempt to Europeanise national labour law systems. The framework provided by the directive for transnational cooperation illustrates how a European approach can solve community-wide issues often encountered

24 See, for example, B Bercusson, "The dynamic of European Labour Law after Maastricht" (1994) *Industrial Law Journal* 1.

25 Schiek, *Europäisches Arbeitsrecht*, n. 23 above, p. 18: "Das Arbeitsrecht der EU ist Teil einer supranationalen Rechtsordnung mit vorrangiger und zum Teil unmittelbarer Geltung in den Mitgliedsstaaten der Europäischen Union. … Das EU-Recht kann daher am ehesten dazu führen, dass ein gemeinsames Europäisches Arbeitsrecht entsteht."

26 Even though directives were issued on social matters prior to 1994 (see, for example, Directive 75/117/EC on equal pay for men and women), the Maastricht Treaty marked the turn towards the pursuit of a social policy by the European Commission as well as an active involvement of the social partners. The first directives following the Maastricht Treaty were issued in 1994. Directive 2002/14/EC on the information and consultation of employees marked the culmination of an eight-year period of active legislating in the area of social policy by the commission and the social partners. Even though directives on social policy are still sporadically negotiated (see, for example, the current negotiations in the sectoral social dialogue with a view to reaching an agreement on the issue of blood-borne infections due to sharp injuries that mainly affect nurses, doctors and healthcare workers: http://ec.europa.eu/employment_social/social_dialogue/index_en.htm), soft law mechanisms have, since 2002, taken over as the preferred method for achieving an approximation of labour standards across the EU.

27 Beginning with Directive 94/45/EC on the establishment of an EWC and ending with Directive 2002/14/EC on the information and consultation of employees.

28 Directive 94/45/EC on the establishment of an EWC and Directive 96/71/EC concerning the posting of workers in the framework of the provision of services.

in the operation of so-called community-scale undertakings. On the other hand, the second directive – Directive 96/71 concerning the posting of workers – is given as an example of an unsuccessful attempt at the Europeanisation of national labour law systems. The problems surrounding the directive have become very topical following a number of rulings by the ECJ[29] and the debate surrounding the reform of the directive has been reignited.[30]

A framework is needed in order to judge whether Directive 94/45 and Directive 96/71 have successfully Europeanised national labour law systems. The problem of judging whether a directive – as an example of European labour law as a whole – has been successfully implemented and used starts with the choice of terminology. It is, first and foremost, difficult to define what one means by "successful implementation". It is argued that the literature on Europeanisation and on the directives has not come up with useful definitions or criteria. For the purposes of this paper, the "success" of an instrument of European labour law is assessed on the basis of whether it has perceptibly altered the *Rechtswirklichkeit*, that is the law in practice rather than the law in theory. In determining whether something has successfully influenced a national labour law system one will always come up against differing degrees of success. Of course, the true extent of the Europeanisation of a legal system, using the present definition, can only be determined with the help of empirical research into individual legal systems and on the basis of individual measures. This goes far beyond the realm of this paper. However, even with the above-mentioned definition one can at least outline the success of a European measure.

The second step is then to look at the criteria that a measure itself, in this case a directive, must fulfil in order to be able to change the *Rechtswirklichkeit* of a national system, that is in order to be successful. It is difficult to generalise the criteria as every aspect of a certain directive that works well in a given situation may not work in a different setting. Much depends on the nature of the measure and on the way in which it is imposed and implemented. This is similar to the problem encountered in comparative labour law in the area of legal transplants. A large body of literature[31] has been devoted to the topic of legal transplants and sharp controversies have arisen regarding the portability of labour law from one system to another. The difficulty with legal transplants is, above all, the different legal traditions and concepts encountered when transposing a rule from one system to another. This is the same for measures of European labour law.

Two main theoretical strands have emerged on the issue of transplantation. For Watson, "a rule transplanted from one country to another . . . may equally operate to different effect in the two societies, even though it is expressed in apparently similar terms in the two countries".[32] This implies that the transplantation of legal rules without adjustment of

29 C-341/05 *Laval un Partneri Ltd* v *Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avd. 1, Byggettan, Svenska Elektrikerförbundet* ECR [2007] I-11767; and Case C-346/06 *Dirk Rüffert* v *Land Niedersachsen* ECR [2008] I-01989. In both cases the ECJ was asked to consider the interpretation of Directive 96/71/EC on the posting of workers. In *Laval,* the ECJ ruled that the objective of the directive was to lay down a set of mandatory rules for minimum protection to be observed in the host country by employers who post workers to perform temporary work in the territory of a member state where the services are provided. The ECJ judged that the directive limited the level of protection guaranteed to posted workers. Neither the host member state nor the social partners can ask for more favourable conditions, which go beyond the mandatory rules for minimum protection in the directive. The ECJ followed this judgment in *Rüffert.*

30 See, for example, the position of the ETUC at http://www.etuc.org/a/5418.

31 Authors who have written on transplantation include: R Blanpain (ed.), *Comparative Labour Law and Industrial Relations in Industrialised Market Economies* (The Hague: Kluwer Law International 2004); O Kahn-Freund, "On uses and misuses of comparative law" (1974) 37 *Modern Law Review* 1; P Legrand, "The impossibility of legal transplants" (1997) 4 *Maastricht Journal of European and Comparative Law* 111; A Watson, *Legal Transplants: An approach to comparative law* (Edinburgh: Scottish Academic Press 1974).

32 Watson, *Legal Transplants*, n. 31 above, at p. 20.

those rules is possible albeit, while positive examples of this form of transplantation can be found, the success of rules borrowed from one legal system and directly imported to another system is rare. The second strand of thinking on the transplantability of legal rules stems from Otto Kahn-Freund. For Kahn-Freund, the degree to which a rule can be transplanted depends on the extent to which it conforms with the foreign political and legal structure.[33] Thus, "we cannot take for granted that rules or institutions are transplantable . . . any attempt to use a pattern of law outside the environment of its origin continues to entail the wish of rejection".[34] For the purposes of this chapter, Kahn-Freund's position[35] on legal transplants is preferred over the alternative arguments due to the inherent pragmatism of his approach. According to Kahn-Freund, rules and regulations are usually closely connected with the social and political structure of a country. This is particularly so in the area of labour law. These rules and regulations cannot easily be directly imported to a different legal system without undergoing some form of mutation.

In general, the measures of European labour law are loosely connected to one or more national legal systems. By way of example, it is very rare for a directive to have a completely European content. Even where this might arguably be the case, as in Directive 94/45 on EWCs, one can still discern ideas which have been borrowed from various national legal systems. In order for the measure to be successful, according to Kahn-Freund's theory, these borrowed aspects from national legal systems must be "mutated". It is argued that this is done at a European level in the area of European labour law before then being "transplanted" into the member states. To clarify, when legislation is initiated in European labour law (e.g. a directive), elements of the European legislation are often borrowed from national legal systems. These are mutated in the course of the discussions on the legislation until an acceptable agreement is reached. This is then passed on to the member states for implementation.

In mutating borrowed measures of national law, the EU must ensure that certain criteria are fulfilled in order to ensure for the success of the measure in Europeanising national labour law systems. The criteria that a European labour law measure must meet are:

1. flexibility, i.e. leaving sufficient room for national systems to adapt the rules contained in the measure to their own system;
2. neutrality, i.e. the avoidance as far as possible of state-specific concepts; and
3. appropriateness, i.e. using the right mechanisms in the appropriate context.

A measure of European labour law that is aimed at the Europeanisation of national labour law systems must fulfil these three criteria in terms of its content. This framework is applied to Directive 94/45 and Directive 96/71 below, in order to illustrate whether or not these measures are successful in Europeanising national systems of labour law.

Directive 94/45 on the establishment of an EWC was adopted with the goal of improving the availability and provision of information to employees and ensuring their consultation at a transnational, European level.[36] It must be noted at the outset that the directive did not, originally, affect the UK as it was negotiated when the UK opt-out to the

33 Kahn-Freund, "On uses and misuses", n. 31 above.

34 Ibid., at p. 27.

35 Ibid.

36 For a good overview of the background to the directive, see e.g. J Pipkorn, "Europäische Aspekte der Informations- und Mitwirkungsrechte der Arbeitnehmer" in F S Everling, Bd. II, Vorträge & Berichte, Zentrum für Europäisches Wirtschaftsrecht, No. 50, 1995.

European social policy was still in place.[37] The directive requires multinational enterprises, which fulfil the requirement of being "Community-scale undertakings or groups of undertakings",[38] to establish transnational information and consultation bodies in the form of EWCs or, alternatively, to set up information and consultation procedures (ICPs). This is meant to ensure that employees are involved whenever decisions are taken in another member state that may affect them. UK companies who fulfilled the transnational requirements of the directive could therefore still be caught by its provisions despite the UK opt-out. Following the reversal of the UK opt-out by the Labour government in 1997, the directive was adopted[39] by the UK, thereby rendering it fully applicable. Space precludes a discussion of the ways in which these EWCs or ICPs can be established.[40]

Overall, the directive is considered to be an effective piece of European legislation in the area of labour law. It is generally accepted that EWCs which have been set up in approximately one-third of community-scale undertakings have enhanced the level and quality of communication between management and employees. They are also seen to have great potential for the promotion of the social dialogue between multinationals and trade unions.[41] However, the directive also displays negative aspects. A majority of multinationals have not set up EWCs. Furthermore, while information is provided to EWCs set up in undertakings, the EWCs are often not involved in the decision-making itself. Meaningful consultation does not always, therefore, take place.

Nonetheless, the directive has largely had a positive impact. A review process that began in 1999 and ended with the adoption of a slightly revised directive on 5 June 2009[42] suggested that the directive has largely been satisfactorily received and implemented by the member states.[43] It can therefore be said that the directive has changed the *Rechtswirklichkeit* in the member states. It seems to have bypassed the usual difficulties associated with labour legislation originating from the EU. In part this appears to be due to the fact that:

> its aim is not harmonisation of existing national systems of information and consultation but the adoption of new measures in each Member State to create a Europe-wide legal framework for a transnational tier of information and consultation within "Community-scale" undertakings or groups.[44]

The directive is, therefore, flexible and neutral enough to be well-received in the member states. In the eyes of some academic writers, it embodies a typical application of the principle of subsidiarity. Pipkorn, for example, writes:

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37 A Protocol and Agreement on Social Policy which broadened the EU social competences and provided a particular procedure for European social dialogue was attached to the Maastricht Treaty after only 11 member states signed it. The UK refused to sign at this point and was given an opt-out. It was only when the Labour government under Tony Blair came to power in 1997 that the opt-out was reversed.

38 Article 2 prescribes that the undertakings must employ a minimum of 1000 employees on the territories of the member states, with at least 150 employees in each of at least two member states.

39 It was implemented through the Transnational Information and Consultation of Employees Regulations 1999.

40 For a good overview see e.g. P Lorber, "Reviewing the EWC Directive: European progress and United Kingdom perspective" (2004) 33 *Industrial Law Journal* 191.

41 For a list of other benefits see list in Appendix III of European Economic and Social Committee Opinion, SOC/139 on the Practical Application of the EWC Directive, September 2003, available at www.esc.eu.int. Also, the EWCs Bulletin 43 highlights a number of benefits recognised by the social partners.

42 The revised directive strengthens workers' rights and improves the practical application of the directive so as to encourage the formation of more works councils.

43 See e.g. COM (2000) 188 final communication on the implementation of the directive by the commission after consultation with member states and European social partners.

44 M Carley and M Hall, "The implementation of the European Works Councils Directive" (2000) 29 *Industrial Law Journal* 103, at p. 103.

> [t]he Directive is characteristic of the original principle of subsidiarity, i.e. the differentiation between the sphere of influence of the State and that of non-state actors who, within their confines, can effectively develop an economic and social order.[45]

Moreover, the provisions of the directive are largely procedural in nature rather than rights-based, thus making them more easily adaptable to national systems of worker representation. This is an example of where the right mechanisms were used in an appropriate context to achieve the aims stated in the directive. As a result, Directive 94/45 fulfils all three criteria set out above which are necessary for the successful Europeanisation of national labour law systems. A further positive characteristic of the directive is "the considerable scope it gives for devolved, national-level regulation of key aspects of the legal framework for the establishment of EWCs".[46] Weiss echoes this sentiment by describing the directive as a "flexible new concept" which is the "secret to the success" of the directive.[47] A working party convened by the European Commission oversees the implementation process, therefore ensuring quite a high degree of harmonisation of procedures. It is this mixed and flexible approach that seems to have had a positive impact and brought about the successful implementation of the provisions of the directive. Although EWCs contain certain core characteristics, they vary greatly from undertaking to undertaking, and from country to country, in terms of the exact model they adopt. While there is therefore some degree of harmonisation of transnational employee representation, there is also sufficient scope for diversity across the member states, thereby reflecting the differences in their labour law systems and structures. This is particularly evident in the UK implementation of the directive. Whereas the majority of European member states, particularly Germany, could draw upon existing representative structures in their industrial relations systems, the UK had to create a "statutory standing works-council-type employee representation body for the first time ever . . . albeit on a transnational basis".[48] While this caused some difficulty in the UK, the directive left sufficient freedom for legislators to create a system of representation specifically tailored to UK industrial relations. Conversely, German legislators profited from the ability, under the directive, to draw upon existing representative structures. The legislation on German works councils, which are already established in a large majority of national undertakings, was used as a basis and then expanded upon to cover EWCs.[49] Directive 94/45 therefore illustrates, particularly due to its flexibility, neutrality and appropriateness, the potential of European labour law to successfully establish a basis for the harmonisation of national labour law systems across the EU.

In contrast, Directive 96/71 concerning the posting of workers in the framework of the provision of services has caused great controversy in the EU. It is a useful example of the difficulties encountered in the Europeanisation of national labour law systems. Directive 96/71 aimed to establish:

45 Pipkorn, "Europäische Aspekte der Informations", n. 36 above, at p. 1127: "[Sie] ist eine Ausprägung des Subsidiaritätsprinzips in seiner ursprünglichen Ausformung, nämlich der Abgrenzung der staatlichen Sphäre von derjenigen, in der nichtstaatliche Organisationen und gesellschaftliche Kräfte wirksam die Wirtschafts- und Sozialordnung gestalten können."

46 Carley and Hall, "Implementation", n. 44 above, at p. 104.

47 M Weiss, "Arbeitnehmermitwirkung in Europa" (2003) 4 *Neue Zeitschrift für Arbeitsrecht* 179: Weiss echoes this sentiment by describing the directive as a "flexibles neues Konzept" which is part of its "Erfolgsgeheimnis".

48 Carley and Hall, "Implementation", n. 44 above, p. 114.

49 For a more substantial discussion, see Weiss, "Arbeitnehmermitwirkung in Europa", n. 47 above.

> a legal frame for labour conditions of workers posted for a temporary period to another Member State. Its content is about equal treatment, a guarantee of minimum protection, fair competition and respect for the regulatory frame in the host country.[50]

With increasing cross-border activity in the form of posted workers in the EU, the European Commission proposed in 1991 to regulate the provision of services in an attempt to find a balance between workers' rights and the free provision of services.[51] This was also in response to decisions of the ECJ[52] which found it justifiable to apply basic protections of national labour laws to posted workers even if this had a "chilling effect upon cross-border service providers".[53] Following these decisions, member states were allowed to "take steps to extend their domestic regulation to posted workers".[54] The European Commission, however, was keen to promote cross-border provision of services. This could only be achieved by providing legal certainty for employers posting workers across borders. The compromise was Directive 96/71 on the posting of workers which:

> presents something of a paradox. On the one hand, [the member states] played their cards so as to produce a Directive which was highly protective of domestic labour regulation. On the other hand, the legal base chosen for the Directive required that a primary aim should be the promotion of cross-border provision of services.[55]

As a result, the directive only aims to achieve "partial harmonisation".[56] It prescribes minimum standards of core working conditions which should apply equally to national and posted workers. Posted workers are those workers who are sent temporarily to work in another member state by their employer. They are guaranteed certain labour conditions that the host member state considers to be of "general interest" to the worker at issue. The aim of the directive is to prevent distortion of competition through lower social standards.

The implementation of the directive has proved problematic due to the diverse interpretation of the provisions in national labour law systems. Certain commentators have levelled the criticism that the directive does not take sufficient account of diversity in national industrial relations systems.[57] As a result, effective national implementation has been lacking. In a 2003 communication on the implementation of the directive,[58] the European Commission concluded that the directive had encountered difficulties in its practical implementation. As a result of these difficulties, the directive has not managed to alter the *Rechtswirklichkeit* in the member states. Above all, there was a failure to monitor compliance, as well as a lack of access to relevant provisions applicable in the host country. Member states thus seem to be lacking in their effective implementation of the provisions of the

50 J Cremers, J E Dølvik and G Bosch, "Posting of workers in the single market: attempts to prevent social dumping and regime competition in the EU" (2007) 38 *Industrial Relations Journal* 524, at 524.

51 Ibid., at p. 526.

52 Case C-113/89 *Rush Portugesa Lda* v *Office national d'immigration* (1990) ECR I-1417 and Case C-43/93 Vander *Elst* v *Office des Migrations Internationales* (1004) ECR I-3803.

53 P Davies, "Posted workers: single market or protection of national labour law systems?" (1997) 34 *Common Market Law Review* 571, at 586.

54 Ibid., at p. 590.

55 Ibid., at pp. 591–2.

56 Case 105/84 *Foreningen of Arbejdsledere i Danmark* v *A/S Danmols Inventar* (1985) ECR 2639, at para. 26: this term was applied to the Acquired Rights Directive (77/187/EEC) to describe the situation where applicable rules are identified but they do not achieve harmonisation across the member states.

57 See, for example, Cremers et al., "Posting of workers", n. 50 above.

58 Report from the European Commission on the Implementation of Directive 97/71/EC concerning the Posting of Workers in the Framework of the Provision of Services (COM 2003/458).

directive. Moreover, a resolution adopted by the European Parliament in 2004 considers the directive to be insufficient to combat unfair competition and social dumping. The European Parliament therefore called for a review of the substantive content of the directive.[59]

Following the enlargements in 2004 and 2007 the debate on the effectiveness of the directive has been given a new lease of life due to large numbers of workers being sent from new to old member states. In practice, this has led to waves of protest across old member states against cheap labour originating from new member states.[60] Moreover, workers from new member states often fail to receive the rights due to them under Directive 96/71. In Germany, such allegations were raised in the meat industry by Polish workers.[61] More recently, the debate surrounding "British jobs for British workers" in the UK illustrated the difficulty of using posted workers in host labour markets struggling with the current economic crisis.[62]

In the UK, application of the directive has been made easier since the introduction of a statutory minimum wage in April 1999. This allows posted workers to demand effectively equal treatment with national workers. Nonetheless, countless workers fall through the loopholes present in the directive and are therefore not benefiting from the relevant provisions. Moreover, workers often suffer from a lack of information and, as a result, cannot avail themselves of the protection under the directive. While textual implementation of the directive is not an obvious problem, its practical application is.[63] The directive has thus failed to alter the *Rechtswirklichkeit* in the UK.

Likewise, implementation in Germany has proved difficult, but for different reasons. It is mainly the absence of a minimum wage that has resulted in a lack of successful implementation. The problem of the directive is, therefore, that it gives posted workers a right to a minimum wage that does not exist in such a form in Germany. Instead, the directive should have focused on providing workers with a procedure to follow in order to receive adequate pay which would have been easier to implement. The directive thus fails the requirement of appropriateness by not using adequate mechanisms in the given context. By requiring a minimum wage rather than leaving room for real alternatives, the directive is also not sufficiently neutral or flexible to allow for the successful Europeanisation of the national labour law system. While in certain sectors in Germany general collective agreements lay down the terms required by the directive, collective bargaining in other sectors is heavily fragmented and does not therefore lead to effective collective agreements. The

59 European Parliament Resolution on the implementation of Directive 96/71/EC in the member states (COM(2003) 458-2003/2168IINI).

60 For examples, see T Krings, "A race to the bottom? Trade unions, EU enlargement and the free movement of labour" (2009) *European Journal of Industrial Relations* 49.

61 C Tenbrock and B Wielinski, "'Kapitalismus Pur': Hungerlöhne, miese Arbeit: Polen in deutschen Betrieben fühlen sich getäuscht", *Die Zeit*, 10 May 2007.

62 The Lindsey oil refinery dispute provided the catalyst to this debate. In January 2009, workers at Lindsey oil refinery began unofficial strike action in protest against perceived discrimination against British workers. The owners of the refinery had awarded construction of a new unit at the plant to an American company which had sub-contracted part of the work to an Italian company. Workers at Lindsey oil refinery commenced unofficial strike action after learning that the sub-contractor would post its own permanent workforce of foreign nationals (Italians) to the refinery to complete the project rather than employing British workers. This illustrates the feeling, as evidenced by many of the placards bearing Gordon Brown's pledge of "British jobs for British workers", that British workers should be accorded preference over foreign nationals, in this case EU workers, in the allocation of employment contracts.

63 Cremers et al., "Posting of workers", n. 50 above, at pp. 529–30.

implementation of the directive has been confined to the building sector for the time being[64] and the debate on an effective form of implementation of the directive is ongoing.[65]

Control mechanisms at a national level are weak and uncoordinated across member states. This has given rise to criticism from the European Trade Union Confederation (ETUC) in its position on the directive. According to the ETUC, coordination and cooperation among member states is, in practice, almost non-existent.[66] This makes compliance with the directive difficult. As Cremers et al. point out:

> the over-riding challenge in all the countries is to develop effective mechanisms of enforcement compatible with the constraints of EU principles and regulations. At the European level, in the meantime, the shift in political climate seems to indicate that the weight is shifting in the opposite direction, towards the supremacy of the free provision of services.[67]

This suspicion is confirmed by recent ECJ caselaw.[68] Directive 96/71 is therefore an example of a failure by the European Commission and the member states to harmonise national labour laws, due to a lack of understanding of the prevalent national systems. As a result, the directive does not fulfil the criteria set out above and fails to successfully Europeanise the national labour law systems.

Conclusion

National labour law systems have been struggling to accommodate the process of domestic change brought about by the EU through its policy of Europeanisation. This has become more difficult following the recent European enlargements in 2004 and 2007 which have enhanced social and political diversity in the EU. As a result of the very different industrial relations systems prevalent in the new member states, the norms and values underpinning the legislative aspects of the EU's policy on Europeanisation have slowly been eroded.[69] In addition, there has been the movement examined briefly above towards soft law mechanisms like the OMC which complicate the process of Europeanising national labour law systems. The underlying rationale for the European social policy has hitherto merely been the demand for broad equivalence in labour standards rather than a uniform harmonisation.[70] However, as such standards, in order to be adopted, need to be acceptable to all member states and can only be so if they are economically viable in the less wealthy

64 Entsendegesetz BGBI 1996. For more detail, see W Däubler, "Posted workers and freedom to supply services" (1998) 27 *Industrial Law Journal* 264.

65 Cremers et al., "Posting of workers", n. 50 above, pp. 530–1.

66 ETUC position on the implementation of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services available at http://www.etuc.org/a/2222.

67 Cremers et al., "Posting of workers", n. 50 above, at p. 535.

68 C-341/05 *Laval un Partneri Ltd* v *Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avd. 1, Byggettan, Svenska Elektrikerförbundet* judgment of 18 December 2007 and C-346/06 *Dirk Rüffert, in his capacity as liquidator of the assets of Objekt und Bauregie GmbH & Co. KG* v *Land Niedersachsen* judgment of 3 April 2008: The ECJ was asked, in both cases, to interpret Directive 96/71 on the posting of workers and to determine the relationship between it and the right to free movement of services as contained in the ECJ Treaty. The ECJ, in its judgment, favoured the free movement provision and established that the rights contained in the directive should be seen as a maximum rather than a minimum level of worker protection which cannot be improved upon by the member states.

69 R Hyman, "The Europeanisation – or the erosion of – industrial relations?" (2001) *IRJ* 280, at 289.

70 N Adnett and S Hardy, *The European Social Model – Modernisation or evolution?* (Cheltenhan: Elgar 2005).

countries and compatible with existing industrial relations and welfare state institutions, they are usually relatively permissive.[71]

Following the European enlargements and the accession of 12 new states with their differing labour relations systems, the EU's task of bringing about domestic change as a result of European integration has become increasingly difficult. It is argued in this paper that the mechanisms used in comparative law to assess the viability of legal transplants may aid the EU in its attempts to successfully Europeanise national labour law systems. By establishing criteria that are sufficiently broad to encompass different labour law systems, the method of comparative law enables the author to judge whether a measure of European labour law has been successful or unsuccessful. In doing so, the paper provides a framework as to the factors that must be taken into account in order to successfully Europeanise aspects of national labour law systems. By illustrating an unsuccessful measure of European labour law, the paper demonstrates the pitfalls that are to be avoided. Comparative law may, therefore, contribute to solving the EU's difficult task of Europeanising national labour law systems.

71 W Streeck, "Neo-voluntarism. A new European social policy regime?" (1995) *European Law Journal* 31 and W Streeck, "Industrial citizenship under regime competition: the case of European Works Councils" (1997) *Journal of European Public Policy* 643.